Promoting the Business and Investment Climate

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Experiences of German Technical Assistance

Edited by

Dr. Sonja Kurz

and Alena Fröde

Deutsche Gesellschaft für
Technische Zusammenarbeit (GTZ) GmbH

Divison Economic Development and Employment
Economic Policy and Private Sector Development

Dag-Hammarskjöld Weg 1-5
65760 Eschborn, Germany

Telephone: +49 61 96 79 -0
Telefax: +49 61 96 79 11 15
E-Mail: eco.emp@gtz.de
Internet: www.gtz.de

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Foreword

The private sector is crucial to accelerating economic growth and reducing poverty. Political, legal and institutional framework conditions constrain private sector development in many countries. An unfavourable Business and Investment Climate often particularly affects SMEs. In order to contribute to the solution of this core problem, the German Agency for Technical Cooperation (GTZ) designs and implements activities in joint responsibility with its partners.

The GTZ activities include the development and dissemination of tools and instruments for improving the regulatory framework conditions, capacity building of key-stakeholders as well as organisational support in the public-private dialogue. In the course of these activities, political decision-makers and representatives of business associations are sensitised and capacitated in key issues and methodologies for improving the regulatory framework conditions. At the same time the institutional set-up for the public-private dialogue is improved.

Building upon the output of GTZ activities, the private sector is now enabled to articulate its demand for improved framework conditions. In the dialogue with the private sector the government analyses and ranks the bottlenecks to private sector development, evaluates the regulatory impact of possible reform scenarios and designs and implements new laws and regulations. The climate is constantly monitored – jointly by the private and the public sector. These participatory processes lead to desired outcome of an improved business and investment climate reflected in reduced "costs of doing business", reduced non-commercial risks and new business opportunities

GTZ's work on a better Business and Investment Climate is also expected to contribute to a rise in the formation of new companies, to an expansion of existing businesses as well as to increased investment in human and physical capital thereby facilitating companies to participate in technical progress. On a highly aggregated level, a better Business and Investment Climate is expected to contribute to the development results of pro-poor growth by reducing constraints and barriers to economic growth and participation of the poor in the growth process.

The German Technical Cooperation (GTZ) offers an extensive and integrated approach to creating a business-friendly environment in our partner countries. We take on a macroeconomic perspective that addresses general and specific restraints to development for sectors and companies and /or regions with great potential for pro-poor growth. Our focus is adapted to the country-specific context. In one country it may be on reducing constraints to agricultural development, in another business start-ups and small and medium enterprises may be the main emphasis.

Our approach aims at sustainable structural change. Our activities focus increasingly on the macro and meso levels. GTZ supports advising and qualifying public and private (intermediary) organisations and promotes the necessary dialogue between public and private sector actors. Our long-standing contacts with governments and associations in our partner countries facilitate bridging the gap between public and private actors.

GTZ participates in monitoring the impacts of the reform process. Indicators are designed using quantitative and qualitative methods of measurement that can measure changes in the business and investment climate. Company surveys and structured interviews form a suitable database.

We hope to contribute with this publication to share experiences and to exchange knowledge in the area of Business and Investment Climate Reforms with our colleagues and partners.

Eschborn, November 2005

Dr. Sonja Kurz   Alena Fröde

A Critical Assessment of the "New Minimalist Approach" to Private Sector Development*

Tilman Altenburg and Christian von Drachenfels

There is an emerging consensus that places emphasis on a rather limited number of market-driven solutions and tends to disregard selective public interventions to encourage and support the private sector, we refer to this as the "new minimalist approach" (NMA) to private-sector development. The NMA has its merits for highlighting the difficulties of selective interventions and shifting emphasis towards policies designed to improve the overall business climate. But the approach is based on a number of unrealistic assumptions and empirical evidence can hardly be found. We conclude that a range of complementary public policies is needed to overcome internal constraints in the small-scale economy.

Recent documents on private sector development (PSD) provide evidence of an emerging consensus among leading development institutions with regard to the design of PSD for pro-poor development. Since this new consensus places emphasis on a rather limited number of market-driven solutions and tends to disregard selective public interventions to encourage and support the private sector, we have termed it the "New Minimalist Approach" (NMA) to PSD.

In keeping with its foundation in neoclassical thinking, the NMA focuses on government failure rather than market failure. It argues that creating a level playing-field through deregulation and guarantees for property rights is the most important – and, according to some authors, sufficient – condition needed to boost economic growth and to make growth more equitable.

While this is nothing new, four innovative aspects justify labeling it the New Minimalist Approach: its explicitly pro-poor reasoning; its emphasis on issues of political economy; its well-founded critique of traditional government-driven and subsidy-based private sector support programs; and its optimistic stance with regard to the growth potential of the informal sector.

This paper critically assesses the underlying assumptions of the new paradigm and considers whether empirical evidence supports the main hypothesis that the proposed policy focus is sufficient to unleash the growth potential of the private sector, especially in those segments of developing economies where the poor live and work. It shows that while much of the criticism of traditional, supply-side small and medium-sized enterprise (SME) policies is well-founded and most of the related policy recommendations are highly relevant, the policy mix recommended is far from sufficient to stimulate a vibrant and competitive private sector. Empirical evidence on the effectiveness of some of the core policies recommended is at best patchy.

The paper is organized as follows. The first section elaborates on the new minimalist paradigm in PSD, with a focus on four core arguments. In the second section we discuss what the new and innovative aspects of the NMA are compared with traditional neoclassical analysis. We then proceed in the third section by making a critical assessment of its empirical relevance, i.e. scrutinizing to what extent the NMA in fact works in practice. The fourth and final section draws policy conclusions for PSD, arguing that while the NMA has its merits in highlighting the difficulties of selective interventions and shifting emphasis towards policies designed to improve

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the overall business climate, the approach is based on a number of unrealistic assumptions. In particular, it is unlikely that guaranteeing property rights, simplifying administrative procedures, and the commercial provision of microcredit and other business development services (BDS) will be enough to make the small-scale economy flourish. Instead, a range of complementary public policies is needed to overcome internal constraints in this sector.

The new minimalist paradigm in private sector development

Comparing recent policy documents on PSD published by international organizations such as the World Bank, UNDP, and OECD-DAC[1] with the mainstream discussion that preceded it, we cannot fail to note a remarkable shift in emphasis. What all these documents have in common is that they are extremely optimistic with regard to the inherent entrepreneurial potential of SMEs and, more specifically, the informal sector, blaming unfavorable government rules and regulations for their disappointing performance, and calling for deregulation. This is a major deviation from the previous mainstream interpretation, which emphasized the *internal* shortcomings of small firms (a lack of basic education, technical, managerial and marketing skills, low productivity, limited formation of capital, and low levels of investment, lack of integration in clusters and value chains, etc.), and called on government institutions to provide a broad range of selective support measures to compensate for these weaknesses. What is more, the new policy documents strongly criticize the current practices of economic (and especially SME) promotion, and make a strong case for privatized service delivery. Governments are no longer expected to provide comprehensive support for SMEs. Instead, they should primarily seek to ensure that business is not hampered by inappropriate rules and regulations (which implies deregulation, simplification, and disengagement). Although the new approach does not altogether dismiss the provision of public goods and certain catalyzing activities undertaken to support private markets, NMA documents emphasize the inherent inefficiencies and risks of misuse involved in selective interventions.[2] As a recent World Bank study concludes, "rather than directly subsidizing SMEs and aiming for a large number of small enterprises, policy-makers should focus on creating a business environment that allows easy entry and exit for firms and assures entrepreneurs and financiers that property rights and contracts will be enforced."[3]

In a nutshell, the NMA is based on the following assumptions:

(i) Selective public policy interventions in markets tend to hamper the formation, registration, and growth of private enterprises and therefore reduce rather than increase economic growth and welfare.

(ii) The key role of the state is to guarantee a level playing-field for the private sector.

(iii) The exit of inefficient firms is an inevitable and even necessary element of structural change that should not be held back by costly efforts to preserve unsustainable entrepreneurial activities.

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[1] UNDP = the United Nations Development Programme; OECD-DAC = Organisation for Economic Co-operation and Development, Development Co-operation Directorate.

[2] The World Development Report 2005, for example, discusses at length what it calls the "basics" of a good investment climate and dedicates only a short chapter to the question "Going beyond the Basics?", which is full of warnings about and references to the risks of selective interventions. (World Bank, 2004).

[3] Beck/ Demirgüc-Kunt (2004), p. 1.

(iv) Entrepreneurial spirit and capabilities are ubiquitous and indeed unfold by themselves once a conducive investment climate is in place; this also holds for the informal sector.

(v) Entrepreneurs are willing to pay for meaningful BDS, and, apart from a few purely public goods, these may (and should) consequently be provided on commercial terms.

The NMA has been strongly influenced by de Soto's work.[4] It is further elaborated in World Bank documents, e.g. the World Development Reports and "Doing Business" reports,[5] and it is also echoed in UNDP's "Unleashing Entrepreneurship" document, in a recent OECD-DAC report on PSD and pro-poor growth, and in other multilateral policy documents.[6]

Many of the policy prescriptions of the PSD documents cited in the previous paragraph are in line with current development thinking, and are based on a quite broad consensus. This includes a call for improved monitoring and evaluation, comprising a more rigorous measurement of outcomes as well as cost-effectiveness, and for more consistent pro-poor targeting of government expenditures. Furthermore, they suggest giving the private sector (including informal and formal SMEs and workers' organizations) more voice by setting up government-private sector councils and advisory bodies. These aspects however lie outside the focus of this paper: instead, we discuss four prominent elements of the NMA that in our view are contentious, or at least strongly overstated. The following sub-sections (1.1 – 1.4) therefore discuss the relevance of and main policy conclusions on each of these elements from the perspective of the NMA. Later on, in Chapter 3, we scrutinize the extent to which the growth-enhancing and poverty-reducing impact of these elements is supported by empirical evidence.

The four controversial policy elements of the NMA to be discussed here are as follows:

1) **Pro-poor tenure policy.** NMA documents argue that an effective property rights policy that provides title deeds to informal enterprises is crucial to order to increase levels of security and to qualify informal enterprises to receive credits, thereby encouraging investment and spurring pro-poor economic growth.

2) **Simplification of procedures and regulations.** Unnecessary and cumbersome red tape is seen as a major constraint for economic growth, especially for the upgrading of the informal sector.

3) **Microcredit schemes**. Microcredit is highlighted as the most important field of economic promotion in which proactive government and donor engagement may have a significant poverty-reducing impact. However, microfinance should be commercially viable, and governments should work to improve framework conditions rather than provide funds.

4) **Supporting the development of competitive markets for non-financial business services**. NMA documents argue that the provision of non-financial business services should largely be left to private providers, assuming that most BDS are private goods and that SME customers are willing to pay for them. This goes hand in hand with strong

4 de Soto (1986; 2000).

5 World Bank (2004; 2005); see also Klein/ Hadjimichael (2003).

6 UNDP Commission on the Private Sector & Development (2004); OECD (2004); and Committee of Donor Agencies for Small Enterprise Development (2001).

criticism of the inefficiency of the predominant current form, namely highly subsidized public providers.

Before describing these four elements in detail, one pertinent critical observation should be made. The language used in the NMA policy documents is sometimes vague and ideological rather than analytical, and tends to obscure some important distinctions. For instance, the documents abound in recommendations to "abolish ineffective or arbitrary tax laws," or references to "red tape", or "administrative burdens". While these may be catchy slogans (and, indeed, tend to be picked up quite easily in the political discourse), they are not helpful for designing better policies on two key grounds. First, they do not determine when, for instance, a tax regime is "efficient"; where exactly the borderline is between "arbitrary" and "tailor-made" provision of support for the private sector; or when administrative procedures are unnecessary (turning them into merely "red tape" or "burdens"). Second, they are ideological in that they insinuate that administration tends to be dispensable (at least with regard to the regulation of markets), or that tax regimes should not be differentiated, and they thus dismiss the potentials involved in using them to achieve more equitable income distribution, to protect vulnerable groups, to signal the scarcity of public goods, and so on.

Pro-poor tenure policy and access to credit

Proponents of the NMA, most prominently Hernando de Soto[7], argue that even the poorest in the informal sector own at least something that can be called their property. The property of the poor ranges from shanties that are built on government-owned land to tools and machines. This property, however, is often not formally registered. Informal dwellers lack registered land titles, and other properties may often have been acquired in informal markets where it is common practice not to make out a receipt or where buyers do not keep receipts. As a consequence, these properties are "dead capital" that cannot be fully used for productive purposes.

The lack of legal tenure, combined with weak property rights enforcement, has severe disadvantages for the productive use of informal assets:

— Informal properties tend to be underrated, given that they cannot be sold (or at least generate far lower proceeds) without a legal title. Securing the rights to land and other property serves to reduce the risks of mistakes and fraud when it comes to property transactions. Buyers, renters, and lenders will in this case be more confident that they will get what they were bargaining for, even if they may have to go to court to claim their rights.[8] Legal titles are therefore assumed to increase the value of land and property significantly, giving a boost to housing markets and creating important assets for the poor.

— Higher levels of security and formality create a strong incentive for investment. The higher the risk, the greater the profitability of a venture has to be to justify the investment.[9] So if risks are minimized, more investments are likely to be made.[10.]

— Informal properties cannot be used as collateral for credit. Property titling can therefore improve access to credit, which is one of the most crucial prerequisites for private sector growth. Banks and other lending institutions tend to have more confidence in borrowers –

[7] de Soto (1997; 2000).

[8] World Bank (2004), p. 80.

[9] OECD (2004), p. 22.

[10] World Bank (2005), pp. 33, 40.

and risks will decrease – if there is no doubt about the question of ownership. As a consequence, a borrower with registered property is more likely to receive credit.[11]

- Obtaining access to insurance services is another key element needed if the poor are to escape the poverty trap.[12] People in the informal sector face higher than average risks related to expropriation, theft, damage by fire, etc. However, they usually cannot have their assets insured, which forces them "to adopt costly (and relatively inefficient) insurance substitutes to enable them to deal with unexpected shocks."[13] Risk-coping strategies in the formal sector – such as insurance services or the possibility of obtaining a credit by providing property as collateral – are superior to those strategies used in the informal sector, e.g. keeping livestock, cultivating drought-resistant crops which will not yield the highest possible return, or falling back on moneylenders who are likely to exploit situations in which people have no alternative. In sum, if the poor are not able to opt for more advanced risk-coping strategies, "the result will be a lower contribution to growth by the poor and slower pro-poor growth."[14]
- Infrastructure services (e.g. roads, electricity, and water supply) are often not delivered to informal premises, where it is difficult to collect fees.
- People tend to work harder if they expect greater efforts to pay off because improvements remain in their possession.[15]

In sum, the ability of the poor to access capital markets, to insure risks, and to invest is seriously constrained by the lack of effective property rights. This results in lower economic activity and a less than optimal allocation of resources, in this fashion holding back overall economic growth, and income growth for the informal poor in particular. This is a relevant issue even in macroeconomic terms, bearing in mind that the book value of informal properties (if they were duly registered) would be enormous. According to de Soto's calculations, the poor in Peru would own US$ 74 billion, while for Egypt the equivalent value would amount to US$ 240 billion.[16] In addition, governments forego revenues if activities are not registered and taxed accordingly. Finally, there may be negative ecological spillovers given that users have fewer incentives to use resources in a sustainable way if they have no certainty that they will be able to remain in possession of their land.[17]

The NMA accordingly strongly emphasizes what it calls "pro-poor tenure policy." This encompasses land-titling programs as well as reforms of the legal and institutional framework for property rights enforcement.[18]

Simplification of procedures and regulations

The NMA emphasizes that some of the main causes of an inefficient private sector include cumbersome registration requirements, restrictions on access to inputs (labor, financing,

[11] World Bank (2004), p. 81.

[12] See OECD (2004), pp. 41-44.

[13] Deininger / Binswanger (1999), pp. 247-76 (253).

[14] OECD (2004), p. 43.

[15] World Bank (2004), pp. 79-80.

[16] Data for the end of the 1990s; see de Soto (1997).

[17] World Bank (2004), p. 81.

[18] See World Bank (2005), p. 38.

infrastructure), the burdensome administration of taxes and regulations, as well as weak contract enforcement. As Klein and Hadjimichael state, "excessive regulations and red tape have severely curtailed the performance of firms, be they local small and medium-size enterprises or medium-size to large foreign firms", and have created a serious obstacle to economic growth in developing countries.[19] The fewer resources (i.e. in terms of time and money) that an enterprise needs to get these procedures done, the more resources it will have left for investment. At the same time, simplifying procedures would free up government resources.[20] UNDP affirms the need for "a genuine commitment to reform the regulatory environment by eliminating artificial and policy induced constraints to strong economic growth."[21] While most policy documents in the past called for increasingly differentiated public policies to confront (presumed) market failure, the focus now is on eliminating troublesome rules and regulations.

The World Bank's Doing Business Report has made an important contribution to breaking such "regulatory burdens" down into more operational categories. In addition to improved property registers, the main areas for administrative simplification are as follows:

— **Starting a business**. To be able to start up a business, would-be entrepreneurs are required to obtain certain permits to operate legally. Business registration and additional requisites, e.g. minimum capital requirements, tend to be extremely cumbersome in poor countries. To facilitate business start-ups and to induce entrepreneurs not to choose to remain informal, these regulations need to be simplified.

— **Hiring and firing workers**. Employment regulation with regard to minimum wages, severance pay, overtime pay, etc. is considered to be a burden for enterprises. The Doing Business Report argues that complex labor regulations make it more difficult for companies to adjust their workforce to actual demand, and may induce them to hire fewer workers or to evade employment regulations.

— **Obtaining credit**. As we have seen in the previous section, registered property is important for obtaining credit. Easing restrictions on assets that may be used as collateral, coupled with strong creditor protection in the form of collateral and bankruptcy laws, may further improve the credit market.

— **Closing a business**. New businesses can start up and grow more easily if insolvency is handled efficiently. Simplified and transparent bankruptcy systems help to avoid protracted legal disputes and to reduce investor uncertainty.

Several NMA texts, most prominently the World Bank's Doing Business Report, accentuate the fact that cumbersome regulations are especially heavily felt by small firms. "Excessive regulation has a perverse effect on the very people it is meant to protect."[22] Heavy regulation encourages entrepreneurs to operate in the informal sector. Market segmentation is seen as a consequence of governments imposing complex bureaucratic requirements without having the respective enforcement capacity. The NMA states that in the informal sector, "workers enjoy no social benefits and cannot use pension plans and school funds for their children. Businesses do not pay taxes […] there is no quality control for products," etc. While traditionally policymakers would

[19] Klein / Hadjimichael (2003), p. 36.

[20] E.g. World Bank (2004a, p. xv): "A doctor can be hired in place of every government official regulating business activity or compliance with employment laws."

[21] UNDP (2004), p. 38.

[22] World Bank (2004a), p. xv.

have concluded that enforcement of these regulations needs to be improved, the NMA calls for their simplification and, in part, removal.

In addition, the NMA takes a very different view of the origins and determinants of the informal sector. According to the formerly mainstream structuralist perspective, a growing informal sector reflects insufficient capacity on the part of the modern economy to absorb (especially unskilled) labor. In the absence of a social security net, the resulting labor surplus forces people to take on survival activities in low-productivity occupations. Owing to labor market segregation, salaries and profits in the formal and informal economies do not converge, contrary to the assumptions of neoclassical theory. The entry barriers separating formal and informal labor markets are mainly attributed to deficient technical and managerial skills, lack of access to capital, spatial segregation, and other structural factors.

The NMA, in contrast, blames the existence of the informal sector on bad regulation. According to Loayza, "the informal economy arises when excessive taxes and regulations are imposed by governments that lack the capability to enforce compliance."[23] Therefore, a key element of the NMA is the recommendation to simplify procedures and regulations for the private sector in order to ease the transition from the informal to the formal economy. Reduced administrative entry barriers are assumed to stimulate pro-poor growth.

The NMA expects large payoffs from the simplification of procedures and regulations. The Doing Business Database was created to collect data on existing administrative procedures related to PSD as well as to benchmark national regulation against the best international performers. This can help to identify unnecessary red tape and set quantitative targets for numbers of licenses, processing times for certain permits, etc. One-stop shops may further help to simplify transactions.

Microcredit schemes

In developing countries most people lack access to credit. As a consequence they cannot invest in productive assets that would enable them to use their resources more efficiently. Low investment rates slow down economic growth and poverty reduction.

For several decades, development practitioners assumed that it would be impossible to provide credit to poor people without offering substantial subsidies. This was widely believed to be the case because (i) transaction costs tend to be high, since poor customers borrow very small amounts of money per transaction, and (ii) the poor often lack collateral, a fact that increases both the risks for the lender and the costs of debt collection. Hence there was a general consensus that microcredit schemes would not function in a commercially sustainable manner.

Today we have learned that microfinance institutions do indeed function.[24] Microcredit schemes around the world now operate on a cost-covering basis. Microfinance institutions have designed ways of making their customers absorb a large share of the transaction costs involved, such as the costs of project appraisal, repayment collection, and risk coverage. This is organized through self-help groups which trust their members and practically guarantee repayment. At the same time, owing to the remaining transaction costs, interest rates are much higher than those in the formal banking sector, although still considerably lower than those charged by moneylenders. Remarkably, poor people who are not "bankable" in the traditional sense are willing and able to

[23] Loayza (1996), p. 129.

[24] Peck Christen / Lyman / Rosenberg (2003).

pay such high interest rates, and default rates are much lower than those at commercial banks, especially when compared with SME credit lines. Now that microcredit schemes can clearly function sustainably across the globe and reach out to tens of millions of poor people (whereas government-sponsored credit programs are fraught with difficulties), microfinance ranks high on the agenda of proponents of the NMA.

Supporting the development of competitive markets for non-financial business services

One crucial condition for the competitiveness of firms in developing countries is their ability to link up with other companies or institutions capable of providing them with assets which they cannot produce themselves. Many of these external linkages include some kind of non-financial service provision, e.g. with regard to information, research and development (R&D), product development, training, logistics, and marketing.

Over the last few years a new paradigm has emerged with regard to who should provide these business services and how. The main contributions to the so-called BDS paradigm () have come from the Committee of Donor Agencies for Small Enterprise Development, which published the document "Business Development Services for Small Enterprises – Guiding Principles for Donor Intervention."[25] The BDS paradigm is based on a transfer of experiences from microfinance to non-financial business services: If microcredit can be provided on a cost-covering basis, why should this not be possible for non-financial business services?

The Guiding Principles state that the "ultimate vision for BDS, on which these Guiding Principles are based, is of a well functioning market with a diverse array of high-quality services that meet the needs of a large proportion of SEs [small enterprises] affordably." The Guiding Principles further argue that "with appropriate product design, delivery and payment mechanisms, BDS can be provided on a commercial basis even for the lowest segment of the entrepreneurial small enterprise sector."[26] Generally speaking, BDS are assumed to be private goods.

The new BDS market paradigm highlights the need for services to be provided at cost-covering rates and by providers who operate in a demand-driven and businesslike manner. Service providers should either be private companies or public entities organized like firms in terms of their incentive systems, personnel, culture, and attitudes. Services should be regarded as commercial products, and the companies that receive services should be regarded as customers rather than beneficiaries. Providers should therefore always charge fees, and these fees should usually be high enough to secure the provider's financial sustainability. This presupposes that BDS organizations use cost-analysis systems which enable them to determine the total cost and the adequate price of each service product they provide. Competition among service providers should serve to induce them to seek to constantly improve on performance. In any case, the aim should be to avoid intervention in well-established service markets that deliver subsidized products that may distort markets and jeopardize other providers. These principles have been adopted in many of the NMA documents.[27]

It is worth mentioning that a distinction is often made between *operational* business services that are needed for day-to-day operations (e.g. transportation and tax administration), and *strategic* services, which help to upgrade a company (i.e. through R&D, advanced training, market

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25 Committee of Donor Agencies for Small Enterprise Development (2001).

26 See Committee of Donor Agencies for Small Enterprise Development (2001), p. 1.

27 See, for example, OECD (2004), pp. 60-62; and Klein / Hadjimichael (2003), p. 82.

exploration, etc.). Donor interventions usually aim at promoting the latter, and these are also the main focus of the BDS approach.[28] The basic assumptions that customers are willing to cover the full cost of services and that privatized service markets will supply the amount of services needed to raise the overall competitiveness of the home economy thus also apply to strategic services.

Wherever no service markets have yet evolved, governments (or donors) should seek to develop commercial BDS firms rather than deliver services on their own. This may be done either through supply-side measures (helping service providers to upgrade their service quality, to improve their costing, to find new customers, etc.) or demand-side measures (especially through market development grant funds, which assume part of the fees if SMEs buy business services).

What is new about the approach?

Neoclassical theorists have always argued in favor of less interventionist governments and emphasized key aspects of the Washington Consensus such as tax reform, privatization, deregulation, and secure property rights.[29] However, the above-mentioned studies and policy papers point to four innovative aspects (and this is what justifies the term "*new* minimalist approach") which go beyond traditional neoliberal thinking and call for a different set of policies.

First, **the NMA's explicit pro-poor reasoning**. While exponents of the Washington Consensus have always claimed that deregulation and a business-friendly investment climate are good for public welfare, the NMA provides convincing arguments that deregulation is especially beneficial for the poor in the informal sector. For example, de Soto and the World Bank's Doing Business reports argue that informality and poor performance on the part of micro and small-sized enterprises are mainly caused by inappropriate over-regulation and biased policies that prevent such businesses from growing. Administrative entry barriers to markets, lack of property rights for informal dwellers, and other "unfair" regulations fall especially heavily on small firms, whereas the rich and politically connected may be able to avoid cumbersome rules, or even be protected by them.

The NMA literature also shows that government entities often use subsidies to support relatively better-off population groups. This has been demonstrated most clearly in the provision of public infrastructure, where urban middle classes typically receive water and electricity supply at subsidized rates while the rural poor are barred from access. However, it also holds for private sector promotion, where a large proportion of government spending tends to benefit a few relatively privileged clients.[30]

Hence deregulation and individual property rights are highlighted as especially effective pro-poor measures. The finding that certain elements of market liberalization benefit the poor in particular has been good news for proponents of liberalization, who often face criticism that their proposed reform packages are socially imbalanced. This explains the extraordinary popularity and rapid diffusion of de Soto's work, especially in Anglo-Saxon countries.

Second, the **emphasis placed on issues of political economy.** Social exclusion is mainly seen as an outcome of regulatory regimes that are deliberately distorted to protect vested interests of non-poor groups, and emphasis is placed on the need to build pro-poor constituencies in a

[28] Committee of Donor Agencies for Small Enterprise Development. (2001), p. 1.

[29] For the original elements of the Washington Consensus and how they changed over time, see Williamson (2000), pp. 251-64.

[30] The World Bank (2004, p. 165) cites an example of rural credit in Brazil, where the largest 2% of borrowers receive 57% of subsidized loans.

political process.[31] Selective policies serve to create rents, transferring resources from taxpayers and/or consumers to certain producer groups, thus weakening their incentives to perform efficiently. In doing so, they inevitably create rent-seeking behavior.

Moreover, the NMA argues that politicians and bureaucrats may use spending for PSD programs for political reasons.[32] Politicians may create programs as a show of public action and in order to gain the support of local communities or certain target groups with the ultimate goal of winning elections. This may even lead them to allocate program funds to specific – and usually non-poor – groups that have more political voice. Bureaucrats working at the level of implementing agencies may act as rational and selfish agents who are mainly interested in maximizing the budgets of their offices and securing their own jobs and salaries. It would therefore be naïve to believe that political decision-makers, funding agencies, and implementing bodies are purely guided by efficiency criteria.

Third, consistent, at least in part empirically backed, **criticism of traditional government-driven and subsidy-based private sector support programs.** Besides the allegation that such policies are often biased against the poor, proponents of the NMA argue that improper incentives often result in an inefficient use of resources. Indeed, SME programs[33] often:

- do not have hard budget constraints. Many programs use taxpayer-funded subsidies without being held accountable for results. Hence, there are no strong incentives to use funds efficiently;
- neglect private sector alternatives and underestimate the signaling function and problem-solving capacity of markets. Governments tend to over-regulate markets, thereby creating unnecessary burdens for the private sector;
- crowd out private competitors. Service delivery at highly subsidized rates distorts markets and hampers the emergence of commercially viable service providers.
- make discretionary use of funds, for example by selectively supporting certain sectors or clusters, even though they may not be the most promising ones;
- lack business orientation and deliver poor quality. Public service providers often operate according to the logic of public administration, e.g. budget allocation is not linked to program performance, employees do not act in a businesslike fashion, and beneficiaries are not treated as clients. As public service providers and private clients work in accordance with different incentive systems, operational routines, and even different mindsets, service delivery is often not tailored to clients' needs;
- place too much emphasis on directly supporting small firms (training, finance, marketing) instead of reducing red tape and securing individual property rights. Taking the case of SME financing, Klein and Hadjimichael claim that such subsidies may even harm economic development: "One clear lesson has emerged from decades of attempts by public agencies to improve the flow of financing to firms. Whether the goal is to provide long-term financing or to help specific small firms with credit, programs that subsidize such financing

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31 See, for example, de Soto (1986). In the same vein, recent World Development Reports have paid increasing attention to this question.

32 E.g. World Bank (2003), p. 7; and Chang (1996), pp. 22ff.

33 See Klein / Hadjimichael (2003), pp. 80ff.; OECD (2004), pp. 58-59; and Gibson (2001).

tend to fail", as this type of. financing "results systematically in net negative economic outcomes."[34]

— lack financial sustainability. Most services are delivered on a highly subsidized basis. Service providers thus depend on continuous public support. In view of the fact that most countries are cutting back on public expenditure, they are typically forced to cancel or substantially reduce many support measures;

— usually have little outreach, given that it is hardly possible to make subsidy-based programs available to everyone. Even in times of high government revenues or deficit spending or substantial inflows of foreign aid, business services usually only reach a relatively small percentage of the target group.

Fourth, emphasis on the **growth potential of the informal sector**. Once micro and small-sized entrepreneurs are operating on a more or less level playing-field, the NMA predicts that they will make significant contributions to economic growth and poverty reduction. In particular, de Soto argues that all that is needed to free up enormous resources and substantially increase the living standards of the large parts of population in the informal sector is deregulation and secure property rights.

This represents a major deviation from the long-established view that the informal sector is trapped in a vicious circle in which low skills, low capital formation, low productivity and low returns on investment mutually reinforce one another. Viewed from the traditional perspective, the *formal* sector has to be the main engine of growth, and it is more promising to try to absorb gradually the informal labor force by expanding economic activities in the formal sector.

Does the NMA work in practice?

The NMA has its merits when it comes to revealing some of the limitations of traditional government-driven economic development programs, including their disregard of market forces, their often inappropriate incentive systems, their bureaucratic costs, and their lack of outreach. This criticism is quite well-founded and is increasingly accepted by policymakers and practitioners. The NMA goes one step further and offers an alternative set of policy options. However, the question is still whether this new set of policies really outperforms traditional PSD policies. More specifically, it has to be proven

— whether those elements that the NMA highlights as its core innovative elements, i.e. pro-poor tenure policy as well as simplification of procedures and regulations, really do play a decisive role for PSD, especially for the development prospects of the poor; and

— whether it is feasible to develop markets for financial and non-financial business services that not only meet the demands of globalizing economies in search of international competitiveness, but also reach out to the poor, and do so without having to fall back on public subsidies.

The following four sub-sections show that empirical evidence for the effectiveness of the recommended core policy elements is at best patchy.

Does pro-poor tenure policy make informal micro-firms creditworthy, stimulate economic growth, and reduce poverty?

Empirical evidence shows that while land-titling and legal reforms geared to improving contract enforcement may increase the value of land, the alleged massive increase in the supply of credit

[34] Klein / Hadjimichael (2003), p. 74.

nevertheless fails to materialize. De Soto's calculations of the amounts of "dead capital" in the hands of the poor that would supposedly be brought into productive use in this way are completely unrealistic. The effects of property rights reforms on overall economic growth consequently appear to be very modest.

According to the World Bank, "studies across a broad range of countries find that the more secure the rights, the faster the growth."[35] While there is little doubt that security and transparency of property transactions (and the rule of law in general) are key to private investment, it is less clear how relevant land-titling programs are in practice. Reliable estimates of the influence of property reforms on market outcomes are few and far between.[36]

Findings from Peru and several other countries question the link between legal titles and credit supply. Beginning in 1996, Peru started to carry out the first large-scale urban property rights reform in a developing country. Around 400 laws were amended, and over a five-year period, more than 1.2 million urban households obtained legal property titles.[37] In his analysis of the Peruvian case, Calderón concludes that even after the property rights reform, "the poor are as scared of borrowing from the banks as the banks are reluctant to lend to the poor."[38]

The reason for this is that even receipt of a legal title may not provide absolute tenure security. Moreover, even if legal titles exist, real estate and other properties of the poor can often not be used as collateral, because transaction costs are too high in relation to the market value of the respective property. Transaction costs are further increased by an inefficient judiciary, geographical distance, as well as a variety of other factors. Banks will only lend on mortgages if the property provided as collateral can be attached within a reasonable period of time and at reasonable cost. In many developing countries, this clashes with legal traditions which state that real estate that serves the purpose of securing subsistence cannot be attached. Furthermore, many poor people are not willing to borrow for fear they may be unable to repay their loan.[39]

Titling tends to increase the transaction prices of land, and several studies show that following titling programs there has been some increase in land-market activity.[40] Some authors, however, question the assumption that liberalized land and housing markets are always good for the poor. They argue, like Mitchell, that "the process of property titling and the use of property as collateral offer up opportunities for speculation, for the concentration of wealth, and for the accumulation of rents". He goes on to note that "the outcome of a process of property titling and the mortgaging of property is that land and housing become even less affordable to the poor."[41] Mitchell points out that throughout history, dispossession has accompanied the development of formal property rights. He argues that "property can only be turned into collateral, and from collateral into credit, if rules and powers are arranged to enable creditors to seize the property of debtors who default."[42] In many countries, this has fuelled a "machinery of debt and foreclosure."[43]

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35 World Bank (2004), p. 79.

36 Field (2001), p. 1.

37 Boucher/ Barham/ Carter (2005, p. 123) for Honduras and Nicaragua; and de Laiglesia (2004) for Nicaragua; see also Gilbert (2001), pp. 9-11, for a literature review.

38 Calderón (2004), p. 300. This is confirmed by Kagawa (2001).

39 Gilbert (2001), pp. 10-11.

40 Boucher / Barham / Carter (2005) p. 107.

41 Mitchell (2004), p. 26.

42 Ibid., p. 8.

43 Ibid., p. 6.

Does simplification of procedures and regulations help to upgrade the informal sector, stimulate economic growth, and reduce poverty?

In many areas such as health, safety, environmental protection, competition, and taxation, governments require businesses and citizens to comply with certain economically and socially desirable standards. This involves some administrative formalities which governments use to collect information, monitor compliance, and intervene in individual economic decisions. Some regulations are necessary to secure the smooth functioning of a market economy. These include rules that guarantee property rights and help to enforce them, as well as competition laws, safety regulations at the workplace, etc. Other regulations are dispensable, or not cost-efficient, and thus unnecessarily increase the costs of doing business. Any analysis focusing on administrative simplification needs to define in the first place which rules and regulations are desirable for development and which are not. The NMA literature tends to overlook this, equating the term "regulation" with the ideas of administrative burden and red tape.

The World Bank's Doing Business reports argue that unnecessary and cumbersome business regulation is particularly bad for poor people. It provides empirical cross-country evidence that cumbersome regulation is associated with lower labor productivity, and that unemployment is associated with complexity in contract enforcement.[44] The report also shows that poor countries tend to regulate business the most. For example, in 2004 11 procedures were needed to start up a business in poor countries, taking an average of 59 days to complete and costing 122 % of an average annual per capita income. By comparison, the average of OECD countries was six procedures, 27 days, and 8% of per capita income.[45] The Doing Business Report very convincingly shows that the poor countries with the heaviest regulation often "have the least enforcement capacity and the fewest checks and balances in government to ensure that regulatory discretion is not used to abuse businesses and extract bribes."[46]

It is reasonable to assume that unnecessary regulations and inefficient or even arbitrary enforcement have a harmful effect on economic performance. In fact, empirical evidence suggests that a less bureaucratic business environment fosters economic growth. Cross-country comparisons by Beck and Demirgüc-Kunt show that "an index incorporating information on entry and exit barriers, the protection of property rights, and the efficiency of contract enforcement is associated with the growth rate of GDP per capita."[47] Provided a certain level of growth is achieved, this can be assumed to contribute to poverty alleviation. On the other hand, Beck and Demirgüc-Kunt also establish that "while a sound business environment tends to help the poor by accelerating aggregate growth, the results do not suggest that the business environment has an effect on poverty beyond its effect on the overall economy."[48] This challenges both the NMA's assumption that red tape restricts the poor (and the informal sector) *disproportionately*, as well as its conclusion that deregulation of the business environment has a pro-poor impact.

Moreover, the findings tell us little about causal relationships and the relative importance of specific elements of the regulatory environment. It remains unclear how and to what extent red tape, corruption, informality, and growth are really interlinked. (This is in part because we still lack time series that document how improvements in the regulatory environment in a given country impact on economic performance.) Three main observations can be made in this context:

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[44] World Bank (2004a), p. xii.

[45] World Bank (2005), p. 18.

[46] World Bank (2004a), p. xv.

[47] Beck / Demirgüc-Kunt (2004), p. 4.

[48] Ibid., p. 4.

— Even though cross-country comparisons compiled in the Doing Business reports tell us that labor productivity decreases as the number of procedures required to start a business increase, and that unemployment is associated with complexity in contract enforcement, this does not necessarily imply a causal relationship. There may well be a third factor (e.g. human capital) that pushes the indicators for both economic performance and quality of public administration in the same direction.

— Aggregate data for Africa cast doubt on the existence of a strong correlation between "administrative burdens" and corruption. In Africa the Index of Economic Freedom, which measures variables such as the fiscal burden of government, government intervention in the economy, property rights, regulation, etc., has significantly improved in the last eight years. At the same time, however, corruption levels have also increased.[49]

— Nor is there is any support for the hypothesis that the size of the informal sector is primarily dependent on the level and quantity of these administrative burdens. On the contrary, Xaba, Horn and Motala[50] find a decline or stagnation in formal sector employment and an increase in informal sector activities in Africa during the 1990s, even though the Index actually improved over the same period.

Overall, there is some evidence that simplified procedures and regulations accelerate economic growth, but there is no proof that these reforms are especially pro-poor. We need to learn more about the impact of specific elements of deregulation policy. Using combined indices that lump together indicators for property rights enforcement with tax and labor issues tends to obscure the relative importance of different policies. Future research should avoid using judgmental terms (e.g. "cumbersome" procedures, administrative "burdens", "artificial" entry barriers), and should unbundle regulatory policies in order to determine clearly and precisely the optimal level of regulation and policy mix.

Do microcredit schemes help to upgrade the informal sector, stimulate economic growth, and reduce poverty?

Empirical studies on the effectiveness of microcredit in terms of poverty reduction show that microfinance has a positive impact on poverty, especially by increasing income and reducing vulnerability.[51] India's Linkage Banking Programme (LBP) is one of the cases that has been thoroughly studied. Here several studies confirm "that considerable socio-economic benefits are accruing from the fast growing LBP to small-scale farmers, rural micro entrepreneurs and landless labourers."[52] Average net incomes of households that participate in self-help groups (for credit and savings) have increased, while the number of families living below the poverty line has sharply decreased. In addition, higher risk absorption capacities and decreased vulnerability have been observed. At the same time, the outreach of microfinance programs is impressive. India's LBF, for example, had by March 2004 reached out to about 16 million rural households.[53]

However, microcredit is no universal panacea for poverty alleviation and pro-poor economic development. The empirical evidence points to two important constraints.

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49 OECD / African Development Bank (2005), pp. 39-41.

50 Xaba / Horn / Motala (2002).

51 E.g. Khandker (2001) for Bangladesh. It is however striking that the majority of microfinance institutions "neither determine the composition of their clientele upon intake nor evaluate the effectiveness of their program in terms of poverty reduction." (Morduch / Haley (2002), p. 1).

52 Hannover (2005), pp. 19ff.

53 Ibid., p. ix.

First, microfinance institutions rarely reach the core poor.[54] Montgomery and Weiss argue that microfinance institutions, "whilst they may be flourishing in commercial terms, and providing a valuable service to microenterprises often run by poor entrepreneurs, have relatively weak impact on those at the very bottom of the income distribution."[55] This is because the poorest people are generally part of the subsistence economy, have little to no surpluses, and may be unwilling to risk not being able to feed their families to start up a business. In similar fashion, Mosley and Hulme provide evidence that poor borrowers rarely invest in technology, fixed capital, or hiring of labor.[56] They often also lack the most basic technical and managerial skills. As a result, micro-loans often do not raise their income substantially, and may even increase their debt if they are unable to meet the repayment schedule. Moreover, some especially vulnerable groups cannot be served by microcredit, since "it is not cost-effective and sustainable […] to serve highly dispersed populations that are costly to reach, populations with high degrees of mobility or instability due to violent conflict or natural disaster, those who lack social capital or social cohesion, and people with life threatening disabilities or diseases."[57] As Hulme argues, "MFI and donor hype have created the impression that microfinance is a cure for poverty. […] This is a potentially dangerous line of argument as it distracts attention from the fact that poverty reduction requires action on many fronts – social safety nets for the poorest and most vulnerable, an effective education system, and many other issues."[58]

Second, the track record of microcredit programs is less convincing when it comes to creating competitive and growth-oriented enterprises and stimulating economic growth. Empirical evidence from different developing regions shows that only a very small portion of micro and small-sized firms manage to master the transformation from family-based to more systematically organized structures that enable them to handle production beyond the threshold of about 20 employees.[59] Although there are no systematic studies available on the use of microfinance programs to upgrade firms, anecdotal evidence suggests that they are rarely successful in facilitating this transformation on two main grounds:

- Owing to high interest rates, microcredit tends to be used for short-term activities, e.g. to acquire household assets, to improve homes, to smooth consumption, to manage emergencies and to fund social obligations.[60] Even if micro-entrepreneurs use loans for productive purposes, this tends largely to be limited to projects with very short terms of repayment (e.g. working capital for retailing). For projects with a longer gestation period, e.g. investment in technology, fixed capital, and training, a credit supply at more moderate interest rates is indispensable.
- Credit does not appear to be the most critical constraint. As firms grow, the entrepreneur's role, abilities, and behavior have to change in order to maintain competitive advantages. Changes in firm size require changes in management style; increasing specialization within the firm requires transparent and efficient processes of delegation; and firms need to establish codified organizational procedures in terms of logistics, human resource development, etc.[61]

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54 E.g. Mosley / Hulme (1996); and CGAP (2000, 2000a).

55 Montgomery / Weiss (2005), p. 26.

56 Mosley / Hulme (1996).

57 http://www.trickleup.org/learnmore.asp?LM_ID=85&P_ID=277; Shaw (2004, p. 1262) confirms these limitations for rural Sri Lanka.

58 Hulme (2000), p. 28.

59 See for example Liedholm (1992) and Mead (1994).

60 See Peck Christen / Lyman / Rosenberg (2003), pp. 6-7.

61 Trulsson (2000), p. 57, shows this for Tanzania, Uganda, and Zimbabwe.

To sum up, microcredit institutions play an important role in employment generation and risk insurance for the poor, and they have proven to be one of the most successful pro-poor policy instruments. However, they cannot provide a universal solution for economic growth and poverty alleviation. Microcredit programs need to be complemented by investment in social and physical infrastructure, and are certainly no substitute for it.[62] While there is growing consensus that microcredit requires high interest rates to guarantee sustainability, grants are needed to reach the most vulnerable population groups. And finally, microfinance institutions cannot serve the investment needs of growing enterprises. The latter need additional and diversified financial instruments, and it may make sense to provide subsidized loans tailored to investing in long-term competitiveness.

To what extent can non-financial business services be privatized, and is this good for growth and poverty reduction?

Although the BDS debate has been underway for almost ten years and has received considerable attention among donor agencies, there is still almost no empirical evidence of sustainable BDS programs. It appears that, in contrast to microcredit, owners of SMEs are rarely willing to pay cost-covering service fees, and service markets are therefore either largely underdeveloped, or continue to be highly subsidized. In particular, the assumption that commercially viable business services can be provided even for the poorest entrepreneurs has no empirical backing. A recent comprehensive review of 27 impact assessments of enterprise development projects concludes that

> in some cases (projects) have contributed to the development of the market for business development services (increasing the demand for and supply of services) by building local consultant capacity and increasing knowledge of MSE needs and requirements. What has not really been established through these studies is the question of sustainability of the services provided or outreach of business services to the poor. […] Many of the studies […] do not entirely resolve the question of whether project interventions have led to the provision of quality services on a sustainable basis. […] While there is overall consensus that clients should pay at least part of the cost of business services, the studies do not shed much light on what the market will bear or how much clients would or could afford to pay for services.[63]

There is no doubt that the potential of market forces has been underestimated, or even neglected, in development cooperation in the past. The new paradigm expressed in the Guiding Principles has important merit in that it shows that BDS systems should operate as closely as possible to the market if they are to avoid misallocation of resources and optimize cost-benefit ratios, and avoid any crowding out of private service providers. However, the Guiding Principles underestimate the degree of market failure.

It is necessary to take into account three points that restrict the leeway available for implementing the new paradigm:[64]

— Some business services are public goods, and there is a case for subsidizing them. In the case of public goods, markets cannot be expected to provide the socially optimal solution. Governments are normally willing to subsidize many BDS schemes, as they expect the social benefits to outweigh the costs. Therefore, even in industrialized countries, where service supply is usually of quite good quality and firms are able to pay sizable fees, many

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62 Shaw (2004), p. 1262.

63 Zandniapour / Sebstad / Snodgrass (2004), p. xii. In the same vein, an evaluation of eight World Bank market development grant funds targeted at firms seeking to hire business services concludes that their performance has been weak, especially with regard to sustainability and development impact (Phillips 2002).

64 See Altenburg / Stamm (2004), pp. 8-9.

services are not provided on a cost-covering basis. In developing countries, market failure may be even more pervasive. Thus it is important to identify carefully which services are actually pure private goods and can and should be provided on a market basis, and those cases in which governments should intervene to maximize welfare. The public good content inherent in a given service depends on the specific local and historical context, e.g. the size and maturity of markets.

— The development of private service markets is a slow and difficult interactive process, and public intervention may be needed to speed it up. In most mature economies, a highly diversified private service sector has developed over time. This is the result of a cumulative and interactive process in which increasing product differentiation, shorter product cycles, emphasis on customer-specific solutions, etc. have spurred the development of business services, and vice versa. In the case of less developed countries, we often observe a vicious circle in which scarcely differentiated, simple non-service sectors do not create demand for advanced services, and the lack of such services restricts competitiveness. The relevant questions here are thus: Even if a certain type of service could and should in the long run be delivered under market terms, is there not still a case for temporary market intervention in order to develop markets and get the above-mentioned dynamics going? Can SMEs in developing countries wait for service markets to be created, considering the pressures they are facing at a time of rapid market liberalization and globalization?

— Reforming public service providers in accordance with the criteria of the new paradigm may represent a more promising approach than trying to substitute private competition for them. Donors and government agencies seeking to improve SME services never start from scratch; instead, they are always forced to deal with established traditional, and often inefficient, service systems that distort markets. Even if private providers were able to guarantee an efficient and massive supply of services, in view of interest group politics and bureaucratic inertia, it would be unrealistic to assume that these institutions would quickly disappear. For the development practitioner, this raises the question of how to manage a gradual transition from bureaucratic, supply-driven, and subsidized provision to businesslike modes of service delivery.

Beyond the level playing-field: a case for proactive public policy in private sector development

Economic liberalization as well as the rapid spread of new technologies have made the business environment more competitive and demanding. The minimum requirements for companies to stay in business – i.e. management skills, technology, infrastructure, logistics, connectivity, etc – are constantly increasing. Companies have to invest steadily more in relationships with external agents, including firms upstream and downstream in their respective value chains as well as specialized service providers. Many of the services required to ensure the long-term competitiveness of individual firms, sectors, or local clusters are not purely private goods, and some public support is needed to maximize welfare.

Public intervention is also needed to bridge the gap between medium and large-scale formal sector companies and informal micro-enterprises. A huge body of empirical studies shows that only a very small number of micro-enterprises ever manage to upgrade themselves into larger units. The reasons are manifold: Micro-entrepreneurs may, for instance, lack information, technical skills, managerial competence, entrepreneurial spirit, and capital; not all societies value individual entrepreneurship, and entrepreneurs may not have a strong will to accumulate capital; some, like Muslim entrepreneurs, may not even want to borrow money; only a small number of micro-entrepreneurs have had the benefit of a full secondary education, and most live in social milieus which do not provide much exposure to innovative business ideas. Graduating out of informality thus entails a slow and difficult process of cultural change.

The NMA rightly points out that traditional government or donor-driven private sector support programs often fail to provide efficient and sustainable solutions to these problems. Its well-substantiated criticism of public service delivery, including disclosure of the often inappropriate incentive systems, is possibly the greatest merit of the NMA literature. But this does not mean that provision must be entirely privatized and paid for by users who are expected to take the risk that public goods will not be provided at all and that long-term investments in strategic assets and capabilities could be lower than the socially optimal level. In several fields of PSD, governments have an important role to play in defining targets and subsidizing programs for their achievement, regardless of who finally delivers the respective services.

The NMA fails to capture the complexity involved in building competitive economies and integrating the informal sector. As we have already demonstrated, it acts on a number of rather simplistic assumptions that are not fully backed by empirical evidence, namely that

— "pro-poor tenure policy is a key policy that automatically sets in motion a process of credit supply, investment, and growth". Empirically, the link between property rights, credit supply, investment, and growth is rather weak in the micro and small-scale enterprise sector, and the supposed massive increase in credit supply has failed to materialize;

— "simplification of procedures and regulations plays a decisive role for PSD, especially as a trigger for pro-poor growth". In fact, reforms aimed at reducing administrative burdens do not seem to have a particularly pro-poor outcome, and only rarely do they enable informal enterprises to graduate into the formal sector. Barriers to growth are manifold, so that administrative simplification alone cannot solve the problem of informality;

— "it is feasible to develop markets for financial and non-financial business services which meet the demand of globalizing economies in search of international competitiveness and also reach out to the poor without the need to fall back on public subsidies". While microfinance institutions are often very successful and achieve significant outreach, most of them do not reach the core poor and fail to solve the problem of credit supply for growth-oriented firms. With regard to (non-financial) business services, the NMA fails to take note of the relevance of public goods and overestimates the ability of small entrepreneurs to anticipate the need for strategic service inputs and their willingness to pay for them. There are no best-practice cases of smoothly functioning and sustainable private service markets.

In sum, the NMA has raised some important new issues for policymakers. It can take credit for having identified the social costs of unnecessary and unfair regulations and weak property rights systems, and for having prompted an overdue discussion of the inefficiencies and limitations of public service provision. However, the recommendations of the NMA should not be accepted at face value, as they tend to be simplistic and are not fully backed by empirical evidence. Policymakers would be well-advised to pursue an eclectic approach, combining the market-friendly perspective of the NMA with selective targeted interventions where public goods are concerned. This would imply, inter alia,

— continuing to provide policy instruments aimed at sensitizing the private sector to important changes in the business environment and at assisting collective action in order to cope with new challenges. Public facilitation is important as a way of recognizing global trends at an early stage in terms of technologies, markets, and governance structures. Well-designed surveys, benchmarking studies and a continuous stakeholder dialogue make it easier to identify such general trends; to uncover strengths, weaknesses, opportunities and threats in a dynamic perspective; and to design adequate proactive policies;

— carrying on supporting R&D, information services, and other activities that tend to be under-provided in market conditions because private actors cannot fully appropriate their benefits;

— assisting in bridging the gap between highly productive enterprise networks which operate on the basis of profound specialization and division of labor, and informal small-scale enterprises. This may require incentives for large companies to enhance the transfer of know-how towards small firms, as well as specific upgrading support for the latter to improve their performance;

— providing incentives for enterprises to improve their environmental performance.

All this requires public engagement and allocation of funds. However, governments and donors should always carefully check whether intervention in markets is really justified. Even if this is the case, co-financing by users should be compulsory. Public institutions should define targets and assure independent monitoring and evaluation of performance, but leave service delivery to private providers or business associations whenever possible. At the same time, competition among providers and market-based solutions should be stimulated.

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Enabling Environment for the Private Sector - GTZ Program: Economic Reform and Market Systems Development in Mozambique

Dr. Friedrich Kaufmann

In order to increase the participation of the poor in the growth process, the basis of economic growth needs be broadened through a more rapid development of local small and medium enterprises (SME). Currently, SME development is constrained by unfavourable legal, political and institutional framework conditions for the private sector including: (a) non-transparent, time-consuming and costly bureaucratic procedures especially with respect to registration, licensing and inspections, (b) outdated laws and regulations for business transactions, (c) the lack of implementation and enforcement capacities at the provincial level, and (d) the high level of corruption. The program design aims at contributing to improve these legal, political and institutional framework conditions and explains its theoretical foundations.

1 What means "Enabling Environment"?

Although the expression "enabling environment" is a relatively new wording in development policy, it has a long tradition and is in fact nothing really new in economics. It expresses the need for a sound and efficient framework for development and growth of an economy.

Roots and basic concepts can be found in the German or more precisely, the Freiburg school, which is called "Ordnungspolitik". It became famous after World War II and is linked to names like Hayek, Mueller-Armack and Eucken[1]. North and others developed it further with a theory about institutional economics.

That concept and the underlying theories discuss and develop the framework and the constitutional elements for efficient economic systems. This includes the necessary institutions and good governance for a positive economic performance. Institutional economics carried forward these concepts, concentrating on institutions, analysing incentives, transaction costs, property rights and underlying information structures (Feldmann 1999, North 1992, Williamson 1985). From a new institutional micro-economic point of view, total costs of production of a business contain what we know as traditional "production costs" plus "transaction costs". Transaction costs are in simple words, the costs of organizing the process of producing and selling the product. Transaction costs exist because of the division of labour, the incompleteness of information and bounded rationality of actors. They occur by nature within companies, but also on markets between actors and companies. Transaction costs are, for example, cost for information, negotiation, contract drafting, enforcement, bonding, follow-up etc. These kinds of costs depend on the existing institutions, say the rules of the game in an economy and the respective society. We consider these rules as the "enabling environment" in a narrower sense of the concept.

In a broader sense "enabling environment" for the private sector would also include all markets for inputs and the public infrastructure. Enabling environment in this context would mean transport, communication, energy, education, labour markets, raw materials, capital markets etc, etc[2], meaning all the factor costs. The following remarks as well as the presented GTZ program focus on the enabling environment in a narrower sense, hence on institutions.

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[1] for a thorough classification of the different schools and their links , see Feldmann (1999)

[2] Esser, K. et al. developed a comprehensive framework called "systemic competitiveness". It links interacting micro, meso and macro levels and contains elements of the institutional economics approach (Esser, K. et al. 1999)

2 Enabling Environment from the institutional point of view

Institutions and interests of actors

Through actions, actors pursue interests. Interests can be material interests determined by economic structures. Further non-material interests such as political power, cultural cohesion or professional ethics can be relevant. In addition to interests, actors' technical and political „capacities" matter. Skills, information and resources are examples. The second dimension of capacity in this context is political capacity. Political capacity refers to the power to influence others by persuasion, negotiation, force or other means. (Hodges, Tibana 2004, pp15). Actors operate within institutional boundaries that set the „rules of the game" for interaction. These rules define what options exist at any given moment and include or exclude actors. In some circumstances, institutions are merely expressions of the interests of one actor or another. Where this is the case, it makes more sense to focus on the actors themselves. In other circumstances institutions can have relative autonomy. They provide incentives to actors that make certain actions and interests more appealing. At the same time institutions also present constraints that limit agencies by ruling out options. Actors may like to influence processes and outcomes in one direction, but the incentives and constraints presented by the institution may lead them in another. Process and outcomes are sometimes biased by institutions and cannot always be reduced to interest and capacity of actors.

We come back to that point later introducing the underlying problem of asymmetric information.

The role of institutions for economic efficiency

The theory of institutional economics emphasises the importance of institutions as rules, regulations, norms and values of a society for its economical growth (Simons-Kaufmann 2003). An economy will not be able to produce economic growth if the society has not the right institutions (Leipold 1997). Therefore the inability to create economic growth has its reason in the failure of creating an appropriate framework of institutions (Mummert, 1998, p. 36).

Institutions are the total of all rules, relations and actions within a society (Hayek, 1969, p. 36), which are created by norms, values and behaviours and which control the economic and political acting of human beings. Human beings need a framework in which they can act. Institutions help the actors in an economy to calculate, to plan and to provide the results of their acting. They can also change either as a reaction to external influence or as a result of political action. There are two groups of institutions: The informal ones, which have the character of an institution and therefore they are obligatory even though not written down and the formal ones, which are created on purpose.

Informal Institutions

In all societies there are restrictions to regulate the living together. Our daily dealing with others is determined by rules, conventions, customs and tradition. These norms are enforced by private sanctions (e.g. social ostracism). There are also intensified norms, which are obeyed because of "psychological sanctions" like shame or bad conscience.

Formal Institutions

Formal institutions are political and economic rules and contracts like constitutions, laws, decrees (North, 1992, p. 56). The function of rules is to facilitate transactions. They are the result of a political act. Whether they are able to create economic growth or not depends on the ability of the political system in setting them in the right way. Individuals are basically interested in the implementation of an institutional framework. But they have also interests in influencing the institutional formation to their own advantage. They try to get exception of existing rules and that limits the effectiveness of the institutional framework. To avoid this, one needs a strong government. But the ability of a government to refuse attempts at taking influence depends again on formal institutions. Therefore it is important to consider informal institutions while creating the formal ones.

The Co-operation of informal and formal institutions

A contradiction between formal and informal institutions creates higher costs of using the system of institutions. For being accepted in a society, formal institutions have to reflect the convictions of the majority of its members. Otherwise more money has to be spent to succeed with them (Mummert, 1998, p. 38).

Example: How should formal institutions be formed in a market economy, if there are informal institutions, which sanction individual efforts to become richer than other members of the group?

That question is very important for a transformation process in less developed countries, which as colonies were forced to take over formal institutions, while their own informal ones have been neglected (Dia 1996).

But on the other hand, no society has a homogenous informal system of institutions. There were and there are no "pure" cultures. Influences are coming from everywhere and are mixing up with others. One part will be kept another will be rejected (Kramer, 1998, p. 256). Therefore institutions (formal and informal) are changing gradually. Little by little some institutions are considered as unnecessary, they become loose and eventually neglected. A political act can push ahead or slow down a changing process. A radical change of the formal institutions (because of revolution, conquering or as conditions of IMF and World bank) has the disadvantage that the informal institutions are not changing. Because of that, there is a discrepancy between informal and formal institutions. That is a lack of efficiency of the formal setting. A change of formal institutions ignores the deep-rooted traditions. Many informal institutions are very tenacious because they solve transaction problems in the informal sector (Kaufmann, F., Navaio, E., 1999). In the course of time both types of institutions will change to get a new equilibrium (North, 1992, p. 107).

Requirements for Institutions

Institutions have the purpose to reduce the uncertainty of human interactions via creating a solid framework. To fulfil this task in a market economy and to enhance economic development formal institutions need some basic requirements (Mummert, 1998, pp. 36):

1. Institutions should define property rights for individuals and not for collectives.
2. These property rights should only be limited if they harm the rights of thirds.
3. Institutions should guarantee an efficiency contest between the economic actors.

4. They have to be stable and only change gradually to guarantee the credibility of the government and to give the economic actors certainty.

Asymmetric information, transaction cost and design of institutions

In our context it is important to notice that institutions should be designed to reduce transaction cost for economic agents (actors). That will improve their competitiveness and the competitiveness of the system. In a democratic system a government is acting as an agent on behalf of the citizens (who are the principals) and so the private sector. The society should benefit from delegating tasks to a chosen government. Like in any principal-agent relation there are basically three problems, which make the relation complicated and costly. (Kaufmann 1997):

- Uncertainty about qualities and abilities of the agent (Hidden Information, Characteristics)
- Uncertainty of behaviour and use of resources in situations difficult to observe and to asses (Hidden Action, Moral Hazard)
- Uncertainty about taking advantage of unclear situations and contract gaps or specific investments (Hidden Intention)

The asymmetry of information causes transaction cost. If we knew and could foresee everything there would be no transaction cost. Institutions should be designed in such a way as to minimize these risks. This can be done by providing information in order to increase transparency and by designing right incentives, rules, sanctions etc.

The following part 2 intends to present the GTZ program " Enabling Environment" in the Mozambican context and to show theoretical links to the part 1.

3 Economic Reform and Market Systems Development Program in Mozambique

Program Justification

Since the end of the civil war, Mozambique has experienced a remarkable change towards a market- based economy. Including the creation of new economic institutions and a GDP growth averaging about 9 percent per year since 1996. This growth process was to a large extent fuelled by foreign direct investment in large-scale projects (EIU 2004). Given their capital-intensive nature, these "mega-projects" are likely to generate only few jobs in Mozambique. In order to increase the participation of the poor in the growth process, the basis of economic growth needs be broadened through a more rapid development of local small and medium enterprises (SME). As it is documented in the literature, especially SMEs can contribute to the development process in a more sustainable way (Kaufmann; Tesfayohannes 1997). So far, the formal SME sector in Mozambique is very weak or almost not existing (Kaufmann, Parlmeyer 2000).

Although formally Mozambique transformed from a centrally planned to a market driven economy, many of the created institutions do not yet work properly or are not implemented at all (Simons-Kaufmann 2004). Currently, SME development in Mozambique is constrained by unfavourable legal, political and institutional framework conditions for the private sector including (Roberts 2003; Nathan Associates 2004): (a) non-transparent, time-consuming and costly bureaucratic procedures especially with respect to registration, licensing and inspections,

(b) outdated laws and regulations for business transactions, (c) the lack of implementation and enforcement capacities at the provincial level, and (d) the high level of corruption.

The program aims at improving these legal, political and institutional framework conditions.

Development Guidelines

Due to these problems the proposed program concentrates on what was described as promoting an enabling environment (see chart 2) in a narrower sense. It refers directly to the promotion of the private sector that is laid down in the new 5-year program of the new Government and in the Performance Assessment Framework (PAF) Matrix as one of the key development goals of Mozambique. The PAF is agreed upon between the government of Mozambique and the donor group, promoting budget support in Mozambique (G 17). Additionally, this issue is likely be given more weight in the new Poverty Reduction Strategy Paper (PARPA II) of 2006. As well it is in line with the policy for private sector development of the German Ministry of Economic Cooperation (BMZ). As stipulated by the agreements between the Republic of Mozambique and Germany the program works in the capital of Maputo plus the three provinces Inhambane, Sofala and Manica.

Presentation of the institutional economics "Economic Reform and Market Systems Development" approach Mozambique

Target Groups and Mediators

The ultimate target group of the proposed program are small and medium enterprises (SME) in Mozambique with the potential to grow and to create productive employment. The mediators of the program activities are the Ministry of Industry and Commerce (MIC), the inter-ministerial working group, the provincial Governments of Inhambane, Manica and Sofala, representing the "public sector" as well as business associations at national and provincial level, representing the "private sector" (see chart 1).

Program Partners and Organisational Structure

The funding agency of the program is the German Ministry of Economic Cooperation and Development (BMZ). The Ministry of Industry and Commerce (MIC) of Mozambique and GTZ will be jointly responsible for the implementation of the program. The Advisor to the Minister for the Private Sector will be the main contact person for the GTZ program coordinator. The Minister of Industry and Trade or the Permanent Secretary, on behalf of the Minister, will politically represent the joint program. At the provincial level, the program plans to cooperate closely with the Governments of Inhambane, Manica, and Sofala. National and regional business associations will be invited to become associated partners of the program. A Program Review Committee will be established to facilitate the smooth implementation of the program. It will include public and private institutions at national and provincial level as well as the GTZ.

Potentials to reduce transaction costs

We now look on the content of the program (see chart 2), the objectives and indicators and try to interpret the three components of the program from the institutional economics point of view.

Objectives and Indicators of the Program

The overall Program objective, which should be achieved at the end of the program, can be described as: "The legal, political and institutional framework conditions provide improved business opportunities for SME in Mozambique". The proposed indicators for the overall objective are:

1) A SME bureaucracy index has improved by x percentage points in the priority provinces Sofala, Inhambane and Manica.

2) An index reflecting corruption in the areas of licensing, registration and inspections, improved by x percent.

3) An index measuring the degree of SME friendliness and service orientation of the public administration increased by x percent in the priority provinces.

Objectives and indicators of program components

Component 1: Strategies and Concepts to Create an Enabling Environment for SME

The objective of component 1 can be described as: "Concepts to improve the legal, political and institutional framework conditions for SME are developed and agreed upon with the involved ministries as well as with the private sector".

<u>The outputs of component 1 are supposed to be:</u>

1) Analysis and prioritisation of bottlenecks for SME development

2) Elaborating a national strategy and action plan for SME

3) Drafting of laws and decrees (e.g., related to inter-departmental one-stop-shops and unified inspections)

<u>The indicators for the objective of component 1 are:</u>

1) A national concept for inter-departmental one-stop-shops is developed and agreed upon with the involved ministries

2) A national concept for unified inspections is developed and agreed upon with the involved ministries

3) A survey among the members of the G15 Private Sector Working Group and the business associations represented at the Annual Conference of the Private Sector (Conferência Annual do Sector Privado) confirms that the interests of the private sector SMEs have been considered in the reform of the framework conditions

Looking on the expected outputs of component 1, it shows, that given the huge variety of the problems and bottlenecks for SME development in Mozambique the prime objective must be to find a concept. Concept in this context means to prioritise needs for the change or creation of institutions and to develop a national strategy. From the institutional point of view this would help to strengthen trust in policy and give economic agents a reliable scenario for their planning. The fact that the institutional priorities should be discussed and be jointly elaborated (see above indicator 2) with representatives of the private sector (including in particular representatives of

SMEs, see indicator 3) aims at reducing transaction cost and harmonizing formal and informal institutions. If formal and informal institutions differ too much, transactions cost tend to be higher or in extreme cases formal institutions simply are not enforceable. To have a binding and agreed upon national concept (including laws and decrees) also aims at reducing transaction costs through more transparency and less arbitrary actions by regulators.

Indicator 2 expresses the need for clear and binding rules to conduct inspections, which are the same for the whole of a country also in order to guarantee a fair competition between economic

actors all over the country. As far as possible, the risks of "hidden intentions" and "hidden actions" must be reduced.

Indicator 1 describes the need to reduce transaction costs by reducing burocracy for economic agents. The one-stop-shops should achieve better cost efficiency by simplifying, increasing transparency and reducing deadlines, especially for new investors. Given the fact that the Ministry of Industry and Trade is not the only player to define a national strategy and to reduce transactions costs for the private sector, the inter-ministerial working group has to play an

important role in coordinating between ministries and streamlining the enabling environment

including ministries such as justice, finance, labour etc. Economic agents might reduce their transaction costs as long as they have comprehensive and stable institutions (rules) to deal with.

Component 2: Registration, Licensing, and Inspections

The objective of component 2 is: "Simplified and more transparent rules for registration, licensing and inspections are applied in the priority provinces".

<u>The outputs of component 2 are:</u>

1) Establishment of a monitoring system for registrations, licenses and inspections that are within the responsibility of the provincial Governments

2) Advice and capacity development during the implementation of the MIC-SISCAL monitoring system

3) Pilot implementation of an inter-departmental one-stop-shop approach in at least one priority province

4) Joint workshops for entrepreneurs and representatives of the provincial Governments (inspectors and employees of one-stop-shop)

<u>The indicators for the objective of component 2 are:</u>

1) A monitoring system for registration, licensing and inspections is applied in all three priority provinces

2) In at least one priority province, the one-stop-shop has gained substantial decision-making power in the field of registration and licensing

3) The average duration for processing import and export licenses in the priority provinces has

decreased from 32 and 16 days in 2005 to 20 and 10 days

Component 2 aims at the implementation of formal institutions, partly as an output of component 1. As the objective describes, transparency and simplicity are key words in order to achieve a reduction of transaction cost. The envisaged monitoring system will help to restrict hidden intention and hidden action of government official through transparency. This will be done by the implementation of the IT-based SISCAL monitoring system making inspections recordable and public. Together with the newly formulated rules for inspections this information

gives a chance for a decent follow-up of such activities for both sides, reducing arbitrary actions and corruption. The necessary capacity building in this process tries to limit the problem of hidden characteristics and hidden information by training public officials and spread the new formal institutions between actors.

Output 3 is the attempt, based on strategies of component 1, to expand activities of the program from the Ministry of Industry and Trade competence to other Ministries, which are very relevant for the private sector and object of criticism like corruption and arbitraries. In a first stage this will include new investments but later on this concept has to be broadened and should include ongoing activities like inspections of various sectors in the form of one “economic inspection”, which is also monitored. In line with output 2 of component 2, this would contribute in a

considerable way to limit hidden intention and action by government activities and create more stable and reliable institutions, hence reducing transaction costs for the private sector and improving the investment climate in the province

Output 4 describes the active role the private sector itself has to play in shaping the institutions and giving a decent feed-back. It needs some auto-organization (see component 3) and can be seen as a kind of joint investment of the private sector to participate and monitor government more actively and jointly. Creating an interaction platform is the first step to enable this process and start a dialogue also on a provincial level, which can be reported back to the national level. Information asymmetries shall be reduced.

Component 3: Strengthening the Political Participation of Business Associations

The objective of component 3 is: “SME benefit from the active role of business associations in shaping the legal, political, and institutional framework conditions for the private sector”.

<u>The outputs of component 3 are:</u>

1) Improving the cooperation between regional business associations and their umbrella organization CTA

Establishing a dialogue forum between the provincial Governments and the regional business associations

Improving the services of business associations for SME

Development and promotion of innovative linkages approaches between SME and big companies by regional business associations

The indicators for the objective of component 3 are:

In a representative survey of SME, 75 % of the enterprises confirm that they were informed by business associations about the relevant rules in the field of registration, licensing and inspections.

The business associations organize an annual dialogue forum between entrepreneurs and representatives of the provincial Governments in the priority provinces.

The number of member companies and the total membership fees of the supported business associations have increased by 25 % relative to the initial values at the beginning of the program.

In order to strengthen the dialogue between government and private sector, the private sector must be organized and SMEs better represented. Instead of individually negotiate or resolve problems with the government it is more transaction cost efficient to build solid institutions of private sector representatives. This holds not only on national level but also on the provincial level. And it includes the need of a better linkage of provincial and national private sector associations. Only this allows an effective input into component 1 of the program and the shaping of efficient institutions on national level, which both limit risks of hidden information and characteristics. The objective is to give all investment climate participants a voice and strengthen accountability (see also Desai; Pradhan 2005).

It is the provincial level, which in the process of decentralization executes business relevant functions and needs a counterpart on provincial level to shape the institutions. In line with component 2 the implementation process of registration, licensing and inspections needs a feed back mechanism by the private sector to limit irregularities (hidden intention) by the government (1.1).

A formalized public-private sector conference at provincial level - which is a symmetric complement to the national event – could be a formal institution, which aims at reducing the respective transaction costs. The presence of SMEs is important to express their needs more strongly and feed into the process of building and shaping the relevant institutions. Efficiency of institutions is mostly designed – if at all - for the needs of big projects. The incentive to join the private sector association should not only be produced by these potentials of reducing transactions costs for individual firms but also by offering more services and information (transparency) through the respective associations. Companies can learn to overcome their informal attitude of “going alone” and appreciate advantages of cooperative actions and synergies.

The interactive role of the three components

It is important and necessary to see the three components of the program in an interactive context (see chart 1). Standing alone, they would not make an impact at all - or at least a very reduced one. They try to focus on the three elements essential to build and shape a transaction cost efficient institutional environment.

- Component one supports the formulation of national SME-friendly stable, formal institutions including private sector representatives
- Component two concentrates on the implementation and the enforcement of institutions and links the provincial and the national level
- Component three reports back from practice to "theory" and harmonizes informal and formal institutions on national and provincial level.

The interaction of the three components works as a triangle in a continuous process approach. Private sector and public sector need to be one communicating system instead of two confronting parties.

Promoting demand to implement and change institutions

There is a variety of actors which could or should have an interest in creating and shaping institutions for private sector development, namely the legislature, political parties, the executive and of course non-state actors such as business associations, professional associations, trade unions, consumer associations, NGOs, media, donors etc. All these potential actors have various limitations in capacity, organization and presence (Hodges, Tibana 2004, pp71). Given these unfavourable conditions and the limited resources, the program concentrates on the government and the business association as a direct counterpart. Nevertheless it would be desirable to come to a more open dialogue and to create more demand for shaping institutions and make the government accountable for the "rules of the game" they are setting.

4 The German Contribution

The overall program-period is planned for 10 years, divided into 3 phases. The total budget will be 15 Mio. Euros, including 4,7 Mio. Euros for the first three-year phase. Two German long-term experts will be located in Mozambique, one in Maputo and one in Sofala province in the first phase. Additionally two local experts will be assigned by the program and ca. 70 man-month of short-term experts.

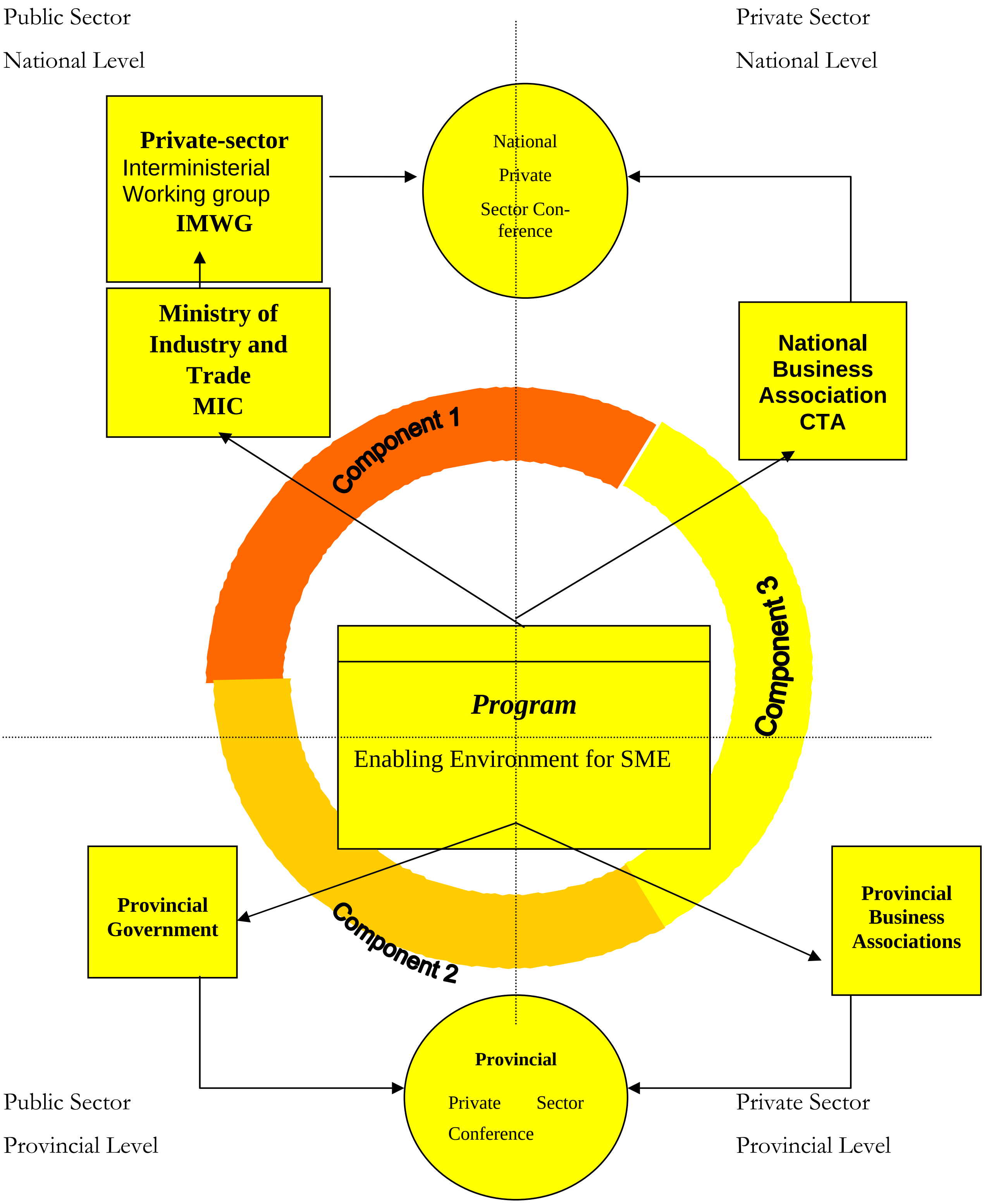
5 Conclusions

Given the lessons from the preparation mission in Mozambique in particular and institutional economics theory in general (Simons-Kaufmann 2003, p. 188), it seems advisable:

- To shape institutions for the private sector development, which enjoy credibility and stability
- To take participative approaches (public-private) seriously in order to minimize conflicts between formal and informal institutions
- To give enough time to the process of institution building
- To include capacity building to enable actors to fulfil their roles and to enforce institutions
- To create institutions in such a way that incentives for actors are transparent and arbitrary activities are reduced

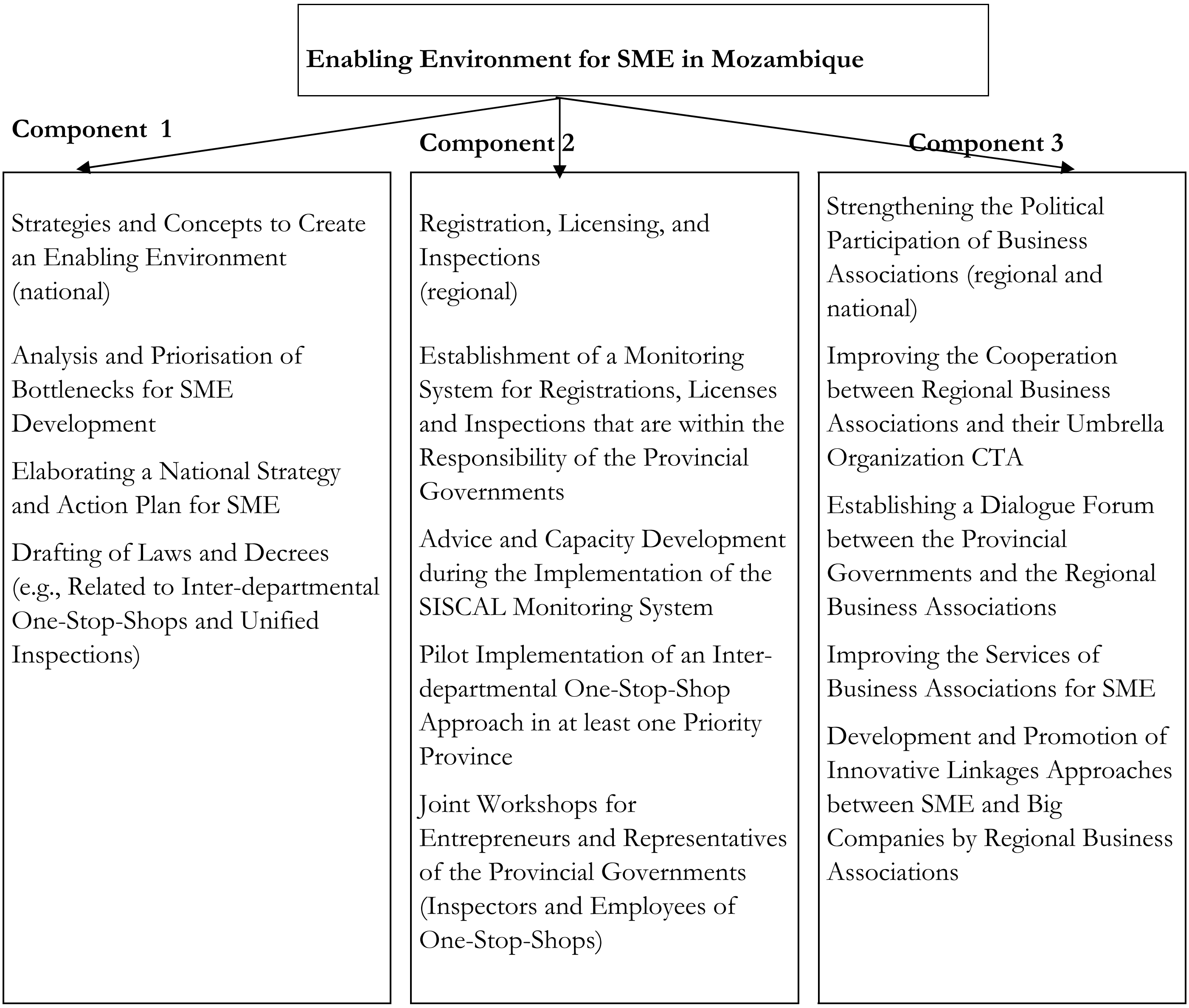
- To strengthen actors to create more and better demand for efficient institutions
- To improve transparency and information generation in order to diminish information asymmetries and transaction costs, hence increasing competitiveness of the system
- To generate more interest between donors for private sector development activities and in particular for creating an enabling environment/institutions instead of direct interventions.

Chart 1: Methodology of the program



(Source: Radke, D.; Spatz, J. , 2005)

Chart 2: The Program and its 3 Components



(Source: Radke, D.; Spatz, J. , 2005)

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Designing Local Business Environment Reform Programs - A Case Study From The Philippines

Martina Vahlhaus

This case study describes and assesses the processes used in the design of a donor-funded business environment reform program in the Philippines. This program was designed to work at local and national levels, engaging the private sector as well as key government agencies. The lessons that can be learned from these processes are of relevance to the design of other business environment reform programs.

The Small Medium Enterprise Development for Sustainable Employment Program (SMEDSEP) was conceived in 2001 as a program that could contribute to the reduction of poverty through private sector development and employment promotion. This case study focuses on the design of a business environment reform program and the processes and challenges that were faced by SMEDSEP management.

1 The Philippine context – the business and investment climate

The incidence of poverty in the Philippines, or the proportion of households below the poverty line, fell from about 40 per cent in 1991 to 32 percent in 1997 when growth was relatively rapid. However, the Asian Development Bank and World Bank (2004) describe how poverty rose again to 34 per cent in 2000 as growth turned slightly negative as a consequence of the Asian Financial Crisis. About 5.1 million households were considered poor in 2000. The majority of the poor are in rural areas where infrastructure is inadequate, productivity low, and non-farm employment opportunities lacking. Seventy three per cent of the country's poor reside in rural areas.

Both domestic and foreign investments in the Philippines have fluctuated over the last ten years. Foreign direct investment alone has dropped in from US$1,591million in 1994 to US$57million in 2004[1]. This drop has mostly been blamed on the 'deteriorating investment climate in the Philippines' (Alburo, Lamberte et al. 2003). While the economic policies of the Philippines were radically reformed in the 1990s leading to a relatively stable macro-economy, growing fiscal deficits have weakened the economy. In addition, Alburo, Lamberte et al. (2003) claim 'vested interests appear to increasingly influence both legislative and judicial proceedings and the weakness of the public sector in creating and enforcing freely competitive and/or regulated markets act as a deterrent to prospective investors and a drag on economic growth. While private enterprises do dominate the economy, effective competition does not exist in many sectors'.

A strong history of pro-business policies, economic liberalization and relatively skilled workforce has contributed to a large private sector. Micro, small and medium-sized enterprises (MSMEs) account for 99,6 per cent of the country's businesses (some 811,89 firms), generate 69,1 per cent of Total Employment and 32 per cent of Value Added according to the Government of the Philippines 2004. The majority of these businesses are micro enterprises as defined in the table below. (see Figure 1)

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[1] Source: World Bank, September 2005.

Figure 1: Micro, small and medium-sized enterprises defined

Enterprise category	Total asset value	Nº of employees
Micro-enterprise	P3, 000,000 or less [Approx US$50,000 or less]	1 – 9
Small enterprise	P3, 000,000 – P15, 000,000 [Approx US$50,000 – 250,000]	10 – 99
Medium enterprise	P15, 000,000 – P100, 000,000 [Approx US$250,000 – 1,500,000]	100 – 199

SOURCE: SMED Council Resolution, January 2003

For a long time, the Philippines Government established and maintained a policy framework that could be broadly defined as 'pro-business'. However, it has been large enterprises and particularly foreign-owned firms located that have captured much of the government's attention in the past. Micro-enterprises have received some attention from Government, but mainly as mechanism to help the poor become engaged in creating their own livelihoods.

SMEs and their specific concerns have recently gained some prominence in the Philippines through policies such as the Magna Charta for Small Enterprises of 1991 which was amended in 1997 and which defined MSME and established a range of government supported services and institutions, namely: the Small Business Guarantee and Finance Corporation to address specific financial needs of MSME; and the Small and Medium Enterprise Development Council for the development of small enterprises in the Philippines. An inter-agency council mandated to promote the growth and development of MSME by mainly 'facilitating and closely coordinating national efforts'. Moreover, government passed the Barangay Micro Business Enterprise Act to specifically encourage micro enterprises to formally register. A National SME Agenda followed by an SME long term development plan (2004-2010) was designed in 2003[2] and promoted by the Department of Trade and Industry (DTI) and SMED-Council to support and foster competitiveness and growth of SME. Since Gloria Macapagal Arroyo assumed the office of the president she has put the promotion of MSME (more specifically the tripling of loans to MSMEs) on the top of her development agenda in order to create six to ten million jobs over the next six years and thus contribute to poverty alleviation (GMA Development Agenda, July 2004).

In spite of these "pro SME" efforts and policies of the Government implementation falls short of the ambitious targets. The business and investment climate still presents great problems for enterprises of all sizes - especially for MSME - to set up a business (formally) easily in the first place as well as to run it and especially to grow it.

The World Bank's *Doing Business in 2005 shows* that the Philippines has a number of improvements to make if it wants to increase its competitiveness. According to the survey the informal economy in the Philippines (43,4 per cent of Gross National Income) is the second largest informal economy in the region after Thailand. This indicates that it seems to be more attractive for micro

2 With the support of Japan International Cooperation Agency, JICA.

businesses to stay informal. Or the other way around: the benefits of formality in the Philippines do not seem to make up for the effort and costs of formalizing. The survey shows furthermore that in comparison with other economies the difficulty and costs of firing workers, getting credit, enforcing contracts and closing businesses seem to be the most problematic areas. (See also Annex 1.)

The investment survey done by the World Bank and Asian Development Bank in 2003 indicates that roughly a quarter of all surveyed enterprises consider the Government of the Philippines as a major obstacle in the areas presented: Corruption, economic and regulatory uncertainty and inefficient delivery of government services are the most pronounced government failures in the business sector's dealings with the authorities.

Figure 2: Government as a business obstacle

Government obstacle	Major Obstacles or Very Severe Obstacle	Inefficient or Very Inefficient	Fully Disagree Or Disagree in Most Cases
Tax administration	25.14%		
Customs and trade regulations	21.66%		
Labor regulations	24.71%		
Licensing and operating permits	13.52%		
Economic and regulatory uncertainty	29.50%		
Corruption	35.17%		
Anti competitiveness/ informal practices	24.27%		
Efficiency of govt. in delivering services		33.97%	
Officials' interpretations of laws consistent and predictable			24.93%

Source: World Bank (2003)

A German appraisal mission in April 2002 designed the existing GTZ supported SME Development for Sustainable Employment Program (SMEDSEP) and identified the following main problem areas:

- Registered MSMEs, in particular, are faced with arbitrary bureaucracy in many cases.
- Chambers and associations are often too weak to assume advocacy or lobbying functions for a better business and investment climate.
- Existing MSME promotion institutions are often dominated by the state and tend to pursue a subsidy-based approach, which has also been supported by donors up to now.
- MSME have limited access to high quality BDS as the market for BDS is poorly developed, and existing service providers concentrate on the more lucrative business with the few large companies.

- Financial and credit services are not geared towards the requirements of the MSMEs. They are usually only provided by the smaller private and rural banks, which are overstretched in many ways (institutionally, financially and in terms of credit technology).
- MSME have limited access to well qualified staff as flexible, labor market-oriented training and upgrading is not available in sufficient quantity and quality.
- Decentralization poses additional challenges. There is little experience of coordinating activities between national and decentralized levels and between the sectoral departments, and few appropriate instruments to do so.

2 The Small and Medium Enterprise for Development Program

In 2001, the Philippine Department for Trade and Industry wrote to the Government of the Federal Republic of Germany requesting technical assistance for private sector development that would help Philippines' industries become more globally and locally competitive. The German Government responded by requesting GTZ to undertake an appraisal mission to the Philippines. In previous Philippine-German discussions it had been agreed that German-Philippine Development Co-operation should be concentrated in the Visayas, which covers the administrative Regions 6, 7 and 8.

The appraisal mission that followed concluded that indeed the German Government could support the Philippines in its efforts to make the private sector more competitive with a strong focus on the needs of SME and activities concentrating in the Visayas. The appraisal team recommended that the program address three fundamental constraints to SME competitiveness. It was believed that while separate, each of these components would create mutually beneficial synergies. These constraints were: (i) political, regulatory and legislative environment; (ii) business development services; and (iii) financial services.

Using the results of the appraisal mission a planning workshop with key program counterparts and other relevant stakeholders was held. This led to the design of the program, which was submitted to the BMZ in form of an offer specifying the element of the program, which formed part of the commission for the GTZ.

SMEDSEP's **target group** is small and medium enterprises, as well as micro enterprises with growth potential. The **overall goal** of SMEDSEP is for state and private institutions to shape the business and investment climate in the Philippines (particularly in the Visayas) in a way that enables the development and use of entrepreneurial potential and stimulates competition.

Four different components with specific goals and respective program activities are contained within SMEDSEP:

1. **Enhancement of SME policies, laws and regulations**

   Component objective: policy proposals for the improvement of the business climate at national and local and regional levels exist and have been implemented in the Visayas on a pilot basis.

2 **Market development for MSME-relevant business development services**

Component objective: business development services in selected areas of the Visayas adequately meet the growing demand from MSMEs

3 **Improvement of access to medium- and long-term loan financing**

Component objective: selected banks in the Visayas Region increase the share of MSMEs in their credit portfolio

4 **Market development for demand-driven technical vocational education and training programs**

Component objective: demand-oriented training is increasingly available for people capable of work in the Visayas Region[3]

The **partner organizations on the government side** with whom this program has been developed and planned are the Department of Trade and Industry (DTI) and the Technical and Educational Skills Development Authority at national as well as at regional and provincial level. One pilot province has been selected by relevant stakeholders per region as suggested by the appraisal mission: Negros Occidentale, Cebu and Leyte. The selection was based on criteria such as growth potential and institutional landscape.

The main **implementing partners** at the local level for the respective components who have been identified up to now and who have signed or are going to sign Service Agreements, Memoranda of Agreement or Result Oriented Contracts with the Program are:

- Local Government Units (LGUs) (Program component 1)
- Postal Bank and the Rural Bankers Association of the Philippines

  (Program component 3)
- Selected Chambers of Commerce, Sector Associations and private Business Development Service Providers including Vocational Training Institutions

  (Program components 2 and 4)

German promotion is scheduled to last for an eight-year period at an estimated cost of €12 million. The first phase is planned to run for three years and is financed with a German contribution equivalent to € 5,317,000.

3 Designing local business reform

The major task at the beginning of program implementation in January 2004 was to identify the reform areas with regard to the business and investment climate for MSME at local and national levels. Moreover, it was necessary to find local governments that were willing and able to design and implement local business reforms.

At the national level, key agents had to be found that were able and willing to lead the program and to assist in feeding back local reform experiences into the national policy process. This was considered important in order to induce long-term change and create broader impacts. In this section the approach taken and innovative tools used during this process will be described.

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3 The forth component had been added during the planning process as it was deemed to be a good idea to integrate the vocational training activities into the program as this would further contribute to the new program goal and create synergies with the other components.

The **Asian Institute of Management (AIM)** Policy Center conducts a bi-annual **Philippine Cities Competitiveness Ranking Project (PCCRP)** which has proven to be extremely useful for the identification of areas for reform at the local level. The survey is an innovative tool that is useful for the analysis of the local business environment. This analysis can be used to inform the design of local reform activities and the monitoring of the impact of such reforms.

According to AIM the study serves as a policy and urban management tool for city leaders in identifying competitiveness gaps and potentials of their respective localities. It helps these leaders to understand their urban area's strengths and weaknesses as business and living environments.

As the project is intended to be a continual exercise (the survey is done this year for the fourth time), looking at these indicators across time traces the development of cities and contributes to realistic planning for longer time horizons. By looking at different Philippine cities, the project attempts to identify what structural issues are weakening the competitiveness of Philippine urban areas, and must be addressed by the national government.

The main drivers of the competitiveness of emerging Philippine cities, which AIM has identified with their partners are:

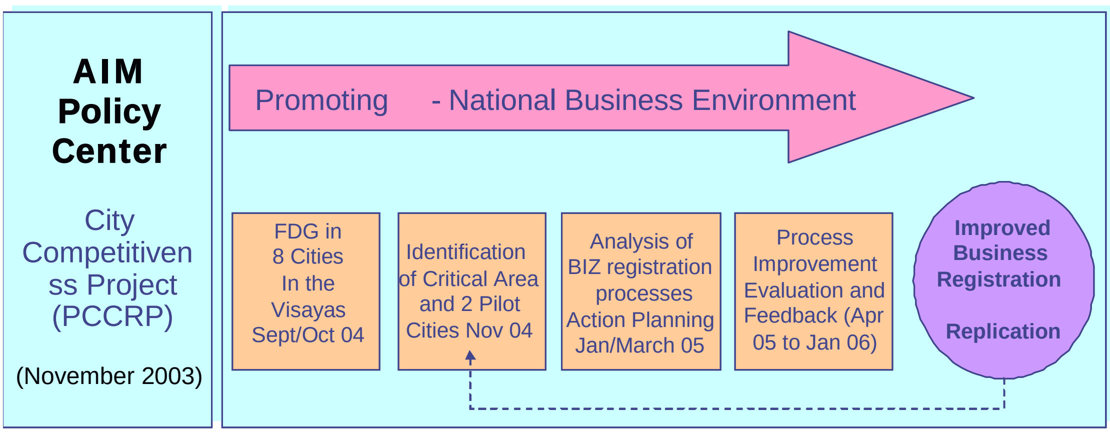
- **Cost competitiveness:** How expensive is it to operate a business in the city compared to other cities? This driver is concerned with the direct costs of doing business, such as those for land, labor, rent, telecommunications and power.
- **Human resources and training:** How well equipped is the population to build and take advantage of opportunities in the locality? The education of the populace is taken to be the most significant component of human resource endowment. The driver primarily refers to the competence of local labor and the availability of training programs for skills' development.
- **Infrastructure:** Are the necessary physical, telecommunications, technological, infrastructure and knowledge support services in place in the city? Transacting business requires not only production factors, but also accompanying infrastructure and services. These include, among others, road infrastructure, information and communications technology, and transport.
- **Linkages and accessibility:** Linkages are one of the significant determinants of city competitiveness. This refers to proximity to other growth nodes, urban centers, and surrounding growth regions. The driver's aspects are accessibility to domestic and international markets and the availability of national government and business support services. Moreover, certain geographical characteristics can be advantages upon which a city can build.
- **Quality of life:** How well off are residents in terms of quality of environment and life? The quality of life factor has been increasingly considered as one of the yardsticks in determining which cities have successfully developed and which have succumbed to the ills of urbanization. Indeed, the long-term competitiveness of the city would significantly be influenced by the degree to which its leaders have taken care of the environment and the local community. Among the relevant aspects of the quality of life are the social welfare of the people, peace and order, quality of living environment, and local amenities.
- **Dynamism of the local economy:** A vibrant local economy is fundamental in attracting inward investments and improving the attractiveness of a city.

- **Responsiveness of the local government:** More importantly, the role of the local government in urban development cannot be undermined. Much of urban competitiveness is determined by the ability of the government to respond to systemic and short-lived issues with a well-grounded and focused vision.

Annex 2 contains a list of 70 qualitative and quantitative indicators used to assess metropolitan cities (i.e., Metro Manila, Metro Cebu and Metro Davao), mid-sized cities (those non-metropolitan cities with more than 200,000 residents), and small cities (cities with less then 200,000 residents). The statistical data are acquired from official publications of national government agencies and local government units that include 21 indicators and are referred to in the study as quantitative indicators. On the other hand, survey-based data are obtained from executive surveys administered to owners and managers of small and medium enterprises whose businesses are located in the city.[4]

On the basis of the PCCRP 2003 the program (SMEDSEP) was able to identify the critical areas of the business and investment climate in the eight cities surveyed in the pilot provinces. (See figure 3)

Figure 3: PCCRP and program design



In order to prioritize areas for local reforms with respective local entrepreneurs as well as policy makers SMEDSEP decided to organize focus group discussion in the eight cities. During these half-day workshops the results of the PCCRP of that respective city were presented and discussed with local entrepreneurs and policy makers. It was intended to see if policy makers would commit themselves to making changes that would improve the local business environment.

4 The study uses purposive non-probability sampling due to the unavailability of an updated and comprehensive listing of small and medium enterprises from national government agencies. The AIM Policy Center Team decided that sixty respondents would constitute the sample size for each city. Survey-based data include 49 indicators and are referred to in the study as qualitative indicators. Most of the indicators are based on qualitative data because the perception of businessmen gauges the attractiveness of the city as a place of living and business.

The study uses two methods to score and rank the competitiveness of cities. The first is a ranking method. (The IMD also uses this method in its World Competitiveness Yearbook.) The second is the scoring method formulated and applied by the Policy Center in its previous City Competitiveness studies.

An application form was designed to describe the local reform project and the support needed. Discussions focused on 18 indicators deemed to be easily influenced by local policy makers and could be supported within the scope of the program. However, after evaluating the first workshop there were already several lessons to be learned which were then incorporated into the design and implementation of the focus group discussions. Eighteen indicators proved to be far too many to be validated and discussed during a morning session. Thus, the number of indicators was reduced to six. See Figure 4, below.

The planned approach as to encourage local governments to commit to some reform on the spot proved to be too ambitious. Instead, it was decided to conduct the full series of discussions to distill common problems and then offer service packages based on international best practice. In addition, the application form was dropped because it became quite clear that local policy makers would have needed substantial support in filling it in (from the program) and that this would then lengthen the selection process of some pilot cities even more.

Figure 4: Indicators used for identifying critical areas of local reform with entrepreneurs

1	In general, the city's regulatory environment (such as licensing procedures and fees, taxes, and other regulatory environment) is conductive to business
2	Securing a business permit is simple and efficient
3	Local policies and regulation in the city are reflective of business needs
4	The city's master development plan is appropriate to business sector's needs
5	Business taxes imposed by the city are reasonable
6	The city government is honest and transparent in its dealings

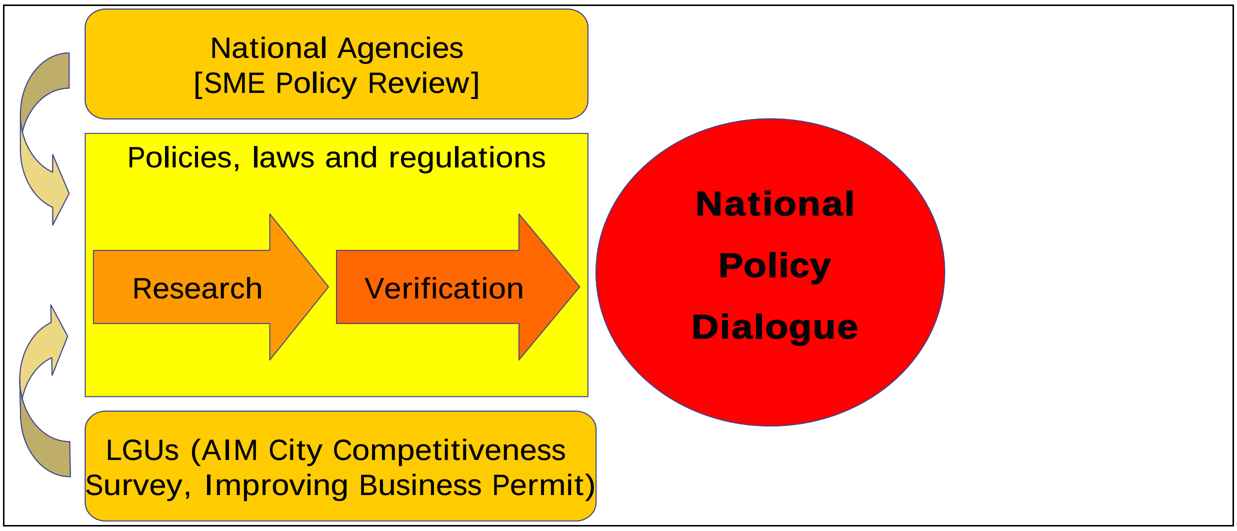
During the focus group discussions, business registration was identified as the most promising area for local reform in most cities with regards to visible short-term impacts to be achieved at very low costs. Ormoc and Bacolod were identified as pilot cities for improving business registration and licensing with their mayors being very committed to design and lead such a change process. It was agreed that the aim should be to cut procedures and time spent on business registration by 30 per cent in the first year. This would help to improve the score of a key AIM indicator: 'securing a business permit is simple and efficient'.

The local government code of the Philippines stipulates that all businesses must renew their business license in January of each year. Therefore it was easy for SMEDSEP to support Ormoc and Bacolod in analyzing their business registration procedures and costs from the point of view of the entrepreneurs by conducting a **time and motion study** in both cities in January 200. The surveys also describe and analyze the procedures and develop ideas how to improve them.

The results were fed into action planning workshops in both cities. In these workshops some examples of best practice in local business environment reforms were described. This proved to be a very powerful way of engaging local stakeholders in understanding what is needed for implementing business licensing and registration improvements.

Other tools were used to assess the business environment at the national level. This included a national review of policy and legal framework affecting MSME investment and employment decisions (Tecson 2004). The results of the focus group discussions as well as the review were actively fed into the national SMED Council, the DTI, League of Cities, Donor-Government Dialogue by organizing respective workshops, holding presentation and trying to present it in the press or other media. See Figure 5, below.

Figure 5: Local and national policy dialogue processes



4 Conclusions and Lessons learned

There are a number of lessons that have been learned by SMEDSEP in the design of a local business environment reform processes. Some of these have been learned through success, others through an assessment of design processes that did not work as well as originally hoped.

Using existing assessments and analysis

GTZ made good use of the assessments and analysis of other agencies when designing SMEDSEP. Rather than undertake its own assessments and surveys, GTZ drew what it could from the work of the Asian Development Bank, the Asian Institute of Management, the Government of the Philippines and the World Bank—in addition to other academic studies and reports. The survey now is also used for monitoring program's success.

Digging deeper as the program is refined

Once agreements had been reached regarding the overall scope and direction of SMEDSEP, the program undertook a number of focused assessments that allowed it to dig deeper into the issues that affected the business environment for MSMEs. This included the conduct of focus group discussions with entrepreneurs and local policy makers in eight cities in the Visayas for identifying local reform areas as well as the national assessment of the policies, laws and regulations that apply to MSMEs.

Continuing consultations

The early stages of SMEDSEP were characterized by a high degree of consultation with government agencies, as well as with the private sector. While two government agencies were assigned as program partners, consultation with other agencies was also sought. Private sector consultations included formal representative agencies, as well as opportunities for MSMEs to participate in forums and studies.

Working with other donors

SMEDSEP has been developed in close consultation with the donor community in the Philippines. The program is an active member of the SME Donor Group, which liaises closely with the Government of the Philippines and, in particular, with DTI and the SMED Council.

Refining program focus

SMEDSEP has gradually refined its area of focus, target groups and program activities as it has developed. While the program remains faithful to the original objectives set by GTZ when it was approved, it has been able to adapt and respond to new information and the demands and opportunities that became apparent through extensive consultation and further investigation. From the start, it has been important for SMEDSEP to develop a flexible approach to planning. As circumstances have changed, the program has changed. While ultimate goals and purposes remain, it has been necessary to recognize and respond to external changes. Thus, the program has been required to be both pragmatic and strategic.

Working with a wide range of actors

SMEDSEP has formed strong relationships with two national partners: DTI and TESDA. These agencies are well placed to take on issues associated with the national policy framework for MSME development. However, there are a number of other agencies that need to be brought into the reform process (e.g., Congressional and Senate Trade and Industry Committees, Small and Medium Enterprise Development Council—at national and provincial levels, Department for the Interior and Local Government, Department of Finance, the Philippines Special Economic Zones Authority, Philippines Chamber of Commerce and Industry, Employers Confederation of the Philippines, selected LGUs, and the media). This is not always easy as these agencies often have conflicting interests and DTI and TESDA are the assigned government partners of the GTZ program.

Applying national and local reform dimensions

SMEDSEP's approach to reform at national and local levels is significant. This approach allows the program to test the impact of national changes at the local level, while also enabling it to pilot new approaches in selected LGUs. There is a sound rationale for this approach, which is informed by the strong decentralization program of the Philippine Government and the work on the competitiveness of cities undertaken by the Asian Institute of Management. Local program efforts also build on the previous experiences, networks and relationships GTZ has in the Visayas.

Applying complementary services

This case study has focused on one component of SMEDSEP, the component dealing with reforms to the business environment for MSMEs. However, there are three other components that make up the program and complement its reform activities. The information and experiences gained in the other components are very useful for reform purposes and the program manager is eager to ensure these are shared across all components.

Supporting current reform efforts

SMEDSEP tries to support and strengthen current reform efforts. International experience (including GTZ experience) has shown that donor agencies wishing to improve the business environment cannot take the lead in these processes. The key lead agencies are domestic agencies: government mainly, but also the private sector. Thus, SMEDSEP works with these agencies to support their reform efforts.

Building a demand for reform

Until now it has been difficult to identify leaders for specific reforms with regard to the business and investment climate such as business licensing and registration at national level. Moreover the private sector does not assume its advocacy function very well due to many reasons – one of them being that at the local level the private sector is very poorly organized. Therefore SMEDSEP spends more resources on its dialogue with domestic partners on these issues, including the private sector. A demand for reform must be created to influence the national policy agenda. This requires a long-term commitment to establish stable alliances with relevant stakeholders.

Focusing on the achievable

SMEDSEP aims to focus on reforms that are possible within the financial and time constraints of the concerned agencies as well as the program. While there are many elements of the business environment that require reform, SMEDSEP has not attempted to address all these. Instead, the program focuses on those elements of the business environment where visible impacts can be achieved in a short time. One of the main problems in the Philippines is that there are so many good policies, laws and regulations formulated, but implementation is poor. More of the same would therefore be to the detriment and not induce any change at all.

Keeping a long-term perspective

While SMEDSEP is focusing on what is achievable within the bounds of its timeframe and resources, it also focuses on long-term results. It is easy, for example, to focus on the simplification of business registration procedures and to lose track of broader business environment issues. Thus, SMEDSEP promotes discussion on the purpose of the business environment reform and the benefit of private sector development in general and MSME development in particular.

Positioning small enterprise development within a larger context

While the promotion of MSMEs is a central concern for SMEDSEP, it is the broader business environment that the program wishes to improve. The experiences of MSMEs provide a lens through which the broader business environment can be viewed. Thus, the experiences of MSMEs in the business environment are a kind of litmus test that shows the effect the investment climate has on the private sector. SMEDSEP's work with this target group complements the work of other agencies (e.g., World Bank, Asian Development Bank) that are more concerned with larger, formal firms (e.g., through investment climate surveys and assessments). Thus, SMEDSEP provides a sharper focus on specific issues by highlighting the investment climate constraints that affect MSME development.

Engaging the private sector

SMEDSEP is eager to work with the private sector in its support for business environment reforms. It has ensured that private sector representatives are invited to all workshops and has endeavored to capture the concerns of this sector in all studies and assessments. In the Philippines this is especially important as government agencies are still designing and implementing their policies and support programs in this sector without much consultation of the private sector.

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Annex 1: Snapshot of Doing Business in 2005, Philippines

Indicator	Philippines	East Asia and Pacific Regional Average	OECD Average
Starting a business (2004)			
Number of procedures to start a business	11	8	6
Time to start a business (days)	50	52	25
Cost to start a business (% of income per capita)	19.5	47.1	8.0
Hiring and firing workers (2004)			
Difficulty of Hiring Index	22	20.6	26.2
Rigidity of Hours Index	60	30.0	50.0
Difficulty of Firing Index	40	22.7	26.8
Rigidity of Employment Index	41	24.2	34.4
Firing costs (weeks of wages)	90	53.0	40.4
Registering property (2004)			
Number of procedures	8	4	4
Time (days)	33	51	34
Cost (% of property per capita)	5.7	4.3	4.9
Getting credit			
Cost to create collateral (% of income per capita)	8.3	1.9	5.2
Legal Rights Index	5	5.4	6.3
Credit Information Index	2	2.0	5.0
Public credit registry coverage (borrowers/1000 adults)	0	33.9	76.2
Private bureau coverage (borrowers/1000 adults)	34	67.3	577.2
Protecting investors (2004)			
Disclosure Index	6	2.6	5.6
Enforcing contracts (2004)			
Number of procedures	25	27	19
Time (days)	380	316	229
Cost (% of debt)	50.7	57.0	10.8
Closing a business (2004)			
Time (years)	5.6	3.6	1.7
Cost (% of estate)	38	29.8	6.8
Recovery rate (cents on the dollar)	3.9	30.4	72.1

Source: World Bank (2004)

Annex 2: City competitiveness indicators

The following qualitative **(ql)** and quantitative **(qn)** indicators were used to assess metropolitan cities (i.e., Metro Manila, Metro Cebu and Metro Davao), mid-sized cities (those non-metropolitan cities with more than 200,000 residents), and small cities (cities with less then 200,000 residents) (AIM Policy Center 2003).

COST OF DOING BUSINESS (6 Indicators)

1 (ql) In general, profitability of doing business in this city is very high

2 (ql) Informal fees (bribes) in the city are non-existent

3 (qn) Cost of power for industrial use

4 (qn) Average rent of commercial space

5 (qn) Average installation cost of new telephone lines

6 (qn) Local minimum wage

DYNAMISM OF LOCAL ECONOMY (10 Indicators)

7 (ql) In the next six months, the revenues in the city are likely increase considerably

8 (ql) In general, the city's regulatory environment (such as licensing procedures and fees, taxes, and other regulatory requirements) is conducive to business

9 (ql) Tourism as an industry is a very vibrant sector

10 (ql) In my city, access to financing for private businesses is readily available

11 (qn) Average household income

12 (qn) Local inflation rate

13 (qn) Percentage of top 200 companies in city

14 (qn) Population vs. fast-food chain locators

15 (qn) Market size

16 (qn) Consumer Price Index

LINKAGES AND ACCESSIBILITY (6 Indicators)

17 (ql) Raw materials and other production inputs are located near the city

18 (ql) The transportation system for moving raw materials from domestic sources to the city and finished goods to other domestic markets works very well

19 (ql) International entry and exit points such as airports, seaports, and other trans-shipment points are located near the city

20 (ql) In my city, the availability of support services, such as advice on product or process development, marketing, and business strategy making, is readily available

21 (ql) The benefits of collaborating with other firms in my industry are very positive

22 (ql) The level of services provided by national agencies (e.g., DENR, BFAR, BFAD) is very good

HUMAN RESOURCE AND TRAINING (15 Indicators)

23 (ql) Skilled labor needed by my company is available in the city

24 (ql) Workers from the local pool are eager to developing skills

25 (ql) Curricula and academic programs in local colleges, universities and other tertiary-level training institutions equip graduates with basic skills needed by local industries

26 (ql) IT training programs available in the city equip students with needed IT skills

27 (ql) Investing in training and skills development is very important

28 (ql) In my city, training programs jointly organized by schools and industry partners are highly present

29 (ql) My business allows on-the-job trainees from schools

30 (ql) Good performance by workers is expected

31 (ql) Effective management of my firm's human resource is the least of my worries

32 (ql) In my city, relations between management and labor are generally constructive

33 (ql) The link between the job satisfaction of my workers and productivity very strong

34 (ql) Worker suggestions about ways to improve business operations are encouraged

35 (ql) In my city, poor labor practices such as discrimination and harassment are discouraged

36 (qn) Number of tertiary educational institutions

37 (qn) Number of Vocational Institutions

INFRASTRUCTURE (12 Indicators)

38 (ql) The city's roads/road network and traffic management are well managed

39 (ql) During peak hours, roads are always clear

40 (ql) Electric power in the city is reliable

41 (ql) The water supply in my city is abundant

42 (ql) Connecting to telephone lines from other service providers is easy

43 (ql) Cellular phone signals in the city are always adequate

44 (ql) Internet Service Providers (ISPs) are reliable

45 (ql) The city's waste management program works very well

46 (qn) Number of banks

47 (qn) Road Density

48 (qn) Vehicle density

49 (qn) Number of ISP providers in the city

RESPONSIVENESS OF LGU (12 Indicators)

50 (ql) Securing a business permit is simple and efficient

51 (ql) The city government is honest and transparent in its dealings

52 (ql) The city's administration of justice is fair

53 (ql) Policies and regulation in the city are reflective of business needs

54 (ql) The local government holds regular forums to elicit opinions of its constituents

55 (ql) The city government's Clean and Green Program has been very effective

56 (ql) Business taxes imposed by the city are reasonable

57 (ql) The city's master development plan is appropriate to business sectors' needs

58 (ql) Land-use regulations, such as zoning, are reasonable and flexible

59 (ql) Local government units are involved in developing human resources dynamically

60 (ql) Local government programs to assist displaced workers are effective

61 (qn) Percentage of IRA to total LGU revenue

QUALITY OF LIFE (9 Indicators)

62 (ql) The city, especially its roads and public open spaces, is always clean

63 (ql) Open bodies of water in the city are clean

64 (ql) Air quality in the city is clean

65 (ql) The city's rest and recreational facilities (i.e., cinemas, bookstores, malls, etc.) are adequate

66 (ql) The security environment is conducive for business

67 (qn) Incidence of theft per 100,000 Population

68 (qn) Incidence of murder per 100,000 Population

69 (qn) Life expectancy at birth

70 (qn) Hospital beds per 100,000 population

Human Resource Development for a Market Economy (HRDME) GTZ Program in Lao PDR – An overview of the approach to improve the Business Environment

Dr. Manfred Matzdorf

Lao PDR is undergoing a comprehensive economic and social transformation process towards a market economy but is still one of the poorest countries in South-East Asia. She has mapped out her development aspirations in the National Growth & Poverty Eradication Strategy (NGPES) with ambitious growth objectives. The HRDME program has been designed to support the development process in three areas with the respective government institutions & ministries responsible for: Economic framework conditions for business & investment as well as the implementation of the NGPES (Committee for Planning & Investment), Vocational Education & Training (Ministry of Education), and Promotion of small & medium-sized enterprises (Ministry of Industry & Handicraft).

The emphasis is on joint public-private sector dialogue, monitoring & learning processes to improve the effectiveness of policy action & interventions for the sake of economic development of the country, in general, and a dynamic private sector, in particular.

1 Background and the Core Problem

Within the South East Asian region, Lao P.D.R. has a special status. The per-capita income is one of the lowest in the region and the 30% share of poor people out of the total population (2002) is extremely high in the South East Asian context.

The country is undergoing a comprehensive economic and social transformation process. Promoters of economic reforms have to constantly battle against the heritage of the socialist economic system and the directive style of government. Core problems are the **inadequacy of the legal, institutional and policy framework**[1] for a dynamic private sector-led development. Due to this fact, the pace of economic growth and investment is comparatively slow.[2]

The HRDME program has been designed to contribute to the achievement of the ambitious objective of the **National Growth and Poverty Eradication Strategy (NGPES), i.e., to increase Lao's per-capita income beyond the LDC level[3] by the year 2020 through ensuring an average rate of GDP growth of 7% p.a. during that period.**

Pillars of the *NGPES* are, i.a., the promotion of **private sector development** (particularly of SME's), **human resource development** (particularly vocational education & training) as well as **improving the capability and efficiency of the Lao administrative apparatus.**

[1] The inadequate **institutional capacity** relates back, i.a., to the scarcity of **skilled human resources** in the public sector and low civil service salaries.

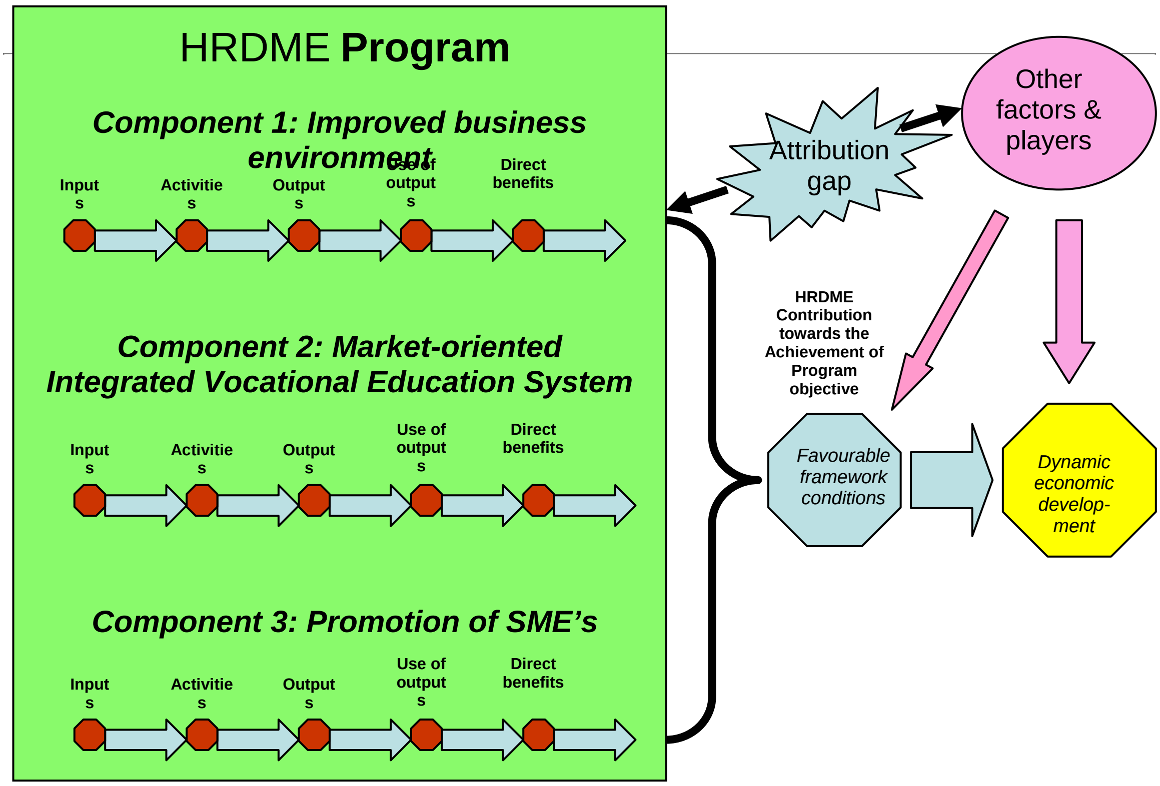
[2] Official statistics seem to put the growth rate more in line with set targets than actual performance.

[3] **Least Developed Country** characterized, i.a., by a level of per-capita income of less than USD 1050 p.a.

2 The HRDME Program and the Intended Development Goals

In order to make significant contributions to the achievement of the **development goal** and reduce the so-called **attribution gap**[4], the **Human Resource Development of a Market Economy** *(***HRDME)** program has incorporated previous technical cooperation projects in the areas of economic reforms, vocational training as well as promotion of SME's and now combines components related to (a) the **general business environment**, (b) **vocational education & training** as well as (c) **small- & medium-sized enterprise (SME) development** jointly with the three decisive ministerial partner organisations, i.e. CPI, MoE and MIH.[5]

Figure 1: HRDME and the 'Attribution Gap'



The overall **program objective** reads:

Government and private sector jointly create appropriate conditions for a more dynamic economic development.

The program is to be implemented in two phases over a period of 7-years, i.e. from June 2004 to May 2011.

Indicators to measure achievements during the program period are at higher impact, result & output levels:

[4] Due to numerous other factors and influences, any achievement of the development goal, can hardly be attributed to the technical cooperation project or program alone.

[5] CPI – Committee for Planning & Investment; MoE – Ministry of Education; MIH – Ministry of Industry & Handicraft

- The percentage of entrepreneurs, assessing the framework for their economic activities positively, is increasing (proven by surveys every two years; results of the first survey serve as benchmark).
- The **Program Steering Committee** identifies a list of problems regarding the legal framework for private enterprises, for vocational education training and business financing. The Committee confirms that at least three problems out of this list are solved.
- The percentage of school leavers from the vocational education system finding employment or self-employment is increasing (proven by annual school leaver tracer studies)
- Decisions of public and private sector committees, responsible for the main fields of cooperation in the three program components (such as the **National Training Council (NTC)**, and **Small and Medium-sized Enterprise Development and Promotion Committee**, **SME-PDC**) are implemented (evidence provided by annual internal evaluation reports).

Objectives of the respective **Program Components** for Phase 1 (to last from 1 June 2004 to 31 May 2007) are the following:

Objective of Component 1 (for Phase 1):

Legal and institutional framework conditions for the dynamic development of the private sector, in general, and for SME development and financing as well as vocational education system, in particular, are improved and innovations are disseminated to concerned stakeholders.

Objective of Component 2 (for Phase 1):

The national vocational education and training system provides a significant contribution to meet the needs for income relevant training and the needs for qualified personnel.

Objective of Component 3 (for Phase 1):

Private sector and government jointly develop an appropriate institutional environment and strategies for SME development and offer respective services.

Respective indicators have also been defined, some of which are **impact indicators** to be tracked by the said periodic surveys. The 2005 survey helped to quantify the benchmarks.

3 The Approach (Activities, innovative tools in analysis, design, implementation & monitoring)

The following aspects of the HRDME will be highlighted:

a) Awareness raising of government officials on the **market economic system context**, the **required reforms** of government as well as **efforts** by private enterprises and related organisations
b) the **program management** and the process of **participatory learning**, decision making, implementation & **monitoring** in **Component Management Committees** and the **coordination** with other **development agencies**

c) the **main fields of cooperation** in each component based on public-private sector dialogue, selection of **priorities**, implementation & **impact monitoring for learning processes**

d) the **main features** the HRDME program to justify expectations on its development impact

e) the **2005 Enterprise Baseline Survey** and **impact monitoring system** for partner organisations

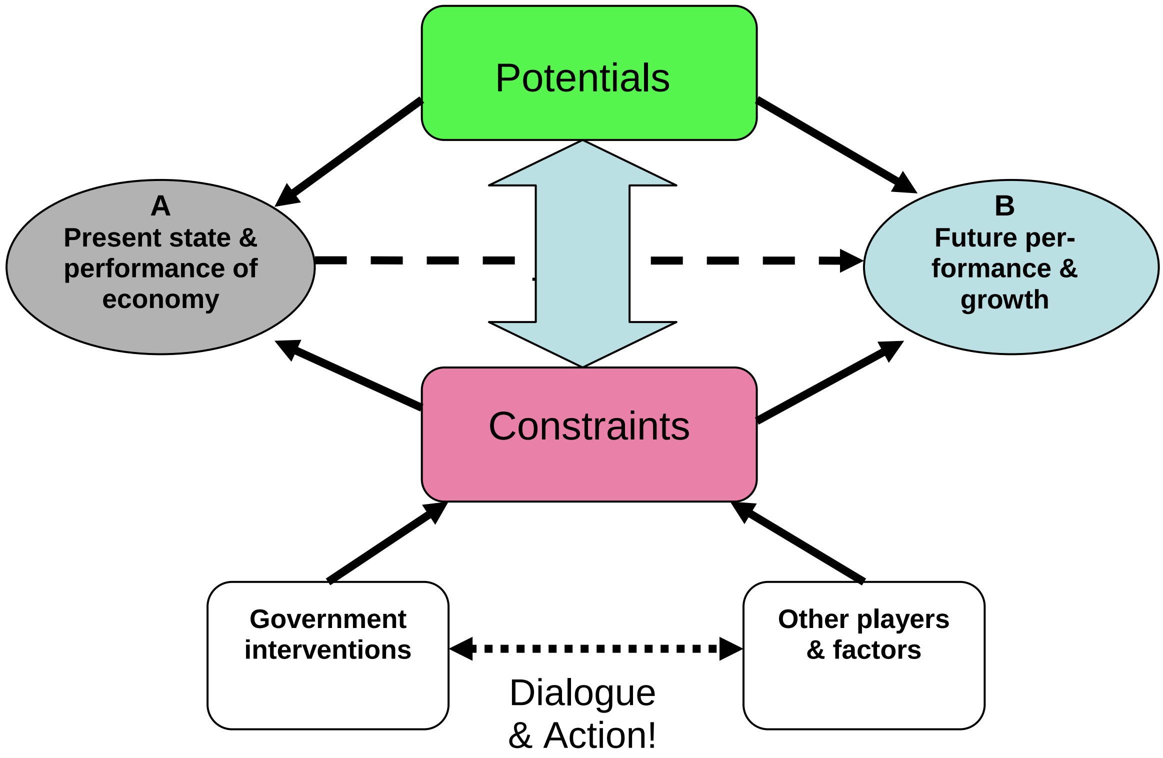
Ad a) Lao P.D.R. is still a **one-party state** with an ideological orientation towards **socialism** and a **directive form of governance**. Therefore, the precondition for institutional capacity building and policy advice on **private sector development** must be developed first through a better understanding by political leaders and Government officials of:

- the **role of government in a market economy***,* i.e., to move away from a '***control***' to a '**regulatory & public service**' function and, then,
- based on the changed policy variables, the **identification of the most promising and effective interventions** to promote private sector development, investment and economic growth
- acknowledgement of required technical capacities in government to design, implement and monitor the impact of government action on the achievement (or failure) of set development objectives and targets.

The acknowledgement by government officials is essential that the main actors in economic development are **private enterprises** (and individual producers). Their investment and risk taking to stay (or become) competitive on changing markets is the basis for economic growth and development. The HRDME, particularly in Components 1 & 3, has to dedicate some resources to clarify the rationale why government should act to **reduce risk** and **remove constraints** (and transaction costs) to private business initiative and investment.

At the same time, the **ability of private sector organisations** (and individual enter-prises) to fight for an improved business environment (through **dialogue** and lobbying) as well as to invest and efforts to **enhance the competitiveness** of their business is equally needed. The **public-private sector dialogue** and the efforts to find and implement appropriate solutions to identified problems are an essential part of HRDME' s support.

Figure 2: What can Government do to dynamize the economy?



Ad b) The HRDME program is managed through a two-tier system of:

- a **Program Steering Board** meeting twice a year to oversee the implementa-tion of agreed **activities** and **outcomes** of the three components, reap synergies among the components and advise on what conclusions to draw for the next period and
- three **Component Management Committees** associated to the key ministerial partner organisations meeting quarterly on all specific planning and implementation matters.

The planning and implementation follows a participatory learning & decision making process. The main **fields of cooperation** were, e.g., discussed, screened and agreed during the first couple of months in the respective **Component Management Committees** combining the key players from the public as well as the private sector. The **coordination** with **other development agencies** active in the respective field led to either formalised or informal agreements to cooperate and share information on support activities.[6]

[6] Examples are: MoU with UNIDO, UNCTAD, IFC, WBI etc.

Ad c) The **main fields of cooperation** in the various components have been agreed as follows:

Table 1: Main Fields of Cooperation & related players in Component 1:

#	Field of Cooperation	Other Players & Dev. Agencies	C1	C2	C3
1	Government – Private Sector Dialogue on business framework	LNCCI WB-IFC, ADB	√	√	√
2	Follow-up of Prioritized Agenda & PSD Strategy	LNCCI WB, UNCTAD	√		√
3	Economic performance monitoring & research	WB, SIDA, JICA	√		√
4	Training of Decision-Makers and Civil Servants	ADB, UNDP, JICA, WBI	√		
5	Publications and Public Relations		√	√	√

Ad #1) The facilitation of the PPS Dialogue spearheaded by the MPDF program at the central level Business Forum will be supplemented through provincial level dialogues (at first in pilot provinces which were part of the 2005 baseline survey)

Ad #4) The focus will be on the topics: 'The role of government in a market economy' and 'How best to promote private sector development & investment'

Table 2: Main Fields of Cooperation & related players in Component 2:

#	Field of Cooperation	Other players & Dev. Agencies	C2	C1	C3
1	IVET Policy Formulation & Reviews	LNCCI UNESCO	√	√	√
2	Capacity Building of IVET schools	DED, KfW	√		
3	Pilot Testing of Dual Cooperative Vocational Training	LNCCI & BMO's	√		√
4	Vocational Teacher (Bachelor) & School manager Training	NUoL, VETC	√		
5	National & international workshops, conferences & study tours on IVETS	BBP-Vietnam	√	√	√

Table 3: Main Fields of Cooperation & related players in Component 3:

#	Area of Cooperation	C3	C1	C2	Other Dev. Agencies
1	Set-up & capacity building of SME promotion institutions SME-PDC & SME-PDO (Decree 42)	√			UNIDO, ADB
2	Study & analysis of potentials & constraints faced by SME's in various industries and locations	√	√	√	LNCCI, UNIDO, ADB, ILO, JICA
3	SME Development Strategy & Action Plan Formulation & Implementation (incl. Donor coordination)	√	√		UNIDO, ADB, ILO, SNV, IFC, LNCCI, DED
4	Monitoring system for SME development	√	√	√	
5	Information creation and dissemination on SMED	√	√	√	UNIDO, ILO

Ad #1) As the SME-PDC & the SME-PDO has only recently been formally formed, the institution & capacity building & training of assigned staff will be the initial focus.

Ad #4) The findings of baseline survey will be used to facilitate a common understanding of the SME-PDC members on the critical issues and the prioritisation of actions as well as to create the basis for periodic impact monitoring of promotional activities by SME-PDO.

The tables above also reflect the **multiplicity of actors** as well as **common interventions** or **support activities** of all three components. These represent **opportunities** and – at the same time – **challenges** to the program management to reap the **synergies** that exist among the components- as already mentioned above.

Ad d) In general, HRDME is expected to make **significant contributions** towards the overall development goals because it:

- is directly placed at three **national policy making institutions** critical to economic & PSD, i.e., CPI, MoE & MIH
- is designed to support required **decision making, change & learning processes**,
- at policy & executive levels as well as
- combining public & private sector perspectives
- has an **adequate time horizon** to do this (though with scarce financial & human resources)
- **focuses on critical constraints** for economic development in all 3 components, i.e., **human resources, institutional capacities of public & private sector**
- **cooperates** closely with **German & international development agencies**

Ad e) HRDME conducted an **Enterprise Baseline Survey in 2005**[7] to be integrated with an **impact monitoring system** with related **learning cycles**:

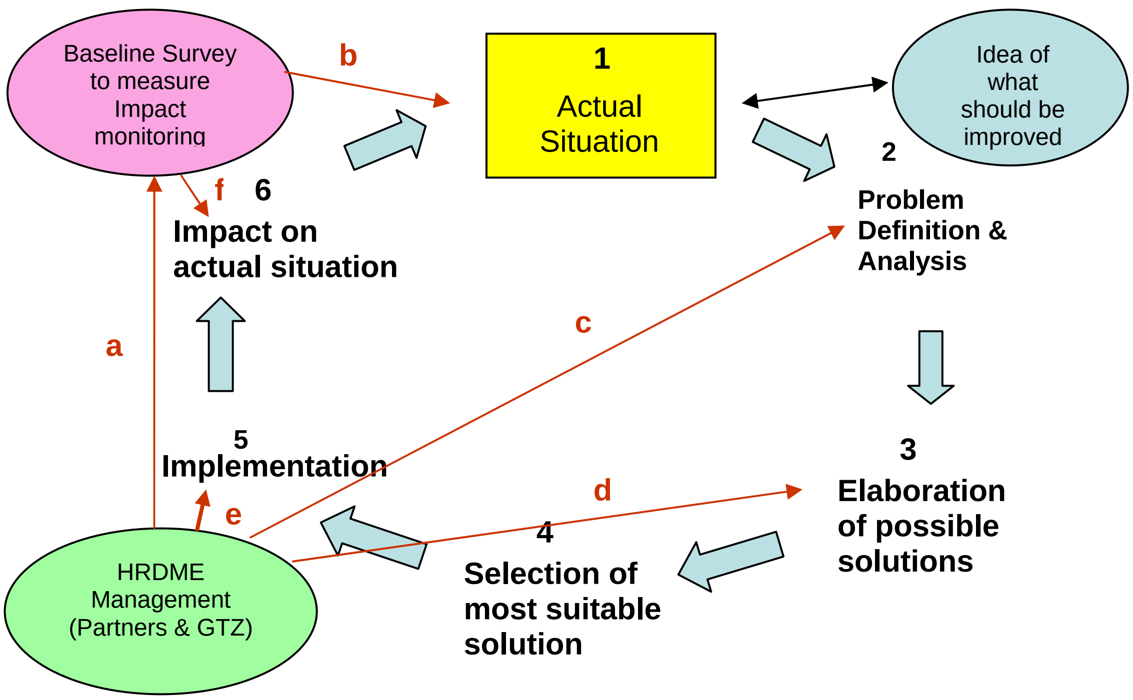
Purposes of the Survey:

- Establishment of a baseline (or benchmarks) of the HRDME indicator(s) at the start of program operations
- Evidence of needed improvements in the business environment
- Building up of an impact monitoring system for the partner organizations.

This leads to the following **use of the survey findings**:

- **Benchmarking (quantification) of indicators** at the start of program operations
- **Identification of critical business constraints** in order to …
- **Advise public-private councils** (NTC & SMEPDC & Business Forum) on directing attention towards identified issues, leading to the …
- Elaboration of solutions and adoption of most promising action
- **Disseminate findings & conclusions** among related Lao & international development partners
- **Monitor impact of action taken** in future surveys

Figure 3: The Baseline Survey and 'Learning Cycles'



[7] Additionally, a nationwide 'Training Needs Assessment' (TNA) has been executed to have a better substantiation of what the foreseeable skill-demands are for vocational education.

4 Lessons learned (unintended consequences, risks, (un-)favourable conditions)

The integration and **balancing of public and private sector interests** is critical in a country where a **directive form of governance** is still alive, skilled human resources in the public sector are scarce, institutional capacity is poor and adequate official incentives for good performance are virtually non-existent. It can only be hoped that the self-interest and the lobbying power of business associations is strong, persistent and effective enough to exert some pressure on either complacent or unwilling bureaucrats or politicians.

The facilitation of a systematic **public-private sector dialogue**, the constructive work in related committees as well as the **follow-up action of issues** raised during the meetings are key instruments for pushing forward the **public sector reform agenda** and the **improvement of the business & investment climate** by **central** as well as **provincial** government organisations. The role of the **media** needs to be exploited.

Globalisation does also affect Lao PDR and the **regional integration** initiative under the **ASEAN Free-Trade Agreement (AFTA)** will increasingly affect the producers and enterprises in Laos through **tightening competition** and the need to become more productive, quality-conscious and customer-oriented. This will pose a serious challenge for almost all enterprises and the liberalisation of the trade regime - including the WTO accession - will not be embraced by all players.

In this context, the **risk** is real that the **satisfaction of entrepreneurs** with the legal, regulatory and policy environment for their business (as contained in the impact indicators mentioned in Chapter 2 above) is **unlikely to improve** in the short run (even if objectively, regulations and their practical application change for the better).

5 The German contribution

Technical cooperation contributions consist of **advisory services** provided by international and local short- and long-term experts, **training** of executive and management personnel from involved institutions from the public and private sector, **supply of materials and equipment** as well as **local financial contributions** particularly for start-up financing and pilot measures in SME and vocational education training.

The entire GTZ-program duration is 7 years (from 06/2004 until 05/2011). Estimated total costs of the German contribution are 9.550.000 EUR. The initial three-year phase (from 06/2004 until 05/2007) is supported with a German contribution of 4.650.000 EUR.

Improving the Quality of Business Environment Reforms - The Example of the Reform of the Enterprise Law in Vietnam

Le Duy Binh

Vietnam has been consistently pursuing the reform of its business environment and is now on a sound track to achieve the MDGs. However, to ensure a continuation of its rapid growth, a new round of business reforms is needed. Most crucial will be the Unified Enterprise Law currently under preparation which is pushing further with the reforms initiated under the successful Enterprise Law of 2000.

German Technical Cooperation is focusing its support to the reform of the Enterprise Law on (i) improving the quality of the law; (ii) more effective implementation of the law; and (iii) development of tools and guidelines to be applied in business law making. The results of the Regulatory Impact Assessment, the recommendations from policy dialogues and consultation processes, as well as other inputs by GTZ have made significant contributions to the drafts of the Law. Several of the tools piloted will be used for other law making processes, thus enhancing the quality of business environment reforms in Vietnam.

1 Unified Enterprise Law and Common Investment Law and the improvement of the business environment

The need for further reform of the Business Environment

Since the mid-80s Vietnam has been consistently pursuing the reform of the business climate for private enterprises. One of the most notable successes was the introduction of the Enterprise Law which has brought about the freedom to do business. After the Law came into effect in 2000, the number of private companies increased by a fourfold to more than 170,000 formally registered enterprises. Within only 5 years, 136.500 enterprises are newly registered with total capital of US$ 14.3 billion (as of May 2005).

Statistics show that the private sector in Vietnam is contributing about 42% to overall GDP (as compared with 39% by state-owned enterprises). Private enterprises provide 56.3% of the country's regular job supply, and absorb the major share of the 1.2 million people entering the labour market each year.[1]

Another success is the growing number of foreign direct investments (FDI) that were attracted into Vietnam. Private foreign investment has recently been flowing into the country at an accelerating rate (possibly reaching USD 5 billion in 2005), largely thanks to the improved business environment of the country.

Nevertheless, significant obstacles to private investments (domestic as well as foreign) persist: private enterprises, especially SME and foreign companies, operate under more difficult conditions than state-owned enterprises. Administrative regulations especially at the provincial level are cumbersome, ineffective and fail to implement reforms purposefully. Enforcement of the legislation is still weak and ineffective. The cost of doing business remains high and the competitiveness of local enterprises is low. Further challenges are posed by the fact that Vietnam is determined to join WTO by end of 2005 or early 2006 and is serious in implementing international and regional trade agreements.

[1] Source: Central Institute of Economic Management and Ministry of Planning and Investment (www.business.gov.vn).

Requirements for further reform of the business investment climate are derived from the following issues and concerns:

(1) In spite of recent impressive growth of the Business Sector, the quality of growth is still a matter of concern.

Despite encouraging progress in terms of enterprise development in the last few years, the incidence of enterprise remains low at 1 enterprise/1,000 population (2004). Most of these businesses are small in size (in terms of labour and capital). An entrepreneurial culture has yet to take root in the country. The social environment is still far from enabling for private enterprise development, resulting in the biased and unfair treatment towards private enterprises

A recent survey by IFC/MPDF found that of all enterprises formally registered, only 73.7% were definitely or probably operational, 13.7% were definitely or most probably closed or non-operational, and 15.7% remain of unclear operational status.[2] This emphasized the alarming difference between the number of enterprises registered (approximately 170,000) in the formal registry and the number of private enterprises which are included in the database of the tax authorities (around 110,000) and are really paying tax.

Most of the enterprises established as a result of the business reforms in the last five years are concentrated in growth poles like Ho Chi Minh City, Hanoi, Da Nang, Hai Phong and in more urban provinces. As a consequence, there is an increasing disparity in terms of enterprise development and thus investment between provinces.

Different local government agencies have repeatedly raised these issues, seeing them as a serious matter of concern about the quality and the real picture of the impressive figures about the business sector growth in the last few years.

(2) The Legal Framework for Business is inconsistent and fragmented.

The playing field for domestic private, state-owned and foreign-invested enterprises is still far from level with enterprises of different economic sectors being subject to different laws and regulations. State-owned Enterprises are subjected to State-owned Enterprise Law, while private domestic enterprises to the Enterprise Law and foreign invested enterprises to the Foreign Investment Law (not to mention that cooperative and household enterprises are governed by other laws and regulations).

This results in differences in the conditions and procedures for enterprises of different ownership to enter into and exit from the market, and to access to necessary production inputs (e.g. land, credit, labour, technology), etc. Overall, the often-seen discrimination and biased treatment by the local authorities towards enterprises of different ownership is to a large extent due to the existence of this inconsistent and fragmented legal framework on business.

(3) Competitiveness of the country is low while competition from outside is fierce.

According to the Doing Business Report by the World Bank, starting a business in Vietnam remains a challenge as compared with many regional countries. In all four measures: procedures required for establishing a business, the associated time and cost, and the minimum capital

[2] IFC/MPDF, "*Beyond the Headline Numbers: Business Registration and Start-up in Vietnam*", 2005

requirement, Vietnam is not doing better than other countries in the same region. Entrepreneurs can expect to go through 11 steps to launch a business over 56 days on average, at a cost equal to 28.6% of gross national income (GNI) per capita.

Worse, a study recently conducted by the Central Institute of Economic Management (CIEM) – a Government think tank – found that on average it takes around 260 days to go through 13 administrative procedures, taking enterprises years to get through and into production.[3] The total cost associated with this is high and extra costs substantially outweigh statutory fees.

In terms of national competitiveness, in the 2004-2005 Global Competitiveness Report by the World Economic Forum, the Growth Competitiveness Index ranked of Vietnam only at 77 among 104 countries, down from 60 out of 101 countries in 2003. Also according to this report, Vietnam was ranked only 73 out of 103 countries in Business Competitiveness Index. The ranking sent off an alarm among the Government and policies makers in Vietnam, prompting many leading economists to warn that the country should not be complacent with the economic success which the country has achieved in the recent past.

The impacts of the reforms in the mid and late 1990s have been very obvious in terms of economic growth and poverty reduction. The boom of private business and foreign investment in the last decade was largely attributable to these reforms. However, the business environment reforms introduced in the late 90s are gradually losing their impact, triggering the need for Vietnam to embark on bolder reforms to become more attractive and competitive.

(4) Imminent accession to WTO require Vietnam to be more competitive to cope with new challenges.

The Vietnamese Government aims at becoming a member of the WTO by the end of 2005 or early 2006. While WTO membership promises a better chance for the Vietnamese economy to develop, it poses a lot of challenges as well.

Adherence to WTO and implementation of different bilateral trade agreements have been an excellent push for bolder reforms. Important legal reforms have been initiated to improve the investment climate and to encourage investment into the country (by both domestic and foreign investors). Most important among these legal reforms are the Unified Enterprise Law (UEL) and the Common Investment Law (CIL), both currently under preparation (see below).

(5) The quality of Business Law making is still poor due to a lack of systematic procedures

Vietnam has already made significant efforts to improve the quality of its regulatory environment, with a working legal and regulatory framework, increasingly sophisticated administrative and institutional arrangements and more efficient, transparent and accountable regulatory practices (based on the "Law Making Law"). Many of its initiatives parallel good international practices.

[3] The study, conducted with the support of GTZ, looks at the whole process, from the moment an entrepreneur works on the business idea until the business is fully operational (including post-registration procedures and steps). The survey conducted by the World Bank's for its Doing Business study only looks at the process until the business is successfully registered. See CIEM/GTZ, "*From Business Idea to Reality. Still a Long and Costly Journey*", 2005.

Evidence of results is given by academics, domestic and foreign businesses as well as the donor community.

However, serious gaps and problems still exist, as expected in a multi-year reform program of the scale needed in Vietnam. Implementation of current policy directions has not yet produced the concrete benefits expected, and the reforms are still mostly on paper, that is, they have not yet been transformed into upgraded skills and cultural changes in the functioning of ministries and drafting committees. Vietnam's regulatory quality is still below that of competing countries. The regulatory environment for doing business is not significantly improved, and is still a major constraint on growth. Significant efforts are required if Vietnam is to create an investment-friendly regulatory environment that is WTO compatible.

The challenges ahead lie in improving policy coherence, quality, and coordination across a multi-layered governance system. In the next few years, new efforts and investments will be required to permit the country to continue its outstanding economic success. They could pay off substantially if reform efforts proceed steadily, if more attention is paid to implementation, enforcement and accountability for results, and if politicians are able to sustain support in the face of continued opposition from conservative bureaucracies at all levels.[4]

(6) Implementation of Business Laws and Regulations is not Consistent

Against this background, implementation of laws is an even more problematic issue. In many cases laws are only loosely stipulated or are written in a generic manner. Regulations to instruct the implementation of laws are slow to be issued. Inconsistence between laws and regulations are common. As a result, the implementing agencies often misinterpret the laws and regulation either unknowingly or purposely. Many stipulations do not fit with the actual conditions in reality due to the lack of public consultation when they are designed, and are therefore not applicable in some provinces.

The fact that different laws govern enterprises of different ownership structure results in inconsistent definitions and concepts on the same terms (e.g. the board of directors, share capital, etc.). Implementation of business-related laws is therefore even more difficult.

Many new laws contain in itself a new way of thinking which require a real shift in the mindset of the people who implement them to ensure that the intended objectives are achieved. This much-needed change in thinking of many regulatory authorities is often slow and limited in scope. Particularly at provincial levels, many provinces are slow to catch up with the reforms being introduced.

New business laws and regulations aim at introducing changes to make the business environment more enabling for the enterprises and hence trying to deprive administrative authorities of their "*vested interests*". Resistance to change can be seen in the implementation of laws and regulation, particularly the ones which make the authorities less powerful and more responsible towards the enterprises. For example, recent efforts to remove business licenses to strengthen the freedom to

[4] For a more detailed analysis see GTZ/PMRC/UNDP: "*Improving the Quality of Business Laws – A Quick Scan of Vietnam's Capacities & Introduction of Best Practices*", 2005.

do business of the people have been obstructed or even thwarted by some ministries and local governments.

The constraint in resources for implementation is also a matter of concern. The Government often lacks the resources (financial and human) to implement, evaluate and monitor the implementation of the promulgated laws and regulations. Often there is no budget allocated for the implementation of the law. Many laws and regulations are passed but not fully communicated to implementing agencies at the provincial and district level.

(7) Improving the Business Environment is Important for Vietnam to Achieve its Development Goals

Lifting Vietnam out of poverty and doubling its per capita GDP in order to reach the level of middle income developing countries before 2010 is really a tall order, however, not at all a mission impossible.

To do this, Vietnam has to at least maintain its currently high growth rate and create enough jobs for more than 1.2 million people entering the labour market each year. While there is a dwindling capacity of the State sector in job creation and in increasing productivity, much of the growth is expected to be derived from the private enterprises (domestic and foreign).

(8) There is a strong political back-up and a national consensus for economic and business environment reforms

Vietnam has a strong ambition and seriousness to achieve the Millennium Development Goals (MDGs). There is a strong political will from the top leaders of the country in support of economic growth, social development and improvement of the living conditions of the people. There is broad and firm consensus among the country leaders that systematic reforms are needed to sustain the currently high growth rate – an important contributor to the achievement of the Vietnam Development Goals (VDGs) and MDGs. [5]

Unified enterprise law and common investment law are two most important ongoing reforms to address these issues

Important reforms are being initiated and introduced to address these issues[6]. Most important of all are the introduction of the Unified Enterprise Law (UEL) and the Common Investment Law (CIL). The two laws have been drafted and widely discussed in the last one year and are expected to be passed by the National Assembly by the end of 2005. Major proposed reforms introduced by the two laws are the following:

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[5] Based on the Millennium Development Goals, the Vietnam Government has developed Vietnam Development Goals (VDGs). The VDGs address a wide range of issues from economic growth to social development and have been integrated in different strategies and policies of the Government and its agencies.

[6] To meet the conditions to join WTO and to make its business environment more competitive, Vietnam has to draft and pass 25 laws within the time frame of 2 years. The Chairman of the National Assembly said that the Assembly would work day and night to meet this target.

- A business registration system will be created and applicable to all investors[7], be they domestic or foreign, resulting in a more level playing field for investors;
- Foreign investors will have same right like local investors in terms of choosing the legal form of their business (sole proprietorship, liability limited, shareholding and partnership)[8].
- The business environment will be more transparent to investors (domestic and foreign) with the introduction of a negative list (list of business lines where investors are not allowed to do business). A restricted list (areas where investors are allowed to do business under certain conditions) will replace the existing positive list system (which states those sectors where investment is permitted). This will be an important step by the Government in opening its market to foreign investors.
- All major issues related to national treatment, most- favoured-nation status will be addressed. For example the removal of the cap on foreign ownership in most of the business sectors except for some selective ones, full participation of the foreign investors in retail, banking, telecom industries, etc. As a result, the country is better prepared for its WTO membership.
- There is a timeframe for State Owned Enterprises (SOE) to be converted and to be subjected to the new law, especially on the issue of corporate governance. As a result, they will be subject to the same rules applicable to private and foreign investors;
- Corporate governance inside the enterprises will be strengthened and brought up to be closer to international standards.

In parallel with other reforms in the field of customs, tax, property right, etc., the reforms introduced by the two laws are expected to boost investors' confidence and create a new wave of investment in/into Vietnam.

The Enterprise Law of the year 2000 has been so far the most important reform of the business environment which has brought about a significant boost in investment. It constitutes also one of the most consistently designed laws, which has been developed in consultation with different stakeholders.

The challenge now is to move ahead in the reform process, to unify the investment climate for companies of different ownership, in line with WTO requirements – and to come up with even better new laws. This is even more challenging as it relates to the future role of FDI in the country. It requires a consistent struggle with those who fear their vested interests potentially violated.

The two laws, if properly debated and passed, will be another important breakthrough in the investment climate in Vietnam. Many economists believe that if the reforms introduced through

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7 For the time being, business registration is only applicable to domestic private enterprises. Foreign investors need to go through complicated and costly "licensing procedures" in order to set up shop in Vietnam. In addition, they need to submit an investment project which needs to be approved by the Government in order to establish a company in the country. Worse, if they wanted to have a second investment project, they have to go through the whole licensing process again.

8 Foreign investments now can only established in the form of liability limited company or a joint venture or a type of business contract like BCC, BT or BOT.

the two laws are adopted by the National Assembly and well implemented by the Government, they will create a new "wave of investment" into Vietnam in the next decade, enabling Vietnam to sustain its currently high economic growth rate and to make its economy more competitive as compared with other economies in the region.

2 GTZ's approach in support of the Unified Enterprise Law (UEL) and the Common Investment Law (CIL)

Overall Approach

Supporting to the Unified Enterprise Law and the Common Investment Law is currently at the centre of the intervention by GTZ in its efforts to improve the business environment in Vietnam.

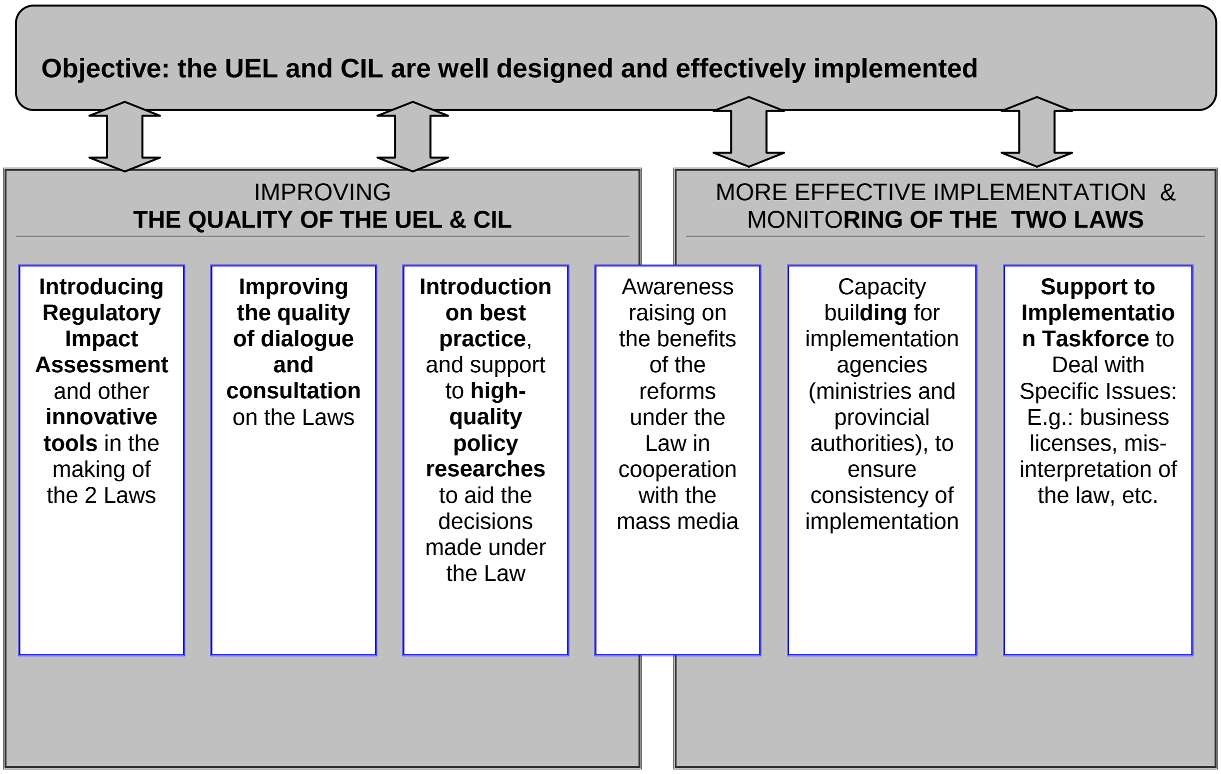
Inputs of different sorts are provided to key national institutions like the Central Institute of Economic Management (CIEM), the Prime Minister Research Commission (PMRC), and the Vietnam Chamber of Commerce and Industry (VCCI). Representatives of these institutions are the core members of the drafting committees of the two laws. Direct cooperation with these institutions gives a higher chance for the supports to be fed into or used in the making and implementation of the laws.

GTZ support the Unified Enterprise Law and the Common Investment Law in the following approach:

- **Improving the quality of the Laws**: This is aimed at through the application of new law making approaches, particularly the *regulatory impact assessment (RIA),* strengthening the participation of the public in the making of the laws, exposing drafting members to international experiences and practices, etc. Consultation of the laws with different stakeholders should equally contribute to increase quality and consistency.
- **Support to Effective Implementation of the Laws**: As law enforcement has always been problematic in Vietnam. The existing cooperation with the Enterprise Law Implementation Taskforce will be strengthened. Focus will laid on monitoring and support to implementation at provincial levels. This will be the focus of the supports after the laws are passed.
- **Development of Tools and Guidelines**: Cooperation is not limited to providing direct inputs and improving the quality of laws. A major objective is to further develop, test, customize and document these tools in order for them to be further replicated and eventually institutionalized in Vietnam.

The selection of this approach is based on the expertise and technical capacity of GTZ in the field, the short and long term objective of the intervention by the organization (the desired impacts to be generated), the requests of national stakeholders and on the analysis of other supports and interventions by other donor projects active in the same field.

Figure 1: Objectives of the GTZ-Program Vietnam



Emphasis of the support by GTZ is on the **drafting of the Unified Enterprise Law**. Due to strong linkage and integration of the two laws (one law could not be implemented without the other and vice versa), many issues addressed by GTZ are cross-cutting and related to both the Unified Enterrpise Law and the Common Investment Law .

GTZ has also committed itself to **supporting the implementation of recently introduced business environment reforms**, e.g. the Unified Enterprise Law and the Common Investment Law. In the last few years, it has built up a strong cooperation with the Enterprise Law Taskforce and other domestic stakeholders. This is doubtlessly a good foundation for its on-going and future interventions in this area. Some of the preparatory works are being implemented in order to fully deliver commitments when these two reform projects are passed by the National Assembly.

However, within the framework of this paper, the following parts will mainly address the **issue of improving the quality of the two laws**, especially in the context that the two laws are being drafted and debated.

2. 1 Regulatory Impact Assessment (RIA) and the Improvement of the Quality of the Laws

RIA was introduced as an innovative tool in the preparation of the Unified Enterprise Law and the Common Investment Law. Understanding the future impacts of regulatory decisions on the private and social sectors is perhaps the most crucial dimension for creating and sustaining a high quality regulatory environment.

In most OECD countries, the tool employed to examine the costs and benefits of decisions is regulatory impact analysis (RIA). RIA is a method of systematically and consistently examining selected potential impacts arising from government action or non-action, and of communicating the information to decision-makers and the public. In essence, RIA attempts to widen and clarify the relevant factors for decision-making. It implicitly broadens the mission of regulators from highly focused problem-solving to balanced decisions that trade off problems against wider economic and distributional goals. RIA has several internal and external objectives:

- Improve understanding of real-world impacts of government action, including both benefits and costs of action
- Integrate multiple policy objectives
- Improve transparency and consultation
- Improve government accountability

To start, an international expert which strong background on regulatory reform and regulatory impact assessment was brought into Vietnam[9]. In addition to presenting to the key national stakeholders the nature and the importance of RIA, he conducted a *Quick Scan on the Capacities of Vietnam in Improving the Quality of Business Laws*. Many recommendations were included in the report and some are being implemented.

Also, the expert cooperated strongly with local stakeholders to work out a plan in order for the first RIA to be implemented in Vietnam. Important advices on the methodology and techniques, documents and tips on the implementation were provided, particularly to a group of local consultants. This helps to initially build up the national capacity on RIA, even though still at a very modest level.

Application of RIA under Unified Enterprise Law and Common Investment Law – An Assessment on Regulatory Impacts of the Unified Enterprise Law and Common Investment Law was conducted and used

The Prime Minister Research Commission (PMRC) has been the key initiator and has requested GTZ and UNDP for support in assessing the likely benefits of the reforms under the new laws. Research has focused on (i) attitudes and expected impacts of the proposed reforms under the Unified Eenterprise Law and Common Investment Law, (ii) assessing the impact of the proposed shift from a system of licensing foreign investment, to registering foreign investments that comply with national regulations, and (iii) suggested guidelines for assessing regulatory impacts. PMRC has played a key role in raising awareness on the potential benefits of undertaking RIA.

The centrepiece of the process has been the study on **attitudes and expected impacts of the proposed reforms under the Unified Enterprise Law (UEL) and Common Investment Law (CIL)**. This is a crosscutting reform of both the UEL and CIL. Specifically, the study tried to answer some of the following questions:

[9] From Jacobs and Associates (www.regulatoryreform.com)

- What are the potential impacts (positive and negative, direct and indirect) of the proposed reform to different groups, e.g. foreign investors, local investors, state-owned enterprises, consumers, regulators, governments?
- Is the reform in the national interest? Are there real benefits of the reforms for the national economy (e.g. an increase in investment inflow, enhanced competitiveness, more compliance with WTO requirements, etc.)?
- How sizeable are the impacts (quantify the impacts to the extent possible)?
- What are the options for the decision-makers in relations to the proposed reform?[10]

The study and the whole RIA process was discussed and shared with key stakeholders, including with members of the National Assembly. In cooperation with other donors, RIA is also promoted and used. Focus is laid on local capacity building in the method and on introducing it to different national bodies, with a view to facilitate its use in future policy-making.

On the basis of the report, a **Regulatory Impact Statement** on the proposed reform is being prepared by PMRC. In a standardized format and more succinct and focused manner, the statement is to provide answers and arguments to the questions raised above. One aim of the RIS is to present the major costs and benefits in an easily understandable form, so that estimates can be subject to public scrutiny and adjusted as necessary. The estimates of costs and benefits in the RIS could certainly benefit from additional scrutiny by key stakeholders, including the National Assembly when it is debating the law in November.

The RIA Methods are being Localized and Developed into a Guideline

As a basis for stronger use of RIA, there needs to be a guideline on the method which includes instructions and tips for implementation. The product of the guideline was aimed at right from the outset of the process.

Implementation of the RIA on Enterprise Law and Common Investment Law gives many inputs to the development of this guideline. Version 1.0 of the Guideline has been produced and made available to all relevant institutions. Further implementation of regulatory impact assessments on other proposed reforms by local stakeholders will provide valuable inputs for further improvement of the Guideline in the coming time.

Additionally, the "*OECD Guiding Principles for Regulatory Quality and Performance*" [11] which highlights the importance of RIA was also translated and distributed to the National Assembly and different Government agencies.

Next Steps

An alliance with local partners to further introduce, replicate and eventually institutionalize RIA has been set up. The alliance includes major reform-oriented institutions in Vietnam like PMRC, Central Institute of Economic Management (CIEM), VCCI and the Ministry of Justice (MOJ). Particularly, the participation and strong interest of MOJ promises a very high chance that RIA

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[10] For the results of the study, please visit www.sme-gtz.org.vn or www.sme.com.vn

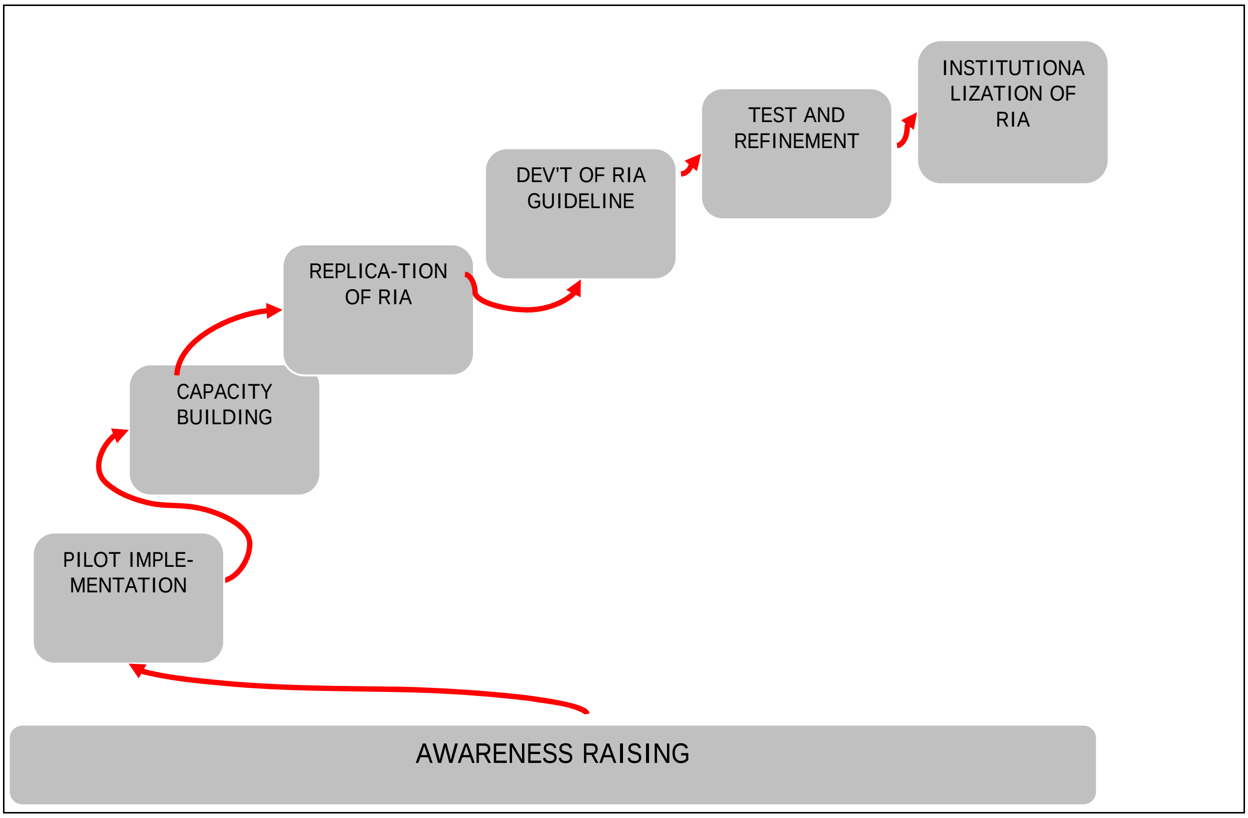
[11] http://www.oecd.org/dataoecd/24/6/34976533.pdf

will be institutionalized in the regulation making process. The alliance has worked out a roadmap in order for RIA to be formalized (please see the diagram).

It is also agreed by the alliance that the next steps should focus on:

- Effective use of the study of the RIA and the regulatory impact statement on the proposed reform of the Unified Enterprise Law and Common Investment Law and, particularly for the discussions on the two laws by the public and by the National Assembly deputies.
- Implementation of two to three additional RIA on selected reforms.
- Further improvement of the RIA guideline with inputs and lessons generated out of the implementation of additional RIA exercises.
- Work out a strategy for institutionalizing RIA techniques in law and decision making in Vietnam.

Figure 2: Implementation of the Regulatory Impact Assessment (RIA)



There are further needs for improving law making. As a result, coordination with other national stakeholders and donors, particularly those who deal more directly with the issue of law making in the country, will be important to ensure the eventual impact of this initiative by GTZ and its partners.

2. 2 Policy dialogues and consultation on the laws are strengthened

Consultation on the laws is strengthened

Policy dialogues and public consultation are essential for improving the behaviour of the Government and its policies towards the business community. They help the Government to be more responsive to the problems faced by the enterprises. In this respect, Vietnam has recently made important strides, increasingly recognizing that public consultation gives citizens and business the opportunity to provide active inputs in regulatory decisions and thus contributes to the quality of laws and regulations.

Nevertheless, the quality of policy dialogue and public consultation still falls short of expectation. Policy dialogues and public consultation on business issues are implemented in different manners at different depth by Government agencies and business associations. The results are not consistent. There has not been a standardized mechanism or a set of procedures on policy dialogue and public consultation.

In policy dialogue, the major partners are Government agencies, business associations, the enterprises and other semi-public organizations. Supports by GTZ are mostly in two forms, including direct inputs to the organization of specific policy dialogues on selected issues and developing a manual on policy dialogue or public consultation which will be shared more widely with related institutions. Additionally, best international practices on policy dialogue and public consultation are also be collected, compiled and shared with relevant stakeholders.

Consultations were used widely in the implementation of the RIA

The major benefits of RIA derive from the systematic processes of stakeholder consultations and analysis of all regulatory impacts. Therefore, RIA helps increase the transparency of policy making processes.

For this reason, the major reform of the Enterprise Law and Common Investment Law which is also the main subject of the first RIA has been widely discussed through different consultation workshops using a technique called **business impact test panels (BIT)**. The business impact test panels were conducted in all major cities in Vietnam, involving nearly two hundred of participants and the press. Results of the consultation workshops were not only used for the purpose of the RIA report but also for the making of the laws by members of the drafting committee.

With the strong use of consultation workshop, the RIA process has become much more meaningful. Thus the whole RIA process is a product, not just simply the end deliverables (the manual and the RIA report). In reality, the whole process, particularly the use of the consultation technique, helps to increase the transparency in the making of the two laws.

2. 4 High quality policy and business issue researchers as inputs to the making of the laws

High quality policy researches are important for decision making. Decisions made by policy makers would be more founded and of higher quality if they are supported by good studies, advices and practices from the reality.

GTZ is trying to address this issue by supporting studies on policy and business issues highlighted by the public to be important to be addressed in order to create a favourable business environment in Vietnam.

The study "*High Time for another Breakthrough: Review of the Enterprise Law and Recommendation for Change*" has been a major input in this context. The study reviews the entire Enterprise Law (of 2000) from a legal perspective and makes important recommendations for to be considered in the drafting of the Unified Enterprise Law. Many recommendations have been included in the latest draft of the Unified Enterprise Law. The study was also shared widely with different national stakeholders.

The study "*From Business Idea to Reality: Still a Long and Costly Journey*" assesses the entire process for setting up a company, i.e. the steps required for registration, obtaining a stamp, a tax code etc. This report prepared by CIEM with support from GTZ is being used as a reference for the drafting committee of the Unified Enterprise Law. Some of the recommendations, e.g. on the reduction of business registration procedures, the use of the same code for tax, customs, etc. are being seriously pursued by the drafting committee of the UEL in the drafting of the UEL and its subordinate regulations. In the long term, the report will be a foundation for building a comprehensive reform program for the enhancement of the business environment in Vietnam.

On the basis of these achievements, another study on "*Business Licensing – the Real Story Behind and a Strategy to Business Licensing*" is on-going with PMRC. Together with the *Review on 6 Year of Implementing the Enterprise Law* to be implemented by CIEM and GTZ, the study will also provide important inputs for an emerging field of intervention by GTZ: business licensing in Vietnam.

2. 5 Awareness raising in support of reforms introduced by the laws

Awareness for reform has emerged as a cross-cutting theme for supporting the business environment reforms. Often it is said that "winning the support of the public for the reform is the battle half won". The public is always the best judge on the quality and the orientation of any proposed reforms or laws. In reality, the press has been proactively involved in the press in supporting proposed reform projects or laws.

For example, in its efforts to support the design of the Unified Enterprise Law, no less than 70 articles have been published on the different proposed reforms of the law with direct or indirect support from GTZ.

The initiative is strongly supported by national partners. However, it is important to provide good and high-quality inputs to the press.

3 Some initial results and impacts

Advanced and Innovative Tools Are Introduced and Accepted by Key Change Agents

In close cooperation with key change agents in the country like CIEM, PMRC, MPI, Regulatory Impact Assessment (RIA) has been introduced in to Vietnam. With the help of the local press, RIA is now being widely discussed among Government agencies and regulatory bodies.

The first RIA report was conducted on one of the most important proposed changes under the Unified Enterprise Law. The result and the process were shared with Government bodies and particularly with the National Assembly.

The whole RIA process with a lot of consultation efforts imbedded in it has helped to improve the transparency and the participation of the public in the making of the Unified Enterprise Law and Common Investment Law.

The Government is considering integrating RIA into its draft Decree on Business Licensing, requiring that a RIA must be conducted before any agency can work out a requirement on business license.

Stronger use of innovative methods by the Government in the designing of its Laws and Reform Initiatives

Additionally, advanced regulation making methods which are new to Vietnam like consultation methods (e.g. the notice and comment mechanism) are being introduced and increasingly adopted by the Government.

The Government has used many types of consultation workshops in the preparation of Unified Enterprise Law and Common Investment Law. Results from the workshops have been communicated to members of the law drafting committees and shared with the public through the press.

Guiding principles of the UEL and CIL as well as their first draft were widely consulted with the business and different stakeholders (both domestic and foreign). As a result, the laws could better reflect the interests and concerns of business and investors in the country.

The improved process of designing new key reforms in business environment promises a higher quality and feasibility of these reforms.

Awareness about the improvement of the reforms in business environment is considerably raised

With support from GTZ, there is a stronger participation of the press and the public in the making of the two laws. This helps to create a good practice in Vietnam: having the laws widely consulted with those who are affected by them before the laws are passed.

In addition, the *Awareness for Reform* is being shaped up as an approach and well regarded by local partners. Local partners like CIEM, PMRC and VCCI have recently used the press in a more skilful manner to win the public supports on sensitive reform proposals. It has been agreed with local partner that more resources will be spent to push for additional reforms and the implementation of this reform. A strong alliance with the press has been established.

Outputs produced with support from GTZ are well fed into many reforms and reform projects

No less than 25 recommendations and best practices introduced in the Report Reviewing the successful Enterprise Law in 1999 ("*High Time for Another Breakthrough")* were reflected in the draft Unified Enterprise Law.

Comments made by the business community were reflected first in the guiding principles of the Unified Enterprise Law and Common Investment Law and in the draft of the Unified Enterprise Law (e.g. many of the documentations of different consultation workshops, including a 40 page written comments by EuroCham).

RIA is being considered to be included as a must in the Decree on Business Licensing under the Unified Enterprise Law. On the basis of the first RIA study, PMRC is currently working on a regulatory impact assessment on the proposed reform under the Unified Enterprise Law and Common Investment Law which will be formally submitted to the Prime Minister and shared with other Government agencies.

Recommendations on reducing the procedures in order for an enterprise to successfully operationalise a business activity are being seriously considered and could be reflected in the upcoming Decree on Business Registration under the Unified Enterprise Law.

4 Challenges

A key challenge is to develop approaches to RIA that are workable in Viet Nam

It is important to recognize that most OECD countries have adopted relatively simple (but credible) methodologies to assess regulatory impacts. Hopefully, background materials being prepared will be a good start for local stakeholders to developing credible and workable approaches that can be readily understood by policy makers and informed readers.

A workable approach is critically important to maintain the interest of national stakeholders in using it, avoiding the risk that RIA is just a new burden for them which brings about little impacts on the regulations and decisions being made.

There is limited local capacity on regulatory impact assessment and innovative tools to improve the quality of business laws

Regulatory impact assessment, advanced consultation techniques, reduction of compliance costs, etc. are all new to many policy makers and regulators in Vietnam, particularly at the provincial level. Undoubtedly, there is very limited capacity among the government agencies, consultants, business associations and even donors in some cases. This is one of the major hurdles in expanding the use of these advanced methods.

The prolonged implementation of the RIA in Vietnam was also largely due to this problem.

Limited Absorption Capacity from the Government Side

Improving the business environment and investment climate is attracting increasing supports from the donor community which are all trying to work with the same "national champions" in this field. Leading national institutions are exposed to a wide range of different methods, experiences, good practices. There have been reported cases that the Government agency is confused with different advises and presentations of methodologies.

Due to limited resources (in terms of human resources, financial availability) from the Government side, follow-up activities of the initiatives with some initial success like RIA are slow and ineffective, thus menacing the sustainability and the eventual impact of the initiative.

This again raises the issue of the cooperation and coordination between donor projects in working with national stakeholders on the same issues.

Many of the issues, if to be addressed properly, go beyond the existing work scope of a PSD project

To institutionalize new and transparent law making methods like RIA and public consultation, it needs actions which are partly outside the scope of work of the existing GTZ PSD Program. For example, improvement of the law making process (which will also benefit the laws and regulation on business environment) seems to be too broad an issue which goes beyond the mandate of a PSD program. Coordination is required to cope with this challenge and to make sure that complementary activities are initiated and implemented in this field to support the changes needed.

5 Lessons learned

Some of the experiences below are drawn out in the implementation the intervention by GTZ in its efforts to improve the reforms of business environment in Vietnam. Despite the fact that some of them might not be applicable in other countries, GTZ see them as critically important to ensure the success of their intervention in Vietnam.

Strengthening the national ownership

National ownership is essential to make reform happen in Vietnam. A ready-made-solution proposed by a donor would rarely work. While strongly respecting advice provided from outside, the Government has always insisted on its own solution to the problem. The conversion of MDGs into VDGs is an example of the aspiration of the Government in strengthening its ownership.

Therefore it is important to build on the national ownership to propose and introduce a necessary reform. This will ensure a more sustained interest from the Partner side and guarantee a better chance of success.

Being well-informed about the reform agenda of the government and the precisely screening the requests for supports

Often, the Government also has a reform agenda and road-map. Being well-informed of the reform agenda of the Government will make a lot of sense in providing the right supports to the Government and improving the quality of such reforms.

Less active Government agencies have less chance of receiving supports from donors. However, many of less active agencies are charged with designing and implementation of important reforms. Being proactive in approaching these agencies and offering the most-needed supports can considerably enhance the use of the limited donor's resources.

Select the right partners for implementation of respective reform initiative

Commitment of the local partner would be stronger and more sustainable if they are made understood that donor projects are providing supports in order for them fulfil better their responsibility and their mission.

It is important to make the partner organization understand that if the cooperation is well designed and implemented, it will help to raise the credibility of the partner organization. Since all partners organization have their own obligations to fulfil, the closer the cooperation activity is to a partner organization mission and objectives, the higher chance of success the activity will have.

Focus on impacts achieved while maintaining flexibility and responsiveness to demands of local partners

In a fast changing environment, it is important to have enough flexibility to react to the demand from the local partners. Capability (both technical and financial) to react to demands from partners from the donor's project will make a lot of difference in terms of the impact and quality of the intervention. A mechanism should be established in a donor project to ensure that support is provided when it is needed the most by local partners.

However, the demands to be addressed should be selected on the basis of the implication of such demand and the limited resources. In any case, the demand from partners should be appraised in relation to the outputs which would be produced and the use of such output, and to the extent possible, the potential impacts of the intervention if such demand is addressed.

Use the press to win public support

The Press must be considered as a strong ally in any reform process. Business issues should be shared with the wider public to win their support. The general public will be the best judge on the design and implementation of a reform initiative.

Look to the long-term cooperation, not just the short-term

The fruits from the business environment reform might take years to be harvested. Persistence and patience are therefore important for a donor project. Additionally, in order for a reform to be introduced, it might take longer time than a conventional intervention. It is therefore necessary that a business environment reform project be designed for a sufficient long-time frame.

Trust building is critically important

In a context where the national ownership is seen to be high, trust building is critically important. Particularly in the area of policy advices – an area long seen to be sensitive in Vietnam, the trust between the Government agency partners and donor projects play a very important role to make the cooperation fruitful. As trust cannot be built overnight, long term cooperation, sincerity and neutrality are the key ingredients to build the trust between local partner agencies and a donor project.

Cooperation makes power

Strong cooperation between key national change agents is important. They should have the same vision on a proposed reform. Well-concerted efforts by donors can help to build of such a shared vision.

Cooperation and coordination between donor projects are also important. While the Government want to hear advises from different perspective on the same subject, cooperation and coordination in providing supports to the design and implementation of Government initiatives in business environment reform are critically important to the digestion of the advices from the Government side.

Cooperation is also the best way to use the limited resources effectively. Many of the activities implemented by GTZ could not have been possible without strong cooperation with other donor projects.

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Barometer "Program de Mise á Niveau" in Tunisia - Measuring the effect of the National Economy Promotion Program

Detlev Jahn

Since 1998, the German Agency for Technical Cooperation (GTZ), committed by the Federal Ministry for Economic Cooperation and Development (BMZ) has been implementing a cooperation project with the Tunisian Ministry for Economy and Energy. This cooperation is embedded in the framework of the national economy promotion program "Mise à Niveau". GTZ together with the ifo-Economic Research Institute Munich developed a qualitative measurement instrument on the same lines as economic climate measurement instrument.

1 The Initial Situation – Reflections of the National Economy

Most national economies in developing countries or threshold countries conduct programs for economic promotion at national and/or regional level in order to strengthen the public and private enterprises and increase their competitiveness. These programs may be structured differently; but they all follow the principle that the state, through its respective institutions, makes financial charges (such as taxation etc.) that is given back following certain rules to enterprises either directly or indirectly. Economic Promotion Programs can be considered as such rules. As the collector and distributor of public means and as the architect of promotional programs, the state is politically committed to prove the efficiency of its actions. The state has the duty to outline the effectiveness of its initiated programs to the taxpayer, to those influencing the political decisions in the country and to the donor community if international financing is integrated.

Nowadays, all national economies operate in a global environment that has been structured by them and, in turn, these structures affect their own national economies. It is therefore necessary that the efficiency of economic promotions programs be continually measured in order to adjust the various elements according to the changing conditions at national and international levels. Such efficiency measurements can be done with extensive assessments which are very time consuming and expensive. At the decision-making level, it is often enough to have a trend statement at hand that supports their position in order to make political "go ahead" or "don't go" decisions.

The barometer Mise à Niveau was jointly developed between the IFO Institute Munich and the National Tunisian Economic Promotion Program (Program de Mise á Niveau/in the following PMN). It is a measuring procedure that leads to such trend statements. PMN is highly relevant to all countries in the MEDA area[1], which, within the Barcelona processes, have started national programs to bring their economies closer to the European contour line.

[1] Ägypten, Algerien, Israel, Jordanien, Libanon, Malta, Marokko, Palästina, Syrien, Türkei, Tunesien, Zypern

2 Tunisia – a Tiger State in North Africa?

Tunisia is generally identified as a country exclusively dependent on tourism, although the breakdown of the GNP shows that it is, in fact, a service/industrial nation (GNP: agriculture 12%, industry: 29% and services: 60%). There is a longstanding commercial relationship between Tunisia and Europe. The first trade agreement between the 2 parties was signed in 1969 and this was extended by a co-operation agreement in 1976. The Barcelona process, which was initiated in 1995 and enforced in Tunisia in 1998 with the intention of forging a political, cultural, commercial/ financial partnership, constitutes a great challenge to the country. This means that all customs barriers currently protecting national industries have to be removed within 12 years and this process has to be complete by the end of 2007/beginning of 2008. This is an enormous challenge for a country of 10 million inhabitants, which makes about 75% of its foreign trade with EU countries. By virtue of its association with the EU, this Maghreb state, roughly twice the size of Austria plays a leading role in North Africa. Since Tunisia will be the first country in the region to open its trade barriers other countries, such as Algeria and Morocco, that will align themselves for EU association in 2010 and 2012 respectively, will be able to orient themselves on the Tunisian experience.

In order to expose its economy to increased pressure resulting from external competition, the government formulated an extensive economic promotion program-PMN, which was first introduced in 1996 and designed to be extended gradually over the 12 year run-up period. For instance, one graduating measure has been the reduction of customs duties by a regular percentage annually since 1995. The structure of PMN is based on 2 columns. The first column focuses on the improvement of the environment for business, e.g. administration, transport and infrastructure while the second concentrates on industry and related service providers.

The structure of the Tunisian industry is composed of 5,200 enterprises, occupying 10 or more employees. It is nearly impossible to get a reliable statistical base of micro enterprises that occupy less than 10 employees. Experts assume that about 3,300 to 3,500 enterprises are directly affected by the opening of the market. The remaining enterprises operate on markets that are not directly affected by international trade either because they are located in remote geographic regions or their products meets the standard of the neighbouring markets and international trade would be unprofitable.

The program PMN is subsiding investments in assets associated with services, providing improvements of an immaterial nature. Once an enterprise has made a successful application to the Ministry of Economy, the subsidy quota it receives is about 14%. Enterprises have to contribute 86% either through their own means or through outside capital. From the onset of the program in 1996 up until the end of 2004, nearly 3,200 enterprises had applied to participate in the program - 2,000 enterprises receiving a positive response to their application and with approximately 1,200 applications still being processed. Subventions to the 2,000 successful applications amounted to 138 million Euro, which roughly equates to 0.3% of the annual gross domestic product of the country and which subsequently induced investments totalling nearly 1.9 billion Euro. During this period, the average subsidy per application on the basis of 1 million Euro total investment amounted to 138,000 Euro (subsidy quote 14%). The total participation procedure in PMN – from application, approval, implementation and completion, lasts several years as the subvention is done parallel to the investments. By the end of 2004 nearly 250 enterprises had completed their application including the final balancing.

3 The Tool – Barometer

The barometer is based on the regular checking of representative samples of enterprises participating in PMN in order to reach conclusions about whether the participation contributed to increasing their competitiveness and thus measuring the efficiency of the program.

The aim of the barometer is to provide the economic promotion programs political decision-markers (in this case the Tunisian Ministry for Economy, Energy & Small and Medium Enterprises) with an instrument to regularly and economically assess the efficiency of this program by monitoring its trends.

Quota sample spot checks have been increasingly accepted in market research as a representative sampling method as they provide comparatively good results in relation to random sampling. Enterprises participating in PMN are enlisted in a data base structure which keeps key information about them. There have been 4 quota established within which enterprises can be categorized in homogenous groups (branch (7), scale classes (2), off shore regime (2), date when submitting the application (4). A cell structure was created with 112 cells on which enterprises were split up according to their characteristics. Within each cell a random sample was drawn considering the importance of the cell for the main unit. In parallel with this, a control group of enterprises was selected which had not been participating in the program yet but which had a certain relation to it (enterprises that had submitted an application on which no decision had been taken). It has been proven that 100 returns that can be evaluated is the most appropriate sampling size (80 enterprises participating in the program / 20 enterprises as control group) thus a return quota of approximately 30-35% requires a sample check of 300 enterprises.

Economic promotion programs are generally carried out over a longer period of time as their effects do not show up immediately; they rather show up effects after a longer period. Information received from regular enquiries enables the establishment of a statistical series and consequently the recording of effects over the course of time. At first glance, this procedure could be compared with a panel approach in which the same persons are questioned on the same subjects at regular intervals. However, in this case, a tracking approach has been used where each sample has to be newly selected from the total unit and determined from scratch. The reason that samples have always been selected from the main unit in this way is because the numbers and structures of the enterprises which constitute the main unit is constantly changing. Appropriate intervals for enquiries are determined by the particular need. In Tunisia, it was decided that enquiries should be carried out every four months as this allowed sufficient time to assess the effects of the economic promotion program in the medium term. The assessment, as such, is done as a self-administered enquiry (without an interviewer) by delivery of a questionnaire via fax. This economical approach helps to keep the total program costs within its financial constraints.

4 The Questionnaire – Instrument for Measuring the Increase of Competitiveness

The aim of the questionnaire is to measure the effects of an economic promotion program and, in particular, to determine whether it has an effect on competitiveness. To measure competitiveness directly is virtually impossible as it is determined by a multitude of single factors which are specific to the respective enterprise and market. The questionnaire of the barometer comprises ten questions, seven of which are standard questions and three of which are variable and can be tailored to suit a specific category or situation. The structure follows a qualitative approach based on consumer confidence. For this reason, the questionnaire asks not how much money has been invested in certain forms of assets but rather whether or not the decision-maker of the respective enterprise considers that his business is running better now than 2 years ago. The standard 7 questions are past and future related and includes positions of enterprises and markets (current economic situation / future developments in markets and enterprises). Thus the questions have a rather descriptive character as the real analysis is done with the evaluation of the data. The evaluation is processed using standard software (SPSS) so that standardised table headings and short report can be established.

5 Experiences and Results from Three Survey Waves

There are data available from surveys done in May-June 2004, September-October 2004 and February-March 2005. Since a big survey topic related survey carried out during the summer of 2005, the fourth wave will be conducted towards the end of the year.

Initially, the single page questionnaires sent out and returned by fax worked well. However, the quality and reliability of available fax numbers has proven poor. Often enterprises neglect to inform the Ministry of Economy about changes in contact co-ordinates or errors occur during entry to the database of the Ministry. This has meant that, on average, 1.6 addresses are required before 1 fax is successfully transmitted. The return average was about 35% with each return usually requiring 2 supporting telephone calls to encourage a response. In summary, 5 addresses were required to establish 3 successful contacts that resulted in one return which had to be supported by 2 phone calls. Therefore, the data enquiry can be considered relatively complex but this is, in part, due to the fact that Tunisia does not have a long tradition in surveys or in the communication of in-house data. Consideration is being given to the idea of conducting the survey to be carried out at the end of 2005 by phone since a number of professional call centres have recently been established.

In the following statements a few key results of the first barometer survey May-June 2004 will be presented in brief. These key results have been repeated in the 2 other barometer surveys. The duration of participation in PMN has been proven to be the highest discriminate criterion. The presentation of the results is consequently based on this criterion which is given within four specific parameters - participation since survey date 1-18 months / 19-36 months / 37-48 months and 49 months and longer.

Present State of Business

The question on the current economic situation of the enterprise forms the opening question of the questionnaire. It asks for implicit impressions and feelings on the present state of the momentary profit situation of the enterprise, which is the most sensible item.

During the first three years of participation in PMN enterprises show a more euphoric attitude and have a positive opinion about their business situation. Afterwards, a more pessimistic attitude dominates, which can be understood when considering the Tunisian frame conditions (inter alia 11 September / Djerba / years with draught / integration in world trade).

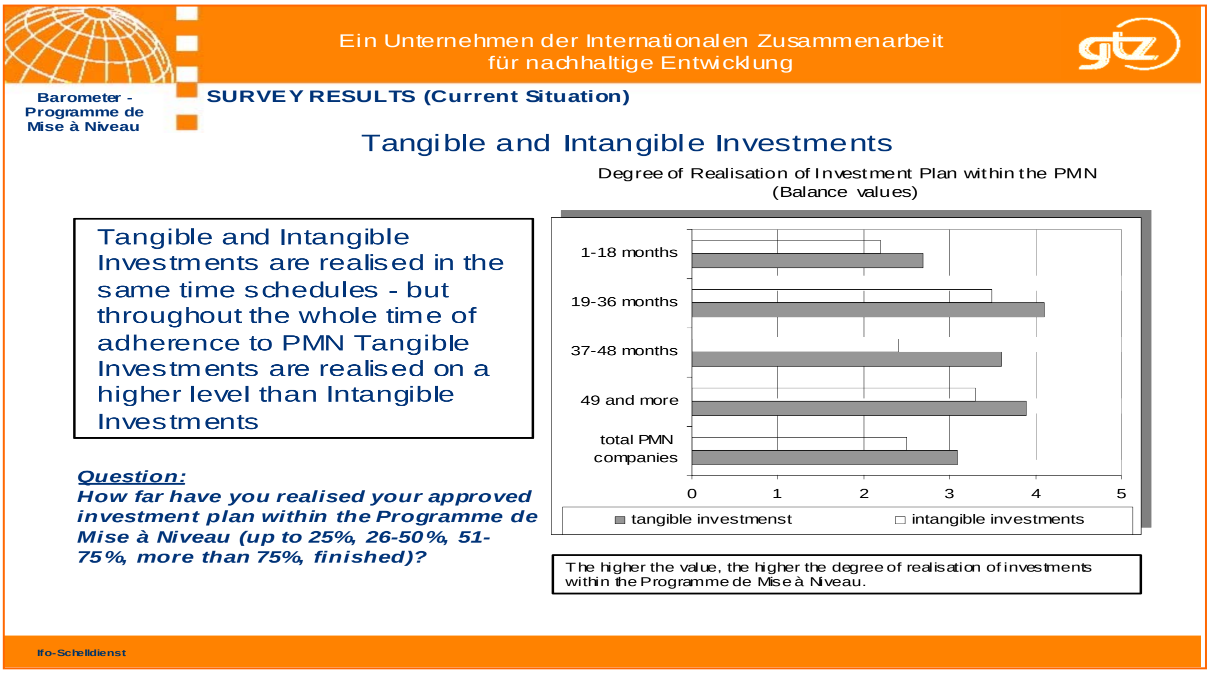
Table 1: Present business situation (Share of companies in %)

Adherence to PMN	Good	Satisfactory	Bad	Total	Balance*
1 – 18 months	17.4	65.2	17.4	100	0
19 – 36 months	17.6	7.6	1.8	100	+5.8
37 – 48 months	21.4	42.9	35.7	100	-14.3
49 and more months	9.7	67.7	22.6	100	-12.9
Total of PMN companies	15.3	63.5	21.2	100	-5.9
Control group	8.3	83.3	8.3	100	0

* Balance is the difference of the share of companies reporting a good and a bad present business situation

Enterprises need a certain warming-up period of up to 18 months in order to implement the planned material and immaterial investments after having received a positive response from the Ministry to the submitted application. During the time interval of 19-36 months, the highest rates of investments are done; some enterprises even manage to finalise their plans. During each time interval, the rates of material investments are higher than that of immaterial investments. Improvement of competitiveness is considered as an optimisation of assets and not of values that improve – e.g. the management – although this is often needed.

Figure 1: Realisation of investment plans



This statement is supported by evaluating the question to priority activities during the next 2 years.

Table 2: Primarily actions during next 2 years for improving company's situations (Share of responses in %)

Planned actions	1-18 months	19-36 months	37-48 months	49 and more months	Total PMN companies	Total control group
Improving quality of existing products	16.7	16.9	13.0	17.1	16.2	18.2
Developing new products	14.3	11.9	16.7	18.9	15.9	11.4
Optimising technical processes	6.0	11.9	9.3	9.9	9.1	9.1
Improving management	4.8	6.8	9.3	4.5	5.8	11.4
Modernising equipment	15.5	13.6	9.3	7.2	11.0	15.9
Improving companies position on exiting markets	9.5	5.1	9.3	7.2	7.8	2.3
Looking for new markets at home	4.8	6.8	3.7	6.3	5.5	6.8
Looking for new markets abroad	19.0	18.6	9.3	15.3	15.9	13.6
Price policy	1.2	0	7.4	3.6	2.9	4.5
Training of staff	8.3	6.8	9.3	8.1	8.1	6.8
Others	0	1.7	3.7	1.8	0	0
Total in % of column	100%	100%	100%	100%	100%	100%
Total of responses	84	59	54	111	308	44
Number of cases: 99 Number of Responses: 352						

On the one hand, enterprises are interested in improving existing set-up, e.g. by improving the quality of existing products (16.2%), improvement of technical processes (9.1%) and improvement of the machine outfit (15.9%). On the other hand, they show a high potential for innovation; 15.9% want to develop new products and a similar percentage of enterprises want to explore new export markets. However, enterprises are convinced that they should be able to reach these goals without having to put in further considerable efforts into such fields as improved management performance (5.8%) and further training (8.1%).

Participation in PMN induces positive employment effects, which are obvious especially during the first 36 months for both groups - workers and office employees. There are positive effects resulting from the rationalization of enterprises that participate in PMN. These positive effects usually continue beyond 36 months for office employees but there is a considerable drop in the positive effects for general workers.

There are also positive effects on exports with participating enterprises showing an increase in their export volume during the previous two years. This effect is very obvious, especially upon enterprises whose participation in PMN does not date back more than 36 months. Consequently, PMN encourages integration in foreign trade but it lasts only for 36 months.

In summation, there are obvious positive effects from PMN on the immediate business situation, particularly during the first 36 months of participation. After this period, they begin to decrease and it is at this point, therefore, that a second push seems to be required.

6 Future Developments of Markets and Enterprises

During the first phases of participation in PMN, (within the 36 months period) enterprises expect a significant growth of their relevant markets. After that period, expectations decrease but continue to be still positive. This is valid for both the national and the international market. This statement is in line with the above mentioned positive effects during the first 36 months of participation of PMN.

When questioned whether their sales in the medium-range (during the next 2 years), will be above, below or in accordance with the market average, enterprises participating within the last 36 months give a significantly more positive response. They assume that their sales will be above the market average but this euphoria drops off significantly after 36 months and then tends to continue more in line with the market trend or even below. This tendency can be observed in the national, as well as in the international, field.

Expected Development of Sales of own Companies' Main Products in the Medium Term (next 2 years)*

	Domestic**				International			
Adherence to PMN	Stronger	About the same	Weaker	Balance***	Stronger	About the same	Weaker	Balance*
1 – 18 months	21.7	13.0	–	+21.7	47.1	41.2	11.8	+35.3
19 – 36 months	33.3	26.7	–	+33.3	46.7	20.2	33.3	+13.4
37 – 48 months	23.1	15.4	30.8	− 7.7	30.0	30.0	40.0	−10.0
49 and more months	13.8	37.9	10.3	+ 3.5	15.4	46.2	38.5	−23.1
Total of PMN companies	21.3	25.0	8.8	+12.5	32.4	36.8	30.9	+ 1.5
Control Group	22.2	77.8	–	+22.2	33.3	55.6	11.1	+22.2

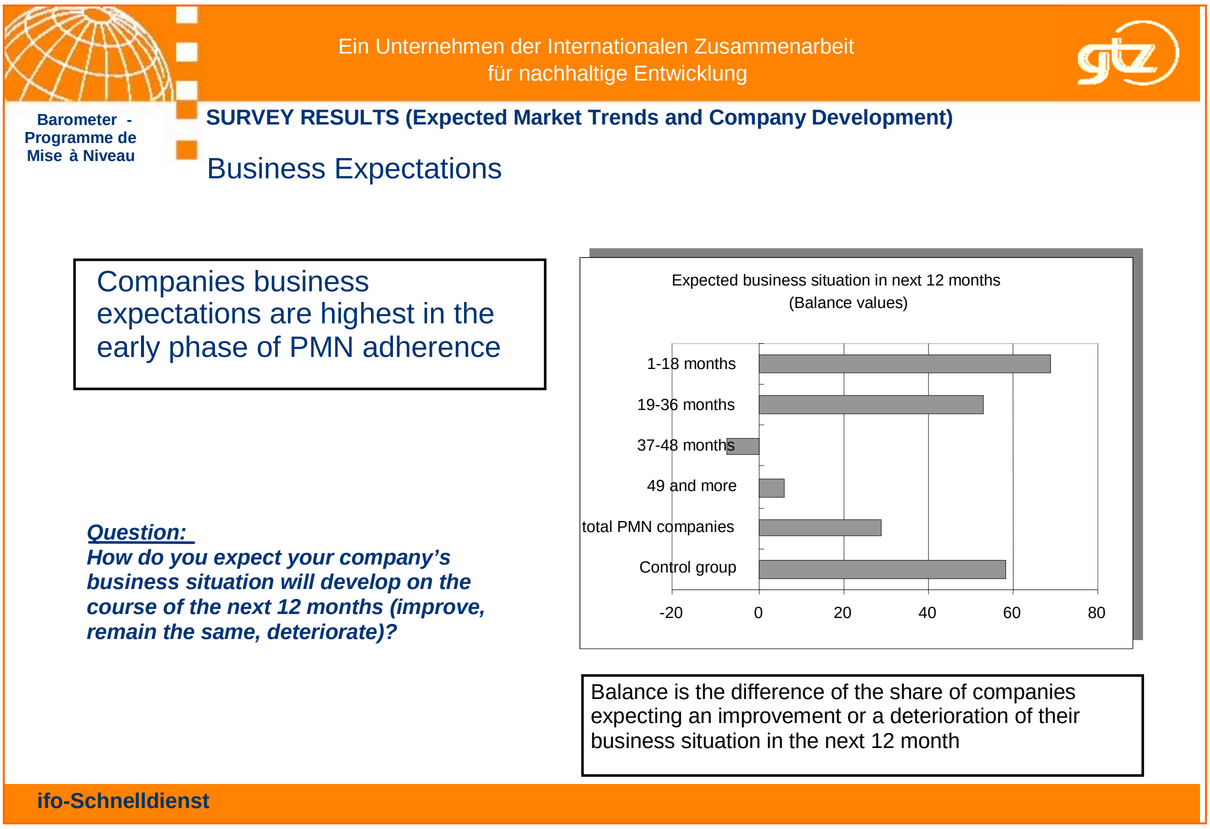
* Compared with the Anticipated General Market Development

** The missing amount up to 100% is due to off-shore companies, which have not been involved in the ranking.

*** Balance is the difference of the share of companies expecting a higher respectively a lower growth of own sales compared to market development.

In response to the question on future business developments during the next 12 months, enterprises which have been participating in PMN from between 1 to 36 months, have a significantly more positive opinion than those who have participated beyond that time frame. This is in accordance with the previously mentioned reduced optimism in future after 36 months.

Figure 2: Expectations on the Future Business Situation



Here, also, the positive effects of PMN can be summarized as lasting for the 36 month initial participation period.

Both fields of analysis show clearly that the PMN induces a positive opinion in enterprises which lasts for 36 months. After that period, enterprises are significantly more aware of the realities of the market and further support measures are needed if they are to maintain the positive effects.

Variable Questions

The Barometer allows for three questions in each assessment to be varied. The results of three barometers (in total 9 questions) to the following thematic fields are presented:

- Enterprises are hardly able to estimate the influence that **reduction customs duties** are likely to have on their competitive situation – it is a learning process.
- The longer enterprises participate in PMN, the more their **relations with their respective banks improve**.
- The **PMN** in general has a positive effect on the improvement of the enterprises own competitive situation.
- More than 40% of participating enterprises delayed **investments** because of financing (role of banks). In nearly 30% of cases, investments are in the range of over 25% of their annual turn over.

- Generally, experiences with **private executive consultants** are positive.
- About 40% of companies have **difficulties finding qualified personnel**.
- The **national institutes for the promotion of international trade** are usually consulted as a first step by new exporters and by established exporters referring to them when searching for new markets. The longer the duration of PMN membership, the more satisfied the enterprise seems to be with the advice and direction given by the institutions.
- **Employees in management positions** are considered partners. Confidence in this group of employees increases with the length of PMN membership.
- **Management by Objectives** is the most applied management system.

7 Benefit

The implementation of a barometer brings the political decision-maker to

- recognise and continually monitor signs of the efficiency of the program;
- register structural strengths and weaknesses of the program;
- support political decision-making processes in the program arrangement with sound arguments;
- optimise the finances of the program;
- regularly support policy decisions with sound argument.

8 Contributions by GTZ and the ifo-Institute

GTZ is accompanying the whole process from development of the barometer and its implementation on a trial basis to the stage of its establishment as an economic-political measurement instrument. These contributions include – besides technical advice relevant to the barometer – sensitisation of the political decision-makers for the need of such an instrument.

The ifo-Insitute Munich acted as professional adviser during the process of establishing and implementing the barometer. Given the institute's extensive experience with measuring data on the economic climate, they could also contribute important inputs.

9 Best Practices

There are extensive empirical data available on the development and implementation of a barometer in the project *Support of Small and Medium Size Enterprises in Opening of Markets* in Tunisia. The work of this instrument dates back nearly one-and-a-half years. Data from three survey waves are available and a fourth one is expected towards the end of 2005. The data can be transferred to other economic areas, taking the country specific conditions into consideration.

The Regional Business Climate Survey for Southern African Development Community Member States (SADC)

Kara Rawden

The essential aspect of the RBCS is that it has put southern Africa as a location to do business onto the agenda, helping economists, businesspeople and investors, who commonly had a blurred and consequently negative picture of southern Africa (except South Africa), to gain a better understanding of how business is done. The RBCS is an eye-opener for strategic and portfolio investors alike. Constraints and supportive aspects of the business environment can now be weighed, and the risks of investments much better assessed. The RBCS do not rate member countries, but intentionally portray the part of the continent as a whole, thus underlining common regional aspects. This character of the survey, being non-discriminatory and not blaming any country, has created a strong feeling of ownership among member countries, both on the part of the private and the public sectors. The success of the RBCS at regional level has led to business climate surveys becoming accepted as helpful instruments to support the national public-private dialogue. It is now important that the regional policy dialogue, based on the results of the RCBS, is translated into topics and indeed an agenda for the policy dialogue.

1 The Project and Intended Development Goals

After an implementation period of altogether 10 years the Advisory Service for Private Business (ASPB) adjusted its focus from a national to a regional one, and from direct firm level support to interventions directed at the policy levels that shape the regional business environment.

The factors determining the business environment in Southern Africa have been changing a great deal during the last decade The SADC Trade Protocol aiming at a Free Trade Area in 2010, the Cotonou Agreement aiming at reciprocity of preferential trade agreements (EPAs) and the impact of globalisation and liberalisation (for instance the abolishment of the Multi Fibre Agreement) amount to revolutions in trade patterns in southern Africa. Governments and the private sector in the SADC region have not fully grasped the significance of this change and the challenges that they pose.

The main intervention areas of ASPB, i.e. strengthening of private sector organisations, promotion of regional trade and supporting the dialogue between government decision makers and the representatives of the private sector, will be highly relevant also for the future development cooperation between Germany and the Southern African Development Community.

ASPB's Objectives, Profile and Approaches

<u>Objectives</u>
ASPB's stated overall objective is:

> "The private sector contributes to regional integration and the improvement of regional competitiveness of SADC"

The project goal is defined as:

> "Private sector organisations contribute to regional trade and investment promotion, in particular for SMEs"

The results to be achieved are stated as:

1. Management, structures, and processes of Private Sector Organisations (PSOs) are improved
2. The capacities of representatives of PSOs to lobby for the sector's interests and to advise governments and SADC organisations is strengthened

3. The capacities of PSOs to promote investments and regional trade is improved
4. Regional and national PSOs offer specialised services to promote exports and cooperation with German business in selected sectors

The objective suggests competitiveness being an important purpose of regional integration, meaning that without regional integration the necessary levels of international competitiveness cannot be achieved. It further suggests that the private sector must be a key driver of integration and competitiveness, thus denouncing protectionist views and challenging the private sector to take up and push the dialogue with its respective government. Already in 1996 the capacity of chambers to become competent policy dialogue partners was a key result of ASPB. Knowing that ASPB's main approach during that phase was the support of individual enterprises, reaching out towards the macro level at that time - before the discussion of systemic competitiveness became prominent - was a visionary approach to private sector development. Since the conception of the project, ASPB has recognized that competitiveness must happen at enterprise, institutional and government levels.

Evolution of ASPB's Profile

ASPB is a multi country and multi partner project. Many private sector development projects in the SADC region follow a multi-country approach, partly because a region and not individual member countries are to be supported, partly because of reasons of operational efficiency.
ASPB's multi-partner approach refers primarily to several chambers of commerce and industry and regional associations, in particular Association of SADC Chambers of Commerce and Industry (ASCCI), being the main partner. The political partner of ASPB is the SADC Secretariat. In its day-to-day activities, ASPB interacts with partners of government and political levels, as well as with the enterprise level.
ASPB went through three main development phases:

1995 – 1998
Zimbabwe, Malawi, Zambia
Services of Chambers
Focus on enterprise support and trade development
Focus on Zimbabwe

1999 – 2002
SADC is Partner
Zimbabwe, Malawi, Zambia plus Namibia
Focus on capacity building of national PSOs
Focus on dialogue at national and SADC level

2003 – 2005
SADC is Partner
Focus on SADC level Dialogue
Focus on Regional PSOs
Lesser concentration on countries, but regional orientation
RBCS

Approaches to Some Result Areas

In the field of **improving management structures and processes of private sector organisations**, ASPB has rendered competent support, training staff, sponsoring seminars financing economists over periods of time, helping chambers to elaborate business plans and identifying sources of income, and exposing chamber staff to best practise. ASPB put more emphasis on developing instruments that chambers can use, rather than investing into developing their organisations.

With regard to **building capacities of private sectors organisation to lobby for the sector's interests and advise governments and SADC organisations** ASPB supported the emergence and the work of ASCCI in 1999.

An achievement of ASCCI is the "White Paper", presented in 2001 and fully adopted by the SADC Secretariat and made an integral part of its Regional Indicative Strategic Development Plan (RISDP) in 2003. The "White Paper" has become the platform for SADC-wide private sector strategies and set out the framework for the public-private dialogue. ASCCI has also contributed to building capacities of member chambers and built awareness among members in economic and commercial terms - especially during its first years until 2002.

Another achievement of ASPB is the initiation, and organisation of the **Regional Business Climate Surveys (RBCS)** under ASCCI's umbrella. The RBCS have met with resounding international interest. The essential aspect of the RBCS is that it put southern Africa as a location to do business onto the agenda, helping economists, businesspeople and investors, who commonly had a blurred and consequently negative picture of southern Africa (except South Africa), to gain a better understanding of how business is done. The RBCS is an eye-opener for strategic and portfolio investors alike. Constraints and supportive aspects of the business environment can now be weighed, and the risks of investments much better assessed. The RBCS does not rate member countries, but intentionally portray the part of the continent as a whole, thus underlining common regional aspects.

All fourteen SADC countries in 2005 participated in the RBCS, through chambers and other routes. The involvement of ASCCI underlines the value of a regional chamber association in promoting joint regional activities. The success of the RBCS at regional level has led to business climate surveys becoming accepted as helpful instruments to support the national public-private dialogue. As national data are made available to each country, national private sector organisations can analyse results and introduce their findings into the national dialogue. This is already happening in Malawi and private sector organisations in other countries are also interested in following suit.

It is now important that the regional policy dialogue, based on the results of the RCBS, is translated into topics and indeed an agenda for the policy dialogue. ASCCI have not yet been able to do this, underlining that such regional organisations require effective secretariats to push matters.

The RCBSs include cross cutting issues, like the response of companies to HIV/AIDS, or SADC specific topics, like the interest of doing business in Madagascar. The latest RBCS showed a high degree of awareness and interest in HIV/AIDS programs among businesspeople in southern Africa.

3 The Regional Business Climate Survey (RBCS)

A business climate survey (BCS) is a measure of the business climate as perceived by business people in a specific market sector and within a specified period. Business climate surveys have proven to be useful tools in many countries, both for the operational needs of the private sector and for public-private sector dialogue. Indeed, the private sector has frequently used the qualitative data contained therein to make investment and market access decisions, and has furthermore used the information gathered in the BCS as a means of lobbying the political authorities. In most developing countries, whilst reliable official data is either released with a time lag or is non-existent, BCS's provide unique information in respect of current business conditions, investor confidence levels and consequently about investment and employment conditions. Private sector organisations notably Chambers of Commerce and Industry, by conducting Business Climate Surveys, thus contribute to providing adequate and reliable tools for rational decision-making both in the business environment and macroeconomic policy.

During April 2004, Advisory Services for Private Business (ASPB) in cooperation with the Association of SADC Chambers of Commerce and Industry (ASCCI), embarked on a process to conduct Regional Business Climate Surveys (RBCSs) in the SADC region. The pilot survey was carried out during June and July 2004. ASPB also assisted with co-ordination services during this exercise. The Namibian Economic Policy Research Unit (NEPRU) provided scientific assistance.

The Regional Business Climate Survey (RBCS) is now in it's second year of implementation. The success of the first year, in terms of interest by national, regional and international private sector businesses, media, governments and international organisations serves to show the necessity and usefulness of the RBCS as a tool for advocacy, dialogue and decision-making.

We are happy to note that 2005, unlike 2004 where only nine countries responded, all fourteen countries of SADC responded to the RBCS. In addition, the newest member of SADC, Madagascar, was also part of the RBCS and this gave a chance for respondents to give their perceptions on Madagascar as an export and import market. The 2005 RBCS also recognizes the impact that HIV/AIDS epidemic is having on business in the SADC region and thus HIV/AIDS was included in the 2005 RBCS.

We are very encouraged by the results of the 2005 RBCS, which are positive and show the optimistic view that the private sector has of doing business in the region. This follows from similar perceptions of 2004. This optimistic and positive view is crucial in attracting investors to the region and accelerating regional integration. In 2005 the survey also included the primary and tertiary sectors.

The following private sector organisations conducted the survey, namely:

- Chambers of Commerce and Industry South Africa (CHAMSA)
- Industrial Association of Mozambique (AIMO)
- Lesotho Chamber of Commerce and Industry (LCCI)
- Malawi Confederation of Chambers of Commerce and Industry (MCCCI)
- Mauritius Chamber of Commerce and Industry (MCCI)
- Namibia Chamber of Commerce and Industry (NCCI)
- Swaziland Chamber of Commerce & Industry (SCCI)

- Zambia Association of Chambers of Commerce & Industry (ZACCI)
- Tanzania Chamber of Commerce, Industry & Agriculture (TCCIA)
- Madagascar Chamber of Commerce, Industry & Agriculture

Market research firms supported the survey in Botswana, Lesotho, Namibia, Tanzania, South Africa, Zambia and Zimbabwe. The Catholic University conducted the survey in Angola and a GTZ project carried out the survey in the Democratic Republic of Congo.

4 Findings

- The 2005 Business Climate Survey for the SADC region reveals a broad- based optimistic and stable market. The SADC regional firms participating in this survey remain optimistic about economic expectations over the ensuing twelve months, for the period-ending 31 March 2006.
- Over 500 companies responded this year from all the SADC member countries. The respondents were drawn mainly from the manufacturing sector, with over 20% from the primary and service sectors.
- An upbeat market is anticipated over the next twelve-month period. Current performance for all sectors is positive, with the best performance seen in the metal, machinery, vehicles and precision manufacturing sector within SADC countries
- Respondents expect employment in the next twelve months to remain mostly unchanged or to increase marginally. Sectors with good current performance expect to conduct most of the recruiting.
- Investors and entrepreneurs are still more "confident" in developing their businesses domestically than in other SADC countries.
- Overall, respondents anticipate earning more from the rate of export revenue earning from countries within the SADC region. Export revenues to countries outside the SADC region are expected to grow more, comparatively speaking.
- The survey results fro both 2004 and 2005 have been utilized to develop a Regional Business Confidence Index (RBCI).
- Amongst the 19 identified challenges to business activities within SADC, fluctuations in exchange rates remain the biggest challenge within the region.
- Madagascar is perceived as an attractive market for selected manufactured goods, notably Chemicals, Pharmaceuticals and Plastics. However, most of the respondents are not yet familiar with this market's opportunities and potential.
- 41.2% of respondents have an HIV/AIDS workplace program in place, whilst 62% recognize a current impact on their organizations.
- Exporting companies expect their exports to non-SADC countries to increase more than to SADC countries.
- A cautious approach to employment is expected in the next 12 months.

- Current performance for all sectors is positive, with the best performance experienced in the services sector.
- Exchange rate fluctuations continue to have a significant effect upon all three categories of challenges, namely macroeconomic, business environment and cross border issues.
- 21% of the respondents consider Madagascar attractive as an export market and 10.7% as a source for imports.
- 74.7% of large companies surveyed, with a staff complement of more than 251 people had an HIV/AIDS policy in place.
- The furniture and wood sector is the worst affected sector in terms of challenges when doing business within the region.
- The introduction of Primary and Services sectors in the 2005 survey, has added more perspective to the Manufacturing sector in respect of comparable performance. This will lead to a better understanding of common areas of opportunities and constraints;
- The Metal/Machinery cluster reflects more optimism both in home and other SADC countries. Whilst highly mechanized this important cluster is a key indicator for industrial growth in the construction and new plant sub-sector;
- The inclusion of the six new business climate indices now provides a valuable measurement, with the two principle benefits being the degree of regional integration and the relationship between of performance, investment and employment levels.

Participating private sector organisations (PSOs) administered a common questionnaire to all respondents. Companies were sampled from the membership list of participating PSO's and other sources such as municipalities; ministries of trade and industry or commerce; company registrars; yellow pages; ministries of labour, social security commission or similar institutions; ministries of finance or receiver of revenues; and pension funds.

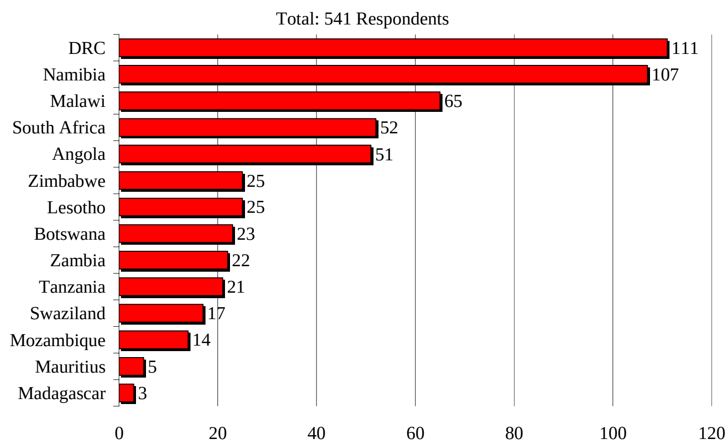


Figure 1:

The procedure by which the questionnaires were administered was left to the participating PSO's. Possible options included mail, email, face-to-face interviews and telephone interviews. This allowed for PSO's in countries where businesses had confidentiality concerns to make use of an anonymous mail survey, while other PSOs could use the most cost effective or most practical method, including direct contact and personal interviews.

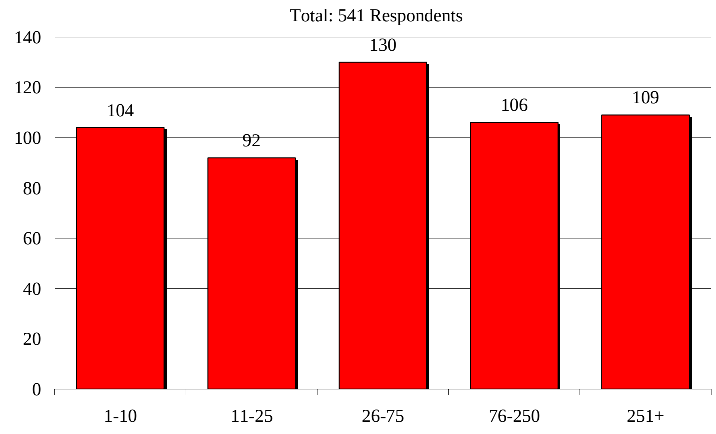


Figure 2:

The response rates differed from country to country. A total of 409 from manufacturing companies, 97 from the service sector and 34 from the primary sector took part in the survey.

The large majority of responding firms were Pty Limited companies (46.5%). Close Corporations (10.35%), Sole Proprietors (26.8%), Partnerships (9.8%) and Other (10%) classifications accounted for the minority of respondents.

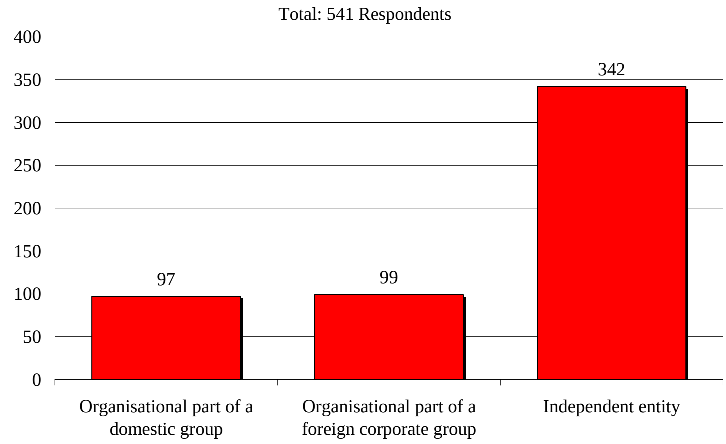


Figure 3:

Table 1: Sub-Sector Clusters

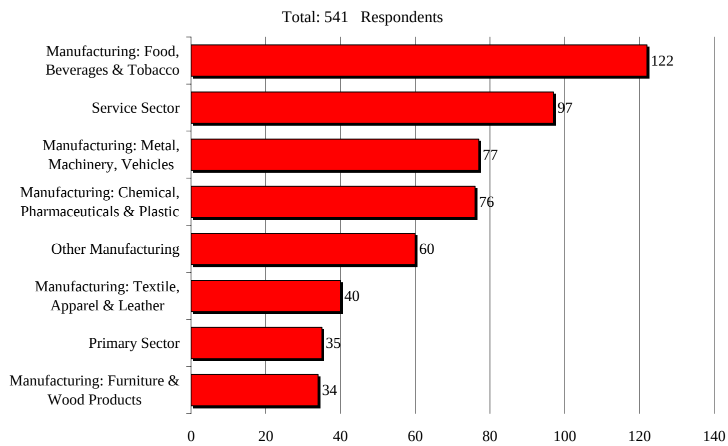


Figure 4:

Firms with between 26 and 75 employees made up the largest group of respondents. Of responding businesses a large majority act as independent entities (63.2%) while the rest act as a part of either a domestic (17.9%) or foreign corporate group (18.3%).

It can be concluded, following a successful second survey that the inclusion of the primary and services sector was timeous and appropriate. Furthermore the catalytic effect of these sectors on the manufacturing sector, whilst not measured in specific terms this year should be included in future.

The RBCS primarily aims too:

- Strengthen public-private sector dialogue at SADC and national level, with dialogue issues resting on empirical evidence;
- Strengthen the relationship between private-sector organisations and their members, through the former providing value-added services to the latter;
- Monitor the business climate across the SADC region, to facilitate the policy decision-making process by both political authorities, private investors and entrepreneurs;
- Improve business opportunities in SADC countries; and
- Develop a sustainable business climate survey model for the SADC region, to ensure follow-up and the development.

5 The Approach

Regional institutions and national governments have several intervention points at their disposal to improve the investment climate and these would include, amongst others:

- **Removal of barriers to competition:** One aspect is to reduce barriers to entry for new businesses, in terms of regulatory requirements and access to land / capital. A further measure would be to accelerate the process of allowing SADC to become a "free trade area".
- **Reduction of risks:** Businesses face multiple risks. These would include risk in terms of the response time and intensity of customers and competitors, factor input costs and resulting inflation or foreign exchange movements. Governments play an important role in safeguarding a stable economic and political environment that mitigates risks to a minimum. Furthermore the protection of property rights, political predictability/consistency and stable bilateral and multilateral relations are critical for limiting risks in the commercial sector.
- **Containing the costs of doing business:** The two above-mentioned points, i.e. removing barriers to competition and reducing risk levels both lead to lower operating costs. Limiting corruption in public institutions to a minimum and improving the service delivery of government services, i.e. delivering better and more relevant services for less, is key to reducing costs of doing business.

Business Confidence Index

The business climate is measured by the RBCS project when using business climate indices, which are based on nine questions:

1. Please rate your current business performance:
2. Please rate your expected business performance for the next 12 months:
3. Over the next 12 months will you employ...?
4. Over the next 12 months will the capital expenditure of your company in your country...?
5. Over the next 12 months will the capital expenditure of your company in the SADC region...?
6. How do you expect your export revenue from other SADC countries to change over the next 12 months?

7. How do you expect your export revenue from outside of the SADC region to change over the next 12 months?
8. How do you expect your expenditure for imports from other SADC countries to change over the next 12 months?
9. How do you expect your expenditure for imports from countries outside of the SADC region to change over the next 12 months?

The business climate indices allow the monitoring of business climate continuously over time. The four climate scores are calculated, each based on a single question and measure the business climate throughout the SADC region:

- Current Performance (P), based on question 1;
- Expected Performance (EP), based on question 2;
- Employment Outlook (EO), based on question 3; and
- Investment Outlook (IO), based on questions 4.

Additionally, two scores are compiled that measure the rate of regional integration within SADC. Intra SADC Trade score (IST) score is determined by four questions based, on exports and imports (questions 6-9). The Intra SADC Investment Index (ISI) score is formulated based on questions 4 and 5.

The Intra SADC Investment score (ISI) is calculated by dividing the index value for capital investments in other SADC countries by the index value for capital investments in the home country, expressed as a percentage. Above 100% means that businesses plan to increase their investments in other SADC countries more than they do in their home country. An ISI reading below 100% means that responding businesses intend to increase their investments in their home country more than in other SADC countries.

It should be borne in mind, that the above-mentioned climate questions do not draw any conclusions regarding the magnitude of investments made. Whether it is a large or small company responding, all respondents carry the same weight. One therefore cannot deduce whether more or less is invested in other SADC countries in real terms compared to the home country. The responses only indicate whether the corresponding investments will increase or decrease, but not by indicating which one is higher.

Table 1: Business Climate Scores

	2004 (Pilot)	2005	Change
Regional Current Performance (RCP)	24.7	24.2	same
Regional Expected Performance (REP)	38.5	42.3	up
Regional Employment Outlook (REO)	14.1	19.6	up
Regional Investment Outlook (RIO)	28.6	31.3	up
Intra SADC Investment (ISI)	51.79%	73.8%	up
Intra SADC Trade (IST)	88.66%	96%	up

The Intra SADC Trade score (IST) is derived by dividing the sum of index values for importing and exporting to and from other SADC countries by the sum of importing and exporting to and from countries outside the SADC region, expressed as a percentage. An IST reading above 100% means that responding businesses intend to trade more with other SADC countries relative to their trade with non-SADC countries. It does not mean that they are in effect trading more with other SADC countries, than with non-SADC countries.

Table 3 reflects the composite index values for the business climate indices for both the "pilot survey" of 2004 and the recent 2005 survey. The results of these surveys are strictly speaking not comparable by virtue of the following. Firstly, not all SADC countries where covered during the "pilot survey". Secondly, the 2005 survey included companies from the primary and tertiary (service) sector, whilst the "pilot survey" was limited to manufacturing companies. Variability in results will occur due to different companies responding from one survey period to the next.
The 2005 data is being used to calculate a Regional Integration Index (RII), which commences with 2005 set 100 (base year) index points. It is calculated by adding up the Intra SADC Investment (ISI) score and the Intra SADC Trade (IST) score and dividing the aggregate by the same value for 2005, times 100. For ensuing years the same divisor will be used, which allows the effective monitoring of regional integration.

$$RBCI_t = \left(\frac{P_t + EP_t + EO_t + IO_t}{RBCI_{2005}}\right) \times 100$$

$$RII_t = \left(\frac{ISI_t + IST_t}{(ISI_{2005} + IST_{2005})}\right) \times 100$$

Table 4 displays the RII for both 2005 and 2004. It should be borne in mind that the 2004 index value has only been included for demonstrative purposes and that a definitive comparison is not valid.

Table 2: Regional Index (RII)

	2004	**2005**	**Change**
Regional Business Confidence Index (RBCI)	90.2	100	Up
Regional Intergration Index (RII)	82.7	100	Up

Additionally, the survey results were used to derive at a Regional Business Confidence Index (RBCI) based on the current and expected performance the employment outlook and the investment outlook scores.

6 Lessons Learned

What were the perceived opportunities?

We realized very early on in the process that the Regional BCS would be very valuable for businesses, ASCCI members, ASCCI itself and policy makers in their efforts to achieve a more conducive environment for doing business in the SADC region. On a National level results would also be valuable when used as a dialogue tool with local governments.

Expected problems identified before we started the initiative:
Our major challenge was identifying "in country" participating partners for all of the SADC countries. In some countries we experienced an overwhelming interest and had little difficulty in sourcing a willing partner. On the other hand, we found that some countries were riddled with logistical problems, mainly in the form of capacity and resource. We, therefore, knew where we would need to assist with additional resource i.e. Market Research Support and other parties very early on in the roll out of the survey.

Business Process and Problem Definition

Business Process: Cooperating partners in 8 out of 12 SADC countries released the survey questionnaire material. A Market Research Company and other partners covered the remaining SADC countries. The material was translated into French and Portuguese to cover Angola, Democratic Republic of Congo, Madagascar and Mozambique. The deadlines were tight and the partners used various methods, mainly email or face-to-face interviews, to get the results they needed. Questionnaires were returned to our Research organization, NEPRU who are based in Namibia, by fax, email or post. Once the questionnaires were returned we needed to carry out data entry and analyze the results. We then needed to begin the process of producing all of the marketing material that would be needed to promote the survey.

Key Steps: The first stage was the analysis and data entry of the results. This part of the project was carried out by NEPRU who then had to write a detailed report. On receipt of this report, we commenced with the production of a brochure, which would be used as a summary document of the results. The brochure highlighted the key findings and also identified the obstacles that the region was currently facing. The brochure was printed and designed by a professional company in time for the SADC Heads of State meeting that took place in Botswana this year. The brochure was initially released at this meeting. The results were then released a week later at a press conference in Johannesburg.

7 The German Contribution

ASPB: ASPB' s main objective is to support specially selected small and medium sized companies within the private sector to promote Regional Trade and Investment throughout the Southern African Development Community (SADC) region The overall aim of the project is "The Private Sector promotes Regional Integration and overall improvement of capacity building within SADC." Capacity building, in this instance, refers to the economical and social development factors on the following three levels: Governmental (Macro Level), Relevant Economical Institutions, Self-Help-Organisations (Meson Level) and Enterprises (Micro Level). The project' s goal is reinforced, as it has become widely recognized that the performance of Private Enterprise within all the project countries is increasingly becoming a major factor for economical and social development.

Objectives and Strategy: Private sector organisations like chambers of commerce and sub-sector associations, thus contribute to rational decision making in business and politics. Further we recognised that by conducting a BCS, private sector organisations could enhance their reputation and improve their communication with their members as well as their dialogue with authorities and the media. The Regional BCS project aimed at promoting advocacy and dialogue between the private and public sector within SADC countries.

Media Relations & Publicity:
We briefed a reputable Public Relations company on the background of the BCS, what our needs were, the main purpose of the publicity and the target audience. We initially set our target for the number of journalists that would attend the event at between 10 and 20. A media release and invitation was sent out to as many media organizations as possible. We then commenced with the task of preparing our team to be "media ready".

What media and format was used to mediate the process?
We identified two main Spokespeople who were business people in the region who would handle the interviews. We also carried out some media training for the entire team who would be available during the Press Conference. Speakers were prepared with media skills and assisted in formulating 5 key communication messages. These five key messages were extremely important, as this was the basis of all of the results and the most important findings that needed to reach our target audience. Press Packs were produced for the Press Conference. The Press Pack included a Press Release, a brochure on the summary of the results, a brochure on the background of the survey and a document, which detailed the results of the summary. All of these documents were also burned onto a CD so that the journalists would have them readily available in electronic format.

Results:
23 journalists attended the media launch including television, radio, print and international media. This was an exceptionally good result and better than our target. A number of radio and television interviews also took place separate from those conducted at the media conference. The result was that we had one national live television pre conference interview conducted by the one of the spokespeople on the morning before the conference. This helped to generate pre publicity in the outcome of the study and raise awareness of our Partner Institution as well as the SADC region. We also had one national live insert for "Business Update" which proved to be crucial in the process of our findings reaching the business community. Numerous radio interviews also took place during the proceedings.

How was success defined?
The media attendance and coverage was excellent due to the huge amount of work carried out in the lead up to the conference. The angle of information that was released prior to the conference was also vital. The initial interview only released enough information to "tease" the journalists. We were front-page news in one of the biggest dailies in South Africa and managed to grab top spots in six other publications. Twelve television and radio interviews took place over a two-day period and were all extremely positive. We defined our success on initial spend verses value of media coverage. The value of the media coverage we received was just over seven times the amount of our initial investment.

Media releases are valued at the size of the article, the publication and the page it appears on, our biggest article was worth approximately Euros 5,000.00 in media space. Television and radio inserts are measured very much in the same way, the values of these interviews ranged from Euro 100.00 to Euro 10,000.00.

Reforming the Business Environment in Afghanistan – Institutional Reforms first

Reinhard Palm, Sebastian Kessing, Shafic Gawhari and Suleman Fatiimie

The Afghan Government with support of Germany and by implementation of GTZ has started at an early point to introduce a new institution as a "One-Stop-Shop" for investors, the Afghan Investment Support Agency (AISA). Without a clear regulatory framework, this investment was a great risk, but is now seen as a success story. The registration time for new businesses was reduced to less than a week; by benchmark of the World bank's/ IFC "Doing Business 2006" survey one of the best in the developing world and the best in the region. After nearly two years of operations, AISA has registered more than 3300 businesses with a planned investment of 1.3 billion USD and more than 130 000 direct jobs envisaged. In addition, AISA became an important voice in the reform of the business environment of Afghanistan.

1 Introduction

After 23 years of war, the regulatory framework in Afghanistan is still outdated and the country's institutional capacities are very weak. The government has embarked on an ambitious agenda to reform the business environment for private sector development, but its capacities to design and implement the reforms are lacking. The international community is supporting the reform of the regulatory framework on a large scale – but with mixed results.

The Government of Afghanistan (GoA), with the support of Germany and through the implementation of the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH has started at an early point to introduce a new institution as a "one-stop-shop" for investors, the Afghan Investment Support Agency (AISA). Without a clear regulatory framework, this investment represented a great risk, but is now seen as a notable success story. The registration time for new businesses was reduced to less than a week which, according to the benchmark of the World Bank/International Finance Corporation (IFC) "Doing Business 2006" survey, is one of the best in the developing world and certainly the best in the region. After nearly two years of operations, AISA has registered more than 3,300 businesses with a planned investment of 1.3 billion USD, and more than 130,000 direct jobs are envisaged.

AISA was set-up as a so-called one-stop-shop for investors. Domestic and foreign investors in Afghanistan can register with AISA. The institution then takes care of all the registrations and licenses needed for companies to be able to invest. AISA accompanies investors before and after the registration process with the aim of enabling them to cope with the difficult environment. Moreover, AISA analyses and markets business opportunities at home and abroad. AISA has also become an important voice in the reform of the business environment of Afghanistan.

Lessons learnt:
In a stable political environment, there should ideally be a regulatory framework before an implementing agency can be introduced. In a fragile state, however, the contrary might be true: **implementation via the right institution should start even if the regulatory framework is not in place. The institution might then create an appropriate regulatory framework for its own operations and for the benefit of the business community.**

In an unstable environment, an institution can be successfully set up if the political will and continuous donor support are in place. A dedicated national institution is better suited to introduce the regulatory set-up needed for its own operations than a donor-driven approach.
A non-discriminatory approach between domestic and foreign businesses is also the most successful way, not only for institutional or regulatory reasons, but also for political reasons: if

the international and domestic business community share the same interests, they might together build a powerful political force for reform.

Business registration services are the entry gate to the formal economy and therefore play a crucial role in connecting the informal economy with the resources of a modern economy.
Weak countries' limited absorptive capacities has led to an approach focusing on long-term financial and technical support with limited short-term consultancies.
In weak environments, a multilevel approach is needed to connect practical support with political and institutional change.

Donors should not refrain from institutional reforms, even if such investments are risky.

2 Background

Political background

In 2001, after 23 years of war and civil war, Afghanistan was a failed state. Its industrial production was near to zero, and the country was one of the poorest and most underdeveloped in the world. Four years on, the overall picture has still not greatly changed.

Business environment reforms are essentially political reforms which change the distribution of power and limiting rent-seeking behaviour. In a country with a very troubled history, it is important to look at some of the dynamics behind the current political situation to understand why some reforms might work and others not. A paper about one of the first newly built institutions in a post-conflict country must necessarily be more political than technical cooperation usually seeks to be. To demonstrate this paper's argument that institution building and capacity building are at the core of the reform of the business environment in Afghanistan, a brief examination of the past and present political landscape is necessary.

Afghanistan has historically never experienced a strong central government. Back in the 1920s, the government was slowly reformed into a modern administration, but central power only extended to the remoter regions to a limited extent. The force of modernisation accelerated after a coup in the 1970s, but this resulted in nationalising industries and starting an industrial base by state-owned enterprises (SOEs). This development was re-enforced by communist governments after 1978 in an increasingly Soviet-style approach. After the collapse of the communist system in 1992, the country would not experience a stable government for nearly ten years. Since a combination of western forces and the mujahedin ousted the Taliban, a modern government has been trying to govern the country as a whole.

By no means did the new Government start from scratch. Most western advisors were surprised to discover how deeply rooted the newly installed government was in old structures. However, as new ideas, new approaches for the regulatory framework and also new personalities (in government and business) have entered the scene, different structures and realities are overlapping*.

In legal terms, the old laws were reinstated at the Bonn Conference. However, in various cases it was impossible to determine which laws and directives were valid. In addition, the ownership of nearly all larger companies and banks was and still is disputed. The same holds true for much of the land, as most of the land usable for industrial purposes is owned by SOEs, companies with mixed ownership or government entities.[1]

Looking at the personal side of governance, to a large extent the new elite (including most of the current ministers) are the same as the old elite of the social system that predated the coming to power of the communists. This elite was fractionalised in exile*, but survived. In addition to the old elite, some military commanders made it into the government, but this group was mostly sacked after last year's presidential elections.[2]

Security and the drug trade

Of course, nothing in Afghanistan can be analysed without referring to the weak security situation and the drug trade. Without a doubt, it is a must for the government and the international community to reform the security sector so that Afghans can guarantee their safety by their own means. It is also a must for the international community to assist the Afghan people by military means for the next few years, even if the methods prove controversial.

The drug economy is about the size of half of the legitimate economy. It goes without saying that no stable, modern economy can be developed given such a misallocation of resources.However, at least some of the old power affiliations have weakening substantially. Disarmament has made great process in the last two years, and the disbandment of the remaining small illegal bandit groups is currently underway. This picture might contrast with conventional perception in the west, which is largely determined by the continuing anti-terrorist operations in the south and south-east of Afghanistan. But in the central, the northern and the western regions of Afghanistan, the central government has consolidated its power, is largely undisputed by competing warlords, and has established some kind of legitimacy in the minds of the people. With continuing assistance from the International Security Assistance Force (ISAF) and the ongoing security sector reform (which means a growing and better trained Afghan National Army and Afghan police), we expect that the most likely scenario is that of an increasingly stable Afghanistan.

However, for the next few years, the fight against drug production and trafficking will represent a continuous challenge for the government and the international community. In addition, the situation in the south-east will remain unstable for quite some time. Nevertheless, it should be noted that these regions were never historically under the control of the central Afghan government. The result of these factors is that reforms in the business environment mainly affect the urban areas of the western, northern and central region where about half of the Afghan population live.

Economic and social background

Afghans must come to terms with 25 lost years. It is one of the last countries in terms of human development, with only the worst war-torn countries in Africa lower down in the index. Per capita income is approximately 250-300 USD, or, including the drug economy, about 315-350 USD, leaving more than two-thirds of the population with under 2 USD per day (the last figure in purchasing power parity-adjusted terms). All social indicators are still extremely low with a life expectancy of 43 years and a level of illiteracy of around 80%, despite an increase in the

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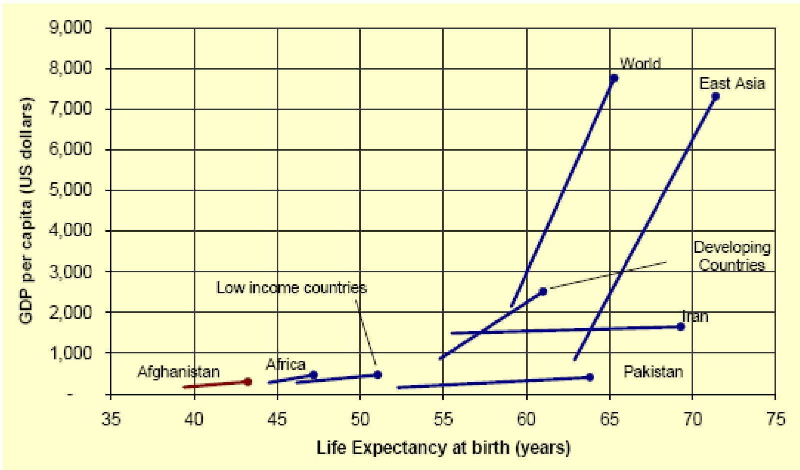
[1] In a resource-poor country, land remains one of the few resources in which corrupt behaviour really pays.

[2] The term "warlord" is in many cases misleading. The western perception of warlords/commanders is not always helpful, as some of them were not merely mujahedin fighters, but also governed regions for many years. The mujahedin structures were more open than traditional Afghan society.

enrolment rate to about 67% countrywide (rising for girls from close to zero under the Taliban to around 65% in the cities and 40% countrywide).
Afghanistan has never had a strong productive base, as the following graph illustrates (from World Bank 2004b).

Figure 1.1: Afghanistan's Level of Development in International Perspective (1975-2002)



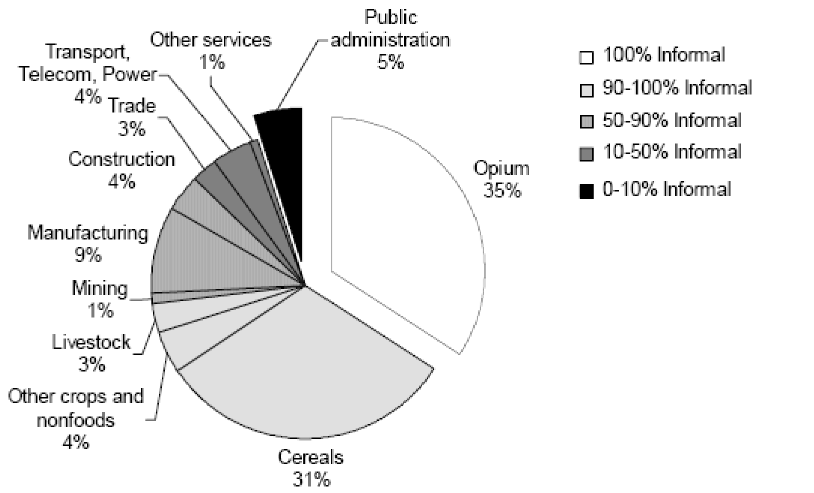
Non-weighted average of country statistics. The non-dotted end represents 1975; the dotted end of each line represents 2002. Source: WDI.

The economy mainly relies on agriculture; manufacturing contributes less than 10% to GDP, and is mainly based on small-scale agricultural processing. The economy is largely informal (figures taken from World Bank 2004b)

Cereal output increased between 2000 – 2003 by 150%, and is now at least at the level of the mid-1990s. There is moreover undoubtedly still large room for a further expansion of agricultural output, both for cereals and livestock products. However, only about 12% of the land is arable, of which just half is used due to the limited availability of water. Even if annual growth in agricultural output of about 5% p.a. were feasible, private sector-led growth in manufacturing and services is badly needed.

Without a doubt, Afghans are highly entrepreneurial and hard work is highly valued. However, traditionally the economy is shaped by subsistence agriculture plus trade. Manufacturing, for its part, has never really left the scale of craftsmanship, with the exception of a few SOEs.

Figure 1.2: The Informal Economy in Different Sectors



Note: % figures refer to share of sector in total GDP, shadings to very rough estimates of the percentage of the informal economy in the sector.

Strategies for Afghanistan's future

The government wants to achieve (legal) GDP/capita of 500 USD/year by 2015. This would entail an envisaged annual growth rate of approximately 9%. The growth rate in recent years has remained steady at about 20%, but this is expected to slow down when a first "peace dividend" is paid. Agricultural growth will also slow down, donor contributions will at best remain at current levels.

Therefore, the government and the international community have put broad-based economic growth at the centre of the strategy of their joint strategic paper entitled "Securing Afghanistan's Future". All papers regard the private sector as the real engine of growth. At the last donor conference, the Afghan Development Forum 2005, there was broad consensus on the need to focus – besides security issues – on accelerated capacity building in the government. However, under the surface a dispute remains concerning how much should be invested into infrastructure and how much into governance projects, capacity building and private sector development. The government seems to prefer a focus on "tangible results" in terms of infrastructure reconstruction.

3 The business environment in Afghanistan

General conditions for doing business

Macroeconomy: We have seen very good progress in the country's macroeconomic conditions. After the successful currency reform in 2002, inflation remains in one-digit figures, and the exchange rate is stable against the US dollar and the euro.

Financial markets: The financial markets also continue to show good progress, More than ten international banks are operating in Afghanistan; international currency transfers run smoothly, and it is easy to access some basic financial services such as letters of credit. However, besides the rapidly developing microfinance business, the local credit market is in its infancy. We expect some developments from recent donor and private sector investments in banks, refinancing schemes, equity finance and credit guarantee schemes. The credit market will remain weak for the near future as the absence of a regulatory framework and the weak judicial system are limiting law enforcement and the use of collateral.

Infrastructure: Power is available in Kabul for around two hours per day (which is better in other cities in Afghanistan), so businesses rely on generators, resulting in very high energy costs. Kabul is potentially the last capital in the world without a central water/wastewater system. The country's road connections have improved greatly and the highway connecting all major cities is near to complete. (It should be noted that some parts of this road (in the south) are still not advisable for foreigners to use, but are safe for freight.) Two mobile phone operators are active in most of the country, and two more licenses have just been issued. Internet connections via satellite are available, but expensive.

Transport: Kabul is slowly getting connected to the world. Dubai and Islamabad are served daily, a few other cities in the region regularly, and Frankfurt twice a week. Air freight to Frankfurt is around 5 USD/ kg and shipping via Pakistan and Iran is possible. Internally, the major cities are served daily.

Services: The market for business services is limited. In particular, foreign investors will have problems renting offices, or finding assistance in any administrative or external trade-related matters. International-standard hotels are not available, but some guest houses do cater for the needs of international travellers. Restaurants for international visitors are getting better, but only in Kabul.

The legal framework

The legal framework is nearly non-existent or completely outdated. As stated before, the main problem is the uncertainty about what rules and regulations apply. Progress in this area has been disappointing.

For most of the issues related to a sound business environment, the situation is clearly difficult. At the start of the project, it was even impossible to determine just how bad the situation really was. When we carried out a study about the obstacles faced in registering a company, the picture that emerged was very bad (about 30 steps involving several payments were needed). Even more worryingly, a similar study conducted by the US Agency for International Development (USAID) recorded worse results (54 steps and 18 payments). Both studies tracked the registration process but with very different results. If specialists in registration procedures are unable to find out what the procedures are, how can a businessman be expected to be successful? For people in business, a complicated process is bad, but a non-transparent and unclear process is even worse.[3]

How did the donors respond to this situation? A main focus, in particular of USAID, has been to support the government in conducting a complete overhaul of the legal framework. As part of a huge program (in the high double-digit millions), advisors were sent into most of the ministries with relevance for the private sector (finance, commerce, telecommunications, mining, etc.). In association with the US Bar Association, drafts for almost everything in the business environment were developed. GTZ also conducted some work, for instance developing an Investment Law and a Privatisation Law. In theory, Afghanistan has a fully modern business code ready for adoption.

In April 2005 a list of the progress made in lawmaking was prepared. 120 laws are in the making, of which only 10 have been finalised (i.e. gazetted). More than half of the 120 laws are part of the business environment, but in this area only two core financial laws plus a first investment law have been finalised.

[3] This argument is similar to the argument that a little bribery does not harm business as long as it is clear when and who you have to bribe. In Afghanistan, however, even this is unclear, even for Afghan nationals.

Why has progress been so slow?

Even if the different draft laws were made under the guidance of one or sometimes several ministries, the technical input relied mainly on foreign advisors and to some extent on formerly expatriate Afghans. The staff in the ministries lacked the technical skills to engage fully in the drafting. In the ministries, there is a general absence of trust between top management and middle management, and decision-making is centralised in the hands of the ministers. The GoA was inundated with too many legal proposals. Capacity, in particular in the Ministry of Justice, was overstretched and the political debate between a few ministries (or more accurately, a few ministers) went on and on and round in circles. A core problem was the high number of ministries involved, as mentioned above. Their responsibilities were never clarified. In a post-conflict situation, in which different factions are represented in the cabinet in a delicate balance of power, struggles over technical problems are classically perceived as power struggles, and compromises can be interpreted as defeat by the constituencies of the different factions.

Different attempts at donor coordination in collaboration with the GoA to work on a legal master plan by prioritising a few key laws resulted in different competing master plans or roadmaps. In this way, attempts at better coordination actually ended up complicating the debate, once again consuming scarce resources and still failing to address the core problem of the GoA's weak capacity.

In the beginning, the vision was to overhaul completely the legal system in one go. Soon, however, it became clear that this was totally impossible. Any attempt to adopt a completely new set of legislations would ignore existing entitlements. On the other hand, the alternative – a step-by-step evolution of a fully outdated body of laws – is a long and delicate process, as reforming one law depends on many other old laws.[4]
In the end, after the conclusion of the core financial laws (and even these were not completed in full compliance with the lawmaking procedures), only parts of the planned legislation (such as the customs law and income tax law) were made effective by several presidential decrees. Moreover, the implementation of the laws is still weak, e.g. when the new customs law and procedures were adopted, the customs stations were not informed and continued to impose arbitrary rules in a highly corrupt manner.

The institutional framework

The degree of faction-fighting in policymaking is one of the major obstacles standing in the way of an effective reform of the regulatory framework. Even today, the structure and the understanding of the government rely to a large extent on the command-and-control style of the pre-war governments. For example, the Ministry of Light Industries and the Ministry of Heavy Industries and Mines were merged only after the election of President Karzai in late 2004. Responsibility for economic governance still remains at the time of writing (the parliamentary elections in September 2005) split between the Ministry of Finance (MoF), the Ministry of Economics (itself the product of a merger between the Ministry of Planning and the Ministry of Reconstruction), the Ministry of Commerce and the Ministry of Industry and Mines, all of which continue to fight for influence. In similar fashion, responsibility for economic policy is shared between the presidential office, the Ministry of Foreign Affairs and different sectoral ministries (telecommunications, transport, agriculture, etc.).

[4] Too many lawyers focused on single laws without really understanding the linkages between them, and failed to understand the way the judicial system works (the civil code of Afghanistan is based on a continental European structure).

Besides the Afghan Investment Support Agency (AISA), nearly all the government's operations are barely accessible to local investors let alone foreigners. Up-to-date land registries and legislation are not available, although a major USAID-funded project is working on this shortfall. Therefore, renting land is difficult and very expensive. Foreigners are constitutionally prohibited from buying land. Customs procedures are – despite best efforts in the regulatory environment – still cumbersome and corrupt, even at Kabul airport.

The role of the private sector in reforms

The government has shown itself extremely reluctant to make the lawmaking process transparent. The business community was involved in the process at a very late stage. However, the business associations showed little ability to comment on the drafts, so some of their imprecise comments backfired and the decision-makers completely lost their interest in starting public debates about pending laws.[5]

The dialogue between the business community and politics is very limited and unstructured. For example, the US-backed new "Afghan International Chamber of Commerce", which is composed mainly of larger businesspeople, mostly US Afghans, is only slowly managing to influence politics. The old Chamber of Commerce and Industries has been co-opted by the government and is only to a limited extent legitimised for dialogue or able to comment on regulatory reforms. This divide between government and the business community is one of the factors contributing to the mixed results of economic governance and reforms in the business environment.

4 Business environment reforms in post-conflict countries in the international discussion

The literature on business environment reforms in post-conflict countries includes some approaches which we would like to present in the following section, as they offer some useful insights into the Afghan situation.

1. In the first few years, donor engagement in political reforms is only possible to a limited extent, because the absorptive capacity of the partners is too low. Post-war countries only reach their full absorptive capacity after three years (Collier/Hoeffler 2002). This capacity is related to growth, which is highest between the fourth and the seventh years after the conflict (Collier/Hoeffler 2002: 5). This additional growth is typically spurred by aid, so both are interlinked through the country's absorptive capacity in the first few years. The study suggests a peak in aid between the fourth and the seventh year and thereafter a gradual phasing out to normal levels until the tenth year. Interestingly, in Afghanistan the growth peak started as early as the second year, but we have to keep in mind that the end of the war was also the end of a several year-long drought, so that these two factors influenced growth positively. Collier and Hoeffler's quantitative analysis clearly suggests that the positive effects are conditional on policy. Aid levels in Afghanistan should therefore remain for the coming years at high – or even higher – levels. However, policy remains crucial. It is hoped that Afghanistan is now entering a phase of higher absorptive capacity. However, the 2002 analysis might still hold for Afghanistan, namely,

[5] For example, when the Ministry of Finance presented a very liberal, transparent customs law and code, the traders marched to Kabul and protested against too high rates. However, the maximum tariffs were set at 16% and most of the budget lines were at 4 or 8%, a record low tariff for a Less Developed Country (LDC). This posed the question whether the traders really wanted a transparent new system or actually preferred the old intransparent system which presented numerous chances for cheating and corruption. The same is true of the ongoing discussion on income tax with a two-step flat rate of 10 and 20%, including provisions of loss-carry forward. Again, this liberal law came under fire when businesspeople calculated an effective taxation of businesses by including VAT and the withholding income tax of their workers in the nominal corporate tax.

aid was arriving too early and might be phased out too soon. According to their analysis, governance and social policies should come first, followed by structural policies (which in their analysis includes much of the private sector-related policy framework) and macro policies last (Collier/Hoeffler 2002: 12 and 21). This analysis also seems to us to support our strategy to invest in practical governance by institution building and not too much in the legal framework.

2. **The time frame for effective reforms is usually very long, so donors should look at realistic aims and gradual reforms.** The list of reformers in the recent report "Doing Business in 2006" by the IFC/World Bank puts Serbia and Montenegro, Georgia, Vietnam and Slovakia at the top. All of these economies have been reforming their economies for 10–15 years, but are currently stepping up the pace of reform. This might be an indicator that effective reforms do not come directly after political turnarounds, but often quite some years later. However, we should not refrain from reforms which are feasible. Afghanistan jumped to place 16 in the world for the regulatory environment for business start-ups according to "Doing Business in 2006" .

3. **It is necessary to focus on some small institutional reforms first.** J. Aaron argues on the basis of African experiences in the Journal of International Development for a specific reform sequence in post-conflict countries with low institutional capacities. She advocates reforms in which small solutions of rule-based systems are the most critical and should come first. Based on such successes, more complex rules might later be added. In addition, the implementation of a full set of new laws does not represent a quick way out as it does not work (Aaron 2003).

4. **Small first reform steps might trigger bigger reforms.** Olofsgard argues in a background paper for the World Development Report 2005 that the first small reform steps might make future reforms possible. According to this strategy, thanks to the first successful (and irreversible) reforms, public demand for reform will grow and support more far-reaching reforms (Olofsgard 2003).

5 The core problem

After 23 years of war, the regulatory framework in Afghanistan is outdated and the country's institutional capacities are very weak. The government has embarked on an ambitious agenda to reform the business environment for private sector development, but its capacities to design and implement these reforms are lacking. The international community is supporting the reform of the regulatory framework on a large scale – but with mixed results.

Business people – domestic and international alike – need transparent and reliable ways to deal with the legal and regulatory environment.
If it is not possible to redefine the legal and regulatory system itself in an efficient and timely manner, well-designed semi-autonomous institutions as the government's face to the business people can solve many of the day-to-day problems that entrepreneurs face.

Of course, the costs of doing business are an important factor, but if risk and uncertainty in a country are extremely high, then the latter factors can become a bottleneck as they determine the "real options" for the investor (World Bank 2004a: 45ff.). This can be seen in Afghanistan, where many promising projects with a high and quick return on investment are simply not taken up. Moreover, very few of the many chances are actually used. The costs are in some sectors somehow higher than in neighbouring countries (in particular electricity and transport costs), but they are not prohibitive. On the other hand, the high transport costs for imported goods make the local production of some goods (cement, building materials and processed foodstuffs) much more attractive.

A long-term thought

If the short political analysis above is right, the crucial point for a long-term strategy to reform the business environment is a new Afghan elite, grounded in the realities and the people of the country, but well-educated and with a sound understanding of the economic problems of the country. Step by step, new and young people are making their way back, most of them quite well-educated in Pakistan or Iran if not in the UK, Germany, US or Australia. Some of them are culturally westernised, and many lack a written knowledge of Dari (the main Afghan language, written in Arabic letters). Very often, they share the concepts and values of the donor community and they frequently come with donor contracts into a country only known from stories by their parents. The development of a new elite is a long-term process, involving the growth of a civil society and a better education system. Moreover, donors will only have a limited impact in building such an elite.

In a risky country, investors should be provided with a foreseeable regulatory system. Moreover, they need to trust in the long-term direction of politics.

One part is a transparent process for business registration. Or to put it differently, after the government with help of the international financial institutions greatly reduced the risk of macroeconomic conditions for investment, there was a considerable need to "**tackle the more microeconomic questions of improving the investment climate**" (Kessing 2005: 7).
As business registration is the entrance into Afghanistan or, in the formal sector, the modern business world, it is crucial to start here. In short, a one-stop-shop is the best place to navigate Afghan and foreign businesspeople through the difficult surroundings.
Of course, businesspeople are interested in a sound legal framework. They are not interested in the legal texts, but in the outcome. They want to know that there is there somebody to deal with their problems quickly and effectively.

In stable political environment, there should ideally be a regulatory framework before an implementing agency can be introduced. In a fragile state, however, the contrary might be true: implementation via the right institution should start even if the regulatory framework is not in place. The institution might then create an appropriate regulatory framework for its own operations and for the benefit of the business community.

5 The project and the intended development goals

The "Economic Promotion" project was commissioned by BMZ (the German Federal Ministry for Economic Cooperation and Development) and implemented by GTZ. It had two main pillars, the first to advise the Ministry of Commerce of Afghanistan on several political issues including some work in capacity building, and the second to create a "One-stop-shop for investors" as a tool designed to improve rapidly the investment climate/business environment in Afghanistan. In addition, some smaller aspects related to investment policies were included in the project, e.g. the development of an approach to develop industrial parks.[6]

The overall program aims to create the legal and administrative conditions for a better investment climate and a business-friendly framework in Afghanistan. These conditions should improve investment and economic growth with the goal of creating jobs and consequently income for the Afghan population.
In this paper, we will discuss only the part of investment promotion through the establishment of AISA as an one-stop-shop for investors in Afghanistan. We will look in particular at how AISA streamlined the investment procedures despite the lack of a sound legal framework. We will examine how AISA managed to survive in the difficult political landscape. We will conclude with some lessons learnt about how an institution should be set up, and how to improve the business environment in a country with limited regulatory capacities.

6 Results

AISA has shaped the business environment in Afghanistan. Without a clear regulatory framework, investing in a new institution represented a great risk. However, AISA is now seen as a success story, as the registration time for new businesses has been reduced to less than a week., Afghanistan's 16th place rating worldwide for business start-ups in the latest IFC/World Bank "Doing Business" Report is the best in its region.[7] As mentioned above, before AISA the registration process took several months, involved at least 28 (if not more than 55 steps) and about 18 different fees. Reports about corruption in the process were common, and investors estimated that they needed at least 500 USD in illegal fees to accomplish registration.

Since starting operations, AISA has registered investments amounting to about 1.3 billion USD. In total, 3,350 projects have been registered, of which 2,814 are of domestic and 536 of foreign origin. The total direct jobs envisaged by the investors is 136,000. Even if these figures are judged cautiously (as they are indeed based on the plans of the investors, and only half of the projects are currently being implemented (in AISA's estimation)), there is still certainly a good dynamic at work in the formal private sector in Afghanistan.

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6 This approach was successfully developed and later used by a USAID-funded project to built industrial parks under the auspices of AISA. This was an "enclave approach" designed to improve the investment climate for strategically important investors (Kessing 2005: 9).

7 The ranking would be even better if IFC did not use a problematic indicator, namely the ratio between fees for company registration and local GNP/capita. Of course, with Afghanistan's extremely low GNP, any reasonable fee will result in a bad fee/GNP ratio. As it is common knowledge that a "fee for service" attitude needs to be created in order to make business services sustainable, it is not helpful that IFC contradicts this in their "Doing Business" reports. AISA certainly needs these fees as the main source of its income (besides the German contributions) to sustain its operations as an actor independent from day-to-day political operations – and in the medium term, independent from donor funding.

AISA was always designed to be non-discriminating in extending assistance to domestic and foreign investors alike. Domestic investors are still allowed to follow the different procedures of the different institutions that are behind the one-stop-shop. If they want to use AISA's services, they have to pay registration fees of between 100 up to 1,000 USD. Even so, many companies still prefer to do this via AISA. Why?

It seems that the additional regulatory compliance costs for starting and running a business without AISA amount to more than the registration fees. We believe that most businesses are not only keen to save time in registering via AISA, but also that AISA offers some form of "insurance" against arbitrary governmental actions. This might be the reason in particular for local small and medium-sized enterprises (SMEs), because they are faced with the highest compliance costs compared to their size (World Bank 2004a: 63), and the possibilities to defend their case are the lowest (World Bank 2004a: 101 f.). In general, small companies benefit more from well-implemented pro-investment policies as they have more problems to adapt to bad policies (World Bank 2004a: 47).

Today, AISA is much more important for the general business environment than was originally planned. AISA is now the central gate for informal SMEs to integrate themselves into the formal economy. AISA has also contributed to bringing informal economic activities into the centre of business dynamics. This change from informal to formal was the lead issue in the World Bank's Afghanistan Economic Report 2004 (World Bank 2004b). Formalising businesses is important to the government as it widens the tax base and the possibilities for regulation, and also for Afghan businesses if they want to have access to modern markets (finance, marketing, production systems, etc.).

In addition, AISA serves investors in many different ways. For foreign investors, the pre-investment services include the provision of information, organisation of trips, etc. AISA also helps all investors with visa requests. The major role for domestic investors is the assistance that AISA provides to the private sector in all kind of discussions and disputes with the government. In particular, AISA helps investors to obtain licences for sectors which are in some way controlled by the government, such as health services. It is also instrumental in land disputes, questions about taxes and the privatisation process.

By playing this role, AISA is seen by many Afghan businessmen as the advocator in the government. Because the business associations are weak, AISA fills a gap in the dialogue between the private sector and the government.

The feedback from AISA's clients is very good. In an evaluation in July 2004, 80% of clients were positive about the amount of time it took until they were received by an investment manager; 98% of clients thought that the institution was well-structured and easy to understand; and 100% said that they received the information and assistance requested. This achievement can mainly be attributed to the staff. As a new institution, AISA was able to attract a group of very well-educated and enthusiastic professionals. The atmosphere and good team spirit at AISA are major reasons why investors like to work with AISA.

AISA has now entered a new phase and is marketing the investment opportunities of Afghanistan by conducting studies on such opportunities, workshops and conferences at home and abroad and increasingly with partnerships with foreign business associations like the Bundesverbands Deutscher Industrie (BDI, a German business umbrella organisation).

AISA is used by different donors as the gateway to SME programs (UNDP, the United Nations Development Program) or as the national contact point for political risk insurance (MIGA, the World Bank's Multilateral Investment Guarantee Agency).

All together, AISA has been quite successful in reducing the "appropriating activities" by parts of government via non-transparent and arbitrary fees and ex post changes to regulations with regard to investments. AISA has also managed to reduce Kafkaesque procedures and has formulated a dedicated policy to make bribery in the registration process near to impossible (for the concept of appropriating activities relating to AISA, see Kessing, 2005: pp. 5 ff.).

6 Implementation and approach

Process

GTZ started – based on an agreement concluded during the visit of German Chancellor Schröder in 2002 – to advise the GoA on trade and investment issues. Soon, it became clear that the administrative procedures and the marketing of Afghanistan were unsuited to attract any investment from abroad. On the other hand, with industrial capacity fully destroyed and poor quality services, the need for an influx of capital and knowledge from outside was evident. So the idea of the Investment Promotion Agency (IPA) was born. The concept paper by Dr. Stephan Kinnemann (GTZ) was distributed in November 2002. A Memorandum of Understanding between GTZ and the GoA was signed in September 2003 (the implementation has de facto already been under way for some months).

GTZ, together with the GoA, searched for a suitable building, renovated and fully equipped it with state-of-the-art IT and other business equipment. The business registration process was assessed and a proposal for the redesign drafted. A plan of operations for AISA was prepared and the staffing of the core positions (Chief Executive Officer (CEO) and first investment managers) was undertaken, in alignment with the Ministry of Commerce.

AISA started its operations in October 2003. In its first few months, AISA was constantly accompanied not only by technical assistance, but also by political support in the struggles with different ministries to ensure the non-intervention of the government in the daily operations of AISA. In the first months, AISA had to fight numerous battles to ensure smooth operations. With great success, further unnecessary steps in the registration process were abolished and the registration time has since been reduced to about three days for non-complex business registrations. AISA is now fully serving as a one-stop-shop and the government shows as a result "one face to the customer".

AISA's operations are still supported by GTZ. The two long-term advisors in the Economic Promotion project are dedicating about 40% of their time to AISA. It was important to have a German-Afghan advisor (Shafic Gawhari) in the team, who was able to "translate" the technical advice and problems in the implementation to the high-ranking officials (in particular the first Minister of Commerce, Kazemi) and could ensure their support.

For specific tasks, short-term consultancies are prepared and major events are jointly organised with AISA. Some highlights include the first major international conference after 20 years of war, the Economic Cooperation Organisation (ECO) Trade & Investment Conference, plus a trade fair in 2004 (attracting more than 1,000 participants). Different international and local workshops have also been organised to look at business opportunities in specific sectors, some of them with up to 400 participants. Roadshows in Europe were organised jointly. In addition, some studies were undertaken to evaluate the investment opportunities and provide investors with better information.

Alliances and political landscape

From the beginning it was obvious that AISA would have to fight to sustain its mandate. Before, various ministries and agencies played some role in the time-consuming registration process. The possibilities for collecting bribes were obvious, as 18 different fees had to be paid. Therefore, it was important to reach a solid political alliance to back the operations of AISA and to give the institutions sufficient autonomy to operate efficiently.

A High Commission on Investment (HCI) acts as AISA's the supervisory ministries with relevance to private sector development (Commerce, Finance, Industries, Economy, Housing & Urban Development, and Agriculture) are members, and the meetings take place at minister-level. The HCI appoints the CEO of AISA, and provides the political guidance for its operations. This supervisory board also recognises investments above the threshold of 3 million USD. The HCI was very instrumental in overcoming the factionalised structure of the government. In the commission, some core decisions for the business environment were debated, e.g. the provision of land to businesses. With the HCI, AISA has a board to feed back the problems of the private sector to the highest political level.

An interesting alliance could be built with the MoF, which is interested in broadening the tax base. AISA is obtaining a Taxpayer Identification Number (TIN) for all investors, which means all companies registered with AISA are also registered with the tax collector. In addition, some basic data about the investment progress must be provided for the yearly renewal of the licence. This additional source of information for the MoF was often criticised by the investors, but is a step to strengthen the tax system.

AISA would not have survived, were it not that the first CEO (Noorullah Delawari, now Governor of the Central Bank) was a very strong political figure. He was able to discuss the problems of AISA's operations face to face with the ministers and had good access to the president.

As soon as AISA started operations, a self-reinforcing process was used to stabilise the organisation. In the government and in the business community, support was increasing and it was possible to streamline further the procedures and to strengthen AISA. AISA is now an influential part in policy discussion about the business environment. On several occasions, AISA built a forum for the most open discussion between the private sector and the government.

Institutional approach

AISA's structures were designed to combine the capacity to deliver government services with a private sector such as customer orientation. It was necessary to find ways how potential political opposition could be channelled.

"Entrusting discretion on sensitive subjects to more autonomous agencies" is in any case an adequate way to give investors some certainties in risky markets (World Bank 2004a: 49). In Afghanistan, the case was to make investment registration on the one hand rule-bound and on the other hand to delegate the remains of discretion to a semi-autonomous agency.

However, a variety of different options exist concerning how to transfer such decisions. In particular, it was left completely open how the institutions could be fitted into the governing system and how it should be structured internally.

Semi-autonomous, parastatal agency: Different investment promotion agency (IPA) models exist, depending on their duties. In our case, the agency should not take over the different governmental duties in registering companies, but instead build the interface between the investors and other government entities. In addition, the public service in Afghanistan is very weak and the salary schedule structure not allow competent staff to be attracted. The solution was the construction of a semi-autonomous parastatal agency. Because Afghanistan at the time lacked some models of juridical persons, a limited liability company with shares in the hand of the government was chosen.

Greenfields institution: There would have been the option to build this institution on the basis of the former Office for Private Investment (originally under the presidential office), but the latter's staffing and the traditions were completely different from what was planned with the new IPA. The old office was therefore integrated into the Ministry of Commerce, and the new institution (AISA) was founded. This was, given the transitional nature of the time, not without conflict as the old office tried to continue its operations even after a presidential decree was issued. In addition, it took about a year until the documents were transferred from the old office to the new agency.

The one-stop-shop as a facilitator in easing administrative procedures between the private sector and government: AISA is issues investment licences, but behind these licences are a few administrative steps which are prescribed by law. While establishing AISA, the necessary steps were reduced to less than ten (according to various different sources/studies, these previously numbered between 28 and over 50). In its first months of operations, AISA was successful in getting rid of some more steps. Now, AISA performs all these for its investors, including company registration at the commercial court, obtaining the TIN, and gazetting the registered company. The administrative steps are undertaken by different institutions outside AISA. The MoF has agreed to send some staff to AISA to issue the TIN directly, which would further reduce the duration of the seminar by another two days.

In practice, investors only visit AISA, which in turn obtains the different permits, etc., from other governmental agencies. It should be mentioned that domestic investors can choose whether to register via AISA or perform all the registration steps themselves.

Investor guidance and assistance: AISA was given the responsibility to accompany the investors in all their pre-investment and post-investment questions. This very broad mandate means today AISA supports domestic investors applying for passports, visas and customs allowances. With regard to international investors, AISA accompanies some investors, including making their transport arrangements, preparing meetings, information gathering, etc. If the market for private service providers were to increase, AISA should cut down some of the services to avoid competing unfairly with such providers.

Investment promotion: AISA is now very good at responding to the demands of investors. Furthermore, it has started proactively to analyse and promote investment opportunities by studies, workshops, international conferences, international roadshows, advertisements, etc.

Internal structure and staffing: AISA is staffed with approximately ten professionals, six of which function as investment managers responsible for advising and guiding investors. AISA is divided into an investment support and an administration department. In addition, the Industrial Parks Development Authority is now occupies a third wing, but is fully autonomous.

Regional representation: So far AISA is only present in Kabul, but it is planned to open offices in the biggest cities of the country (together with the Chamber of Commerce); the first two offices should open this year.

Finance and sustainability

Finance: AISA's institutional set-up and the hardware were financed by GTZ. For the first five years, the running costs were born to a decreasing amount by the German government through GTZ. The remaining costs are covered by AISA's income, based mainly on the issuing and renewal of the investment license. In addition, AISA is charging for a few other services. AISA is ahead of the projections to reach financial sustainability.

Regulatory framework

AISA was started without there being a clear regulatory framework in place, and this is indeed it is lacking.

To reach quick results, a new business-friendly investment law based on a draft provided by a German consultant was enacted by presidential decree in 2002. Since then, a more detailed law with state-of-the art international dispute resolution mechanisms has been under discussion. However, more than two years after different ministries agreed upon a draft, it has still not yet been enacted. Only this law can provide AISA a clear legal framework. So far, only some core responsibilities were defined by presidential decree in March 2004 (one-and-a-half years after starting operations).

7 Lessons learned

People before paper - institutions before laws

In an unstable environment, an institution can be successfully set up if the political will and continuous donor support are in place. A dedicated national institution is better suited to introduce the regulatory set-up needed for its own operations than a donor-driven approach.

Is it better to have the institution before its own regulation framework has been set up? Of course, a clear legal framework is desirable. In addition, AISA would have performed more smoothly if it had been based on a sound law. However, as legal reforms tend to need a very long time, a small solution with an institution using the flexibility of a given framework might solve most of the issues ahead of the legal reform.

In addition, the institution – if working successfully and being legitimised in politics and business – has a good chance to create its own legal framework. Such a framework might be more appropriate than one drafted by foreign consultants.

Alliances for reform: business environment reforms are highly political

Improving the business environment is a highly political task. A simply "technocratic" attempt will inevitably fail. The political will and the active engagement of the partner (at least at ministerial level) are necessary. In addition, the business community must be supportive.

Donors have to determine what the "sweet spot" for reforms is in terms of achieving the perfect balance between being desirable (for public wealth), manageable (by institutional capacities) and politically feasible. (World Bank 2004a: 68). This spot determines the space for reform. The space could be enlarged if one of the three factors changes. This could be done by increasing the capacity to reform or by strengthened political support.

Therefore, sound management of the external relations of a semi-autonomous institution is crucial. In our experience, it will stabilise the institutions if potential losers of the reform are embedded in the institutional set-up (e.g. through advisory boards, etc.). If strong ministries/political powers can be co-opted by offering them a clear benefit, the probability of success will increase (in our case, the cooperation of the MoF by issuing the tax numbers).

Incorporating the business community could increase the pressure for reform and therefore enlarge this "sweet spot".

A long-term process needs a long-term approach

Our experience – and that of the literature – clearly shows that reforming the business environment is a long-term process incorporating many players with different interests and strategic decision-making (World Bank 2004a: 71ff.). To influence them, the donor must make a long-term commitment.For this long-term commitment to be successful, it must be demonstrated by the presence of long-term experts.

To our experience, we have seen in Afghanistan far too many short-term experts flying in and out, writing papers which are even not read by their fellow long-term advisors in the country – not to mention by the Afghan partner. The current trend in technical cooperation – away from long-term presence to short-term advice, intermediate experts, etc. – is simply unsuitable in a post-conflict situation or an LDC.

Trust

The longstanding economic, historical and cultural relations between the partner country and the donor country have all played a factor in this project's success. In addition, it was important to establish longstanding relationships between the government, the Afghan investment promotion team and the implementing agency.

Greenfield investments in the business environment

In the debate about the right institutions in microfinance, greenfield investments have become very popular over the last ten years. The same seems to be becoming true with the setting up of business development service providers. Is the Greenfield approach also the best road to take for institutions seeking to shape the business environment? We believe much more thought should be given to creating new institutions (greenfield investments) instead of reforming old governmental structures.

In the case of Afghanistan, the new structure of AISA (a limited company owned by the government) was later on used as a model to reform other policy fields.

Donor Input

Donors must invest in the business environment from a long-term perspective. Shaping the process is the key to success. Culturally and politically sensitive interventions are needed, and to do this, the staffing of the project should reflect such an approach. A good mix of experts, including potentially working with the diaspora of a country, could represent a promising approach (albeit never at the expense of the quality of the staff).

Flexible projects

In post-conflict situations in particular, we see a need to work with flexible project concepts that combine technical cooperation with the possibility of financial contributions and the provision of hardware.

Non-discriminatory promotion of investors

Institution should be non-discriminatory towards investors/businesspeople regardless of the size of the company or their origins. Most problems for businesspeople tend to be broadly similar for all companies irrespective of whether they are large or small, foreign or domestic. In addition, if the institution is serving a broad community, its political support from its clients should be higher.

From formal to informal

By reducing the regulatory costs (including the time needed) to register a company, the government has encouraged some existing companies to legalise their formerly informal business. In the medium term this not only benefits the company in terms of better access to resources and markets, but also helps the government to broaden the tax base and to regulate the economy.

Political advocacy by parastatal organisations

It the creation of a powerful advocacy structure was an unintended consequence. In a country where the official Chamber of Commerce is still very much co-opted by the government and the newly built business associations are weak and mistrusted by the government, AISA has filled a gap in raising the voice of the business community in the political debate about the regulatory environment (taxes, customs, etc.). We expect this role to decrease as other actors become stronger.

However, for a transitional time, the workshops and conferences organised by AISA were one of the very few places where the government and the business community could engage directly in a structured dialogue about the business environment. In addition, the cases brought forward by AISA stimulated change on various occasions for the benefit of the private sector.

Such a role could be taken on by a parastatal if it is well constructed as a facilitator between the political and the business sphere. However, if the government or the business community is not prepared for a dialogue, then the effects will be limited. Still, the institution itself can stimulate the discussion and raise awareness for a more in-depth dialogue.

From a business environment to an open society

What are the long-term approaches that can contribute to change, leading towards a society open to change and to equal participation of all? Should donors seek to influence deep-rooted perceptions and attitudes towards achieving better levels of participation and greater openness for business?

Discussing the investment climate might in the long run be too narrow an approach. Approaches that seek to invest in the formation of a new elite and an active civil society might be crucial in order to free the entrepreneurial forces of developing countries.

Stimulating the dialogue between politics, business and civil society should accompany more technical approaches if the long-term success of private sector development has been ensured.

Investing in the education and the exchange of "young leaders" could represent a promising part of a broader engagement in shaping the business environment towards an open society.

8 The German contribution

- Hardware (building renovation, equipment including furniture, IT, cars), including oversight for construction and purchases, just under 0.5 million USD.
- Experts: At least one long-term consultant and perhaps six months of short-term consultancy per year are necessary for such a project. In our project, two long-term experts dedicated half of their time to the IPA component of the program. One expert was an Afghan–German (Shafic Gawhari), who was well-suited to communicating the ideas of German cooperation to the Afghan decision-makers at the highest level. In addition, we had a senior consultant (Stephan Kinnemann) who led the discussion at the highest levels and was a credible partner for the GoA based on his lifelong career in investment banking and public sector institutions. In future the long-term presence at AISA will be even stronger, as one person will be placed constantly inside AISA for the further development of the investment promotion activities.
- Direct financial contribution for running costs: 360,000 USD in the first year, now decreasing, at the moment around 300,000 per year (over five years about 1.5 milion USD).
- Different activities such as conferences etc. were jointly conducted.
- A public-private partnership between AISA and the BDI was co-financed by the German government.

Altogether, the set-up of AISA would be an investment over five years costing roughly 3.5 million USD.

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Promotion of the Private Sector – A Case Study from Ghana

Carlo Hey

Overarching economic policy reforms do not always translate into improvements at implementation level. This is especially true in developing countries characterized by an inefficient public sector and weak private sector organizations. Providing substantial amounts of aid money up-front for public reform programs may constitute a serious risk. Two strategies could help to mediate such risks: a comprehensive reform of the public sector and the building of strong private sector associations, which are capable of involving the Government into a constant dialogue process.

Technical Assistance can be a viable contribution to this process. It can help alleviate certain bottlenecks and build capacities within private sector organizations with the aim to stimulate policy dialogue and increase quality of other services. To be effective, Technical Assistance should be integrated into a national policy reform agenda and into the framework of other donor programs.

1 Introduction

The current business environment in Ghana can be characterised as "work in progress". Over the last five years, Ghana's government has been working hard on a new set of policies and strategies designed to convert Ghana from a poverty-stricken country into a middle-income category country by 2015.

Progress has been made in the liberalisation of key markets, and the private sector has been assigned the driving role in this process. The country's macroeconomic management has improved, and in August 2004 Ghana finally met the Highly-indebted Poor Country (HIPC) criteria.

However, so far government institutions do not yet seem to have adapted to their new roles. Domestic and foreign investors are still confronted with numerous unnecessary and time-consuming procedures, corrupt public services and weak infrastructure. All investor climate indices place Ghana low down in the country tables, without having made any substantial progress.

Economic growth has been at around 4 to 5% for several years. However, this growth was driven by the country's two booming traditional commodity markets, gold and cocoa, and this has failed to result in a substantial reduction in poverty.

Private sector organisations are incapable of challenging the government in a constructive and proactive manner. The private sector has no capacity for research or systematic, proactive advocacy. Dialogue processes are undertaken at many levels and platforms, with the government setting the agendas. Private sector organisations must contribute more to ensure a better business environment. Technical assistance can make an important contribution in this regard by supporting capacity building.

Substantial financial donor contributions are delivered through Multi-donor Budget Support (MDBS), through sector baskets and through so-called stand-alone project interventions. Within the private sector development segment alone, a recent study has counted more than a hundred projects.

Over the last two years, donors and the government have worked hard to align their contributions with the aim of achieving a better business environment. A Memorandum of Understanding (MoU) and a composite work plan were signed in May 2005. As a result, Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH technical cooperation projects and programs need to be embedded into a framework of government programs and donor contributions.

The strength of German technical cooperation projects is their close involvement with implementing organisations in the public and private sectors. This form of cooperation is greatly appreciated by many partner organisations.

Providing substantial amounts of aid money upfront for public programs is a key risk in countries that have poor economic management systems in place and inefficient public sectors where corruption is widespread. Technical cooperation can reduce these risks by building capacity and improving services.

The yardstick for technical cooperation is the impact it has on the business environment vis-à-vis the required resources. Each project and program has to pass such a test on its own. Impact monitoring as a binding tool for project/program management is a step in the right direction, but this is also a form of work in progress. More needs to be done in this direction, together with our partner organisations.

The Promotion of the Private Sector (PPS) Ghana project clearly illustrates the transition process of German technical cooperation in the field of private sector promotion (*promotion of economic development*). In its initial phase, the project delivered special services directly to investors and exporters. In its current phase, the project is supporting capacity-building measures of intermediate organisations which provide services for investors and exporters*.

Currently the project is undergoing a review and redesign process in order to formulate a revised concept that can be embedded into a national program and harmonised with the goals of other development partners. The aim here is to deliver more significant and effective contributions towards achieving an "enabling environment" in Ghana by generating more synergies with other WIRAM[1] components and/or German sectoral programs in Ghana.

In its current phase the project has not developed any innovative tools which need to be presented here, but it has managed to integrate project management into a process that may have far-reaching implications for technical cooperation. The coordination of donor contributions into government programs has reached an advanced level in Ghana. MDBS and basket funding are the modes of delivery that are preferred by the government and public institutions. On the donor side, substantial amounts are provided by the International Monetary Fund (IMF), the World Bank, the UK Department for International Development (DfID), the Danish International Development Agency (DANIDA) and the European Union (EU). Germany has contributed too, albeit at conservative levels. Indeed, conventional technical cooperation is facing serious criticism, although surprisingly enough it is often recommended by practitioners of donor organisations that focus on financial contributions.

This paper does not attempt to discuss the pros and cons or even to deliver a judgement about the respective merits of funding aid vis-à-vis technical cooperation. It simply presents some practical experiences gathered and lessons learned. At first sight, these may not appear to favour technical cooperation; however, when seen in the broader perspective of complex economic reform processes, some important advantages become visible.

This paper is organised as follows. Chapter 1 briefly describes the background of economic development in Ghana and the characteristics of the recent economic reform process. It explains the role of development partners in Ghana and provides an overview of GTZ's contributions in the relevant areas. Chapter 2 describes the current approach and concept of the PPS Ghana

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[1] WIRAM stands for Wirtschaftsreform und Aufbau der Marktwirtschaft, or "Economic Reform and Development of the Market System".

project. It highlights the challenges met and lessons learned during project implementation. Finally, Chapter 3 draws some more general conclusions and makes some recommendations.

2 The Business Environment in Ghana

Ghana's Economic Development

In order to obtain a better understanding of Ghana's economic or business environment, one should first take a short look at recent historical developments.

The post-war Gold Coast was a model colony of the British Empire, endowed with a relatively advanced infrastructure and network of social service institutions in the fields of health and education. These facilities were financed with the proceeds from cocoa and gold exports. Upon independence, the country – now renamed Ghana – had accumulated a level of wealth comparable to today's middle-income countries.

With independence, the idea of "Pan-African Socialism" gained swift acceptance within Ghanaian and other African political circles, and Dr Nkrumah, the first Ghanaian leader after independence, was one of the leading protagonists of this movement. In Ghana itself the new paradigm created such aspirations as free education, a health service, mass housing and public transport. Substantial investment into industrialisation and ambitious infrastructure projects were financed from the financial reserves accrued during pre-independence. The state soon became the dominating economic actor, managing all areas of production and trade through government-controlled enterprises.

In 1965/66 the international cocoa markets collapsed, partly caused by Ghana's own ever-increasing production. This drastically exposed the vulnerability of a mono-crop economy. Since then, there have been ups and downs in economic fortunes, following the international markets of cocoa, gold and timber, Ghana's three main export commodities. The disintegration of the economy was further aggravated by poor management of public institutions and state-owned enterprises. Capital flight rather than capital inflows became the rule. Not only did the volume of investments continue to decline, but even the maintenance of existing assets and infrastructure was grossly neglected, and the provision of basic public services almost collapsed.

In 1992, when democracy was restored, average productivity and real income had fallen to very low levels, with the vast majority of Ghanaians living in absolute poverty. However, even after the restoration of democracy, poor fiscal and macroeconomic management continued, with inflation rates above 50% the norm. Until the end of the last century, Ghana's economy continued to be dominated by state-controlled enterprises. The public sector accounted for more than 50% of formal employment, and agriculture remained the main source of income and employment for the majority of Ghanaians.

3 The Economic Reform Process

Since 2000, however, there has been a significant improvement in economic management, and some degree of economic stability has been restored. A new liberal government paved the way for a revitalisation of the private sector, liberalising markets, privatising several public enterprises, and declaring export-led growth of 7% GDP per annum (p.a.) as a strategic objective. The government's official target is to achieve a "world-class business environment".

The Poverty Reduction Strategy I was launched in 2002 and provided an overarching framework for other policies. Various other sectoral strategies followed, such as the Private Sector Development Strategy, the Trade Policy and Trade Sector Reform Program, the Agricultural Sector Strategy, and the Public Sector Reform Policy.

Ghana's key economic objective is rapid economic growth of 7% p.a., led by non-traditional exports (NTE[2]). Ghana's abundance of water resources and its tropical climate make it suitable for the production of many fresh agricultural products throughout the year. In addition, large areas of sweet water provide enormous potential for fish farming, while the Atlantic Ocean offers an excellent source of fresh fish for export and local consumption. Ghana's relative proximity to European markets offers clear advantages for these products.

In order to realise these opportunities, foreign investment plays a key role. Foreign Direct Investment (FDI) not only provides the much-needed financial resources, but also ensures technical know-how and market access. In order to attract more FDI, two strategies are essential: first, the need to improve the business environment; and second, the need to promote specific opportunities in target markets. Improving the Ghanaian business environment is not only important to attract foreigners, but also for the development of local business. A flourishing local economy is the best possible tool, and will automatically attract more foreign investors. These principles are laid down in Ghana's Investment Policy.[3] The Ghana Investment Promotion Centre (GIPC) has been mandated to promote the country as a destination for FDI.

Regional integration is instrumental for the industrial development of Ghana. Even though most Economic Community Of West African States (ECOWAS) markets are even smaller than Ghana's home market and difficult to penetrate, they still provide an opportunity for the Ghanaian manufacturing industry, which lacks any other realistic option. Consequently the Ghanaian government has declared the integration of regional markets to be another strategic goal.

However, the reform concepts applied do appear somewhat inconsistent – which comes as no real surprise, after only half a decade of serious political and economic reforms. The following ambiguities remain:

- The government has proclaimed that a liberal market system driven by the private sector is its goal, yet it continues to distort essential markets and keeps unnecessary regulations in place.
- The crucial Public Sector Reform has lost momentum. Staff capacity and quality remain virtually unchanged.
- Public institutions maintain numerous instruments to control private sector activities.
- The politically sensitive reform of land registration has not even been touched upon.
- The privatisation of state-owned enterprises has been half-hearted. Essential services are still provided by inefficient state-owned enterprises.
- Anti-corruption programs exist, but corruption is still widespread.

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[2] This term comprises all export products apart from unprocessed cocoa, gold and timber logs.

[3] Ghana Investment Policy, Geneva 2003.

- Agricultural development is seen as being instrumental in the fight against rural poverty, yet cocoa farmers are effectively the most heavily taxed economic group in Ghana.
- Ghanaian exports to neighbouring countries must overcome not only many non-tariff barriers in target markets, but also many home-made administrative constraints.
- Infrastructure rehabilitation is underway, but progress is often too slow.
- The Bank of Ghana has embarked on a stringent fiscal policy, but the government borrows heavily on the local market in order to finance expensive consumer subsidies.

Consequently, the results of policy reforms are equally mixed:

- The economy has grown within the range of 4 to 5% p.a., which is in itself a good result, but not good enough to achieve a significant reduction in poverty, especially considering that the country had benefited from several boom years in cocoa and gold exports.
- The informal sector in rural and urban areas still provides more than 90% of employment opportunities.
- FDI, which is urgently required for the diversification of the economy, still oscillates at far below target levels.
- The export structure is starting to show the first signs of diversification, but the economy still depends on export revenue from cocoa and gold, which together contribute 76,3% (2004) to the total export revenue.
- Poverty has been reduced, but mainly in the southern parts of the country. More than 80% of the population in the northern parts is still extremely poor.
- Inflation and interest rates have been reduced, but are still high compared to international standards.
- Public services are not delivered efficiently and substantially increase the cost of production for local producers, as well as delay the implementation of projects.

4 The Role of Development Partners

Development partners (DPs) and the government agree that concerted efforts are needed to drive the ambitious reform process further. In 2003 and 2004 the Private Sector Development Strategy and the Trade Policy were developed after intensive consultation with private sector organisations and other parts of the civil society.

Substantial financial donor contributions are delivered through MDBS, through sector baskets and through so-called stand-alone project interventions. A recent study counted more than a hundred projects within the private sector development segment alone. In June 2005, all DPs signed a memorandum committing themselves to contributing towards these strategies in a coordinated manner. Some DPs have opted to support the implementation processes through special basket funding mechanisms, while others, including the German government, have chosen to provide direct support in the form of projects.

An Oversight Committee, composed of the government, private sector representatives and DPs, was formed to oversee and monitor the complex process.

Various committees form part of the consultation mechanisms. The Ghanaian government submits documents, plans and budgets for discussion. DPs then provide their comments after internal consultation, and every three months a progress review is carried out. Reports are discussed again and commented. The amount of proposals, monitoring reports and other documents handled does not however usually permit a detailed technical discussion.

In spite of the substantial financial contributions received from the international donor community, the Ghanaian government is clearly the driving force in this process and follows its own vision of economic development.

GTZ project staff are also actively involved in the various sectoral consultation processes. Some inputs are provided in the form of research, impact monitoring, best practice discussions, thematic conferences, etc., albeit mostly on an ad hoc basis.

4 GTZ Contributions towards Economic Reform and Market Systems Development

Since 2003, Germany and Ghana have agreed on three focal areas of economic cooperation: Good Governance, Agricultural Development, and Economic Reform and Development of the Market System (WIRAM). Within the WIRAM focal area, contributions are delivered through a variety of projects. The following table provides an overview of these:

Table 1: GTZ Ghana: Economic Reform and Market Systems Development Components

Level	Area of Cooperation
National (Macro) Level	**Improve taxation systems**
Institutional (Meso) Level	**Reduce business registration time for foreign investors**
	Enable selected private sector organisations in rural and urban areas to participate competently and proactively in the public-private policy dialogue
	Strengthen the capacity of selected private sector organisations to provide services to members and other businesses
Micro Level	**Improve access to funding for micro, small and medium-sized enterprises (MSMEs)**
	Support the development of non-financial services (business development services, BDS) for micro enterprises in urban and rural areas

A program for Market-oriented Agricultural Development (MOAP) applies the value-added-chain approach and has many interfaces with WIRAM. In addition, the Good Governance Program, with its Anti-Corruption and Reform of Land Registration components, provides important contributions towards achieving an enabling environment. GTZ also actively participates in the consultation process between DPs and the government on public sector policies, strategies and programs.

Projects are implemented with public and private sector organisations. Ministries are the political partners.

5 The Core Problem

Local and international investors are still confronted with numerous obstacles and a business environment which requires much improvement. These constraints have been well researched and documented by numerous studies. The most important constraints are the following:

- Multiple legal systems (traditional and British-based "modern law" exist in parallel). This creates insecurity, especially among foreign investors, and can make contract enforcement difficult.
- Land ownership is based on traditional laws, which creates a high level of insecurity for investors. Access to finance is therefore restricted, since land is generally not accepted as bankable security.
- Interest rates and inflation are still high in comparison to international levels.
- Markets are very small for most manufactured products and do not permit the use of economies of scale.
- The infrastructure is inadequate in many export-relevant areas: roads, ports, communications, utilities and energy, storage facilities, cool houses, market information systems, etc.
- Public service institutions are inefficient. Many bureaucratic procedures are not transparent and are extremely time-consuming, causing long delays and creating high transaction costs for business. Consequently, the level of corruption remains very high.
- Private sector organisations are weak and often depend on donor support. They are incapable of involving government proactively in a constructive dialogue.
- The qualification levels and productivity of the workforce are very low, which balances out the advantage of relatively low wages.
- The number of start-ups has increased substantially, but the owners/management of these companies lack the skills and know-how required for their successful development.

For local companies, high interest rates and limited access to capital are often quoted as the main restrictions for growth. For foreign companies, on the other hand, the most important hurdles for investment are the insecurity resulting from the pluralistic legal system and traditional landownership structures. Furthermore, bureaucratic procedures and inefficient public services create high transaction costs for all businesses.

6 Intended Development Goals, Purpose and Outputs

Following the government's national strategies, the project is designed to stimulate local and foreign investment in and exports to regional and international markets.

Project Purpose	To enable exporters and investors to implement their business plans more efficiently and effectively.
Output 1	Selected public and private institutions are strengthened, enabling them to observe good practice in the formulation and implementation of sectoral policies.
Output 2	GIPC's ability to serve investors efficiently and to attract foreign direct investment is enhanced.
Output 3	Selected providers of business services are supported, enabling them to offer investment and export-relevant services.

GIPC is nominated by the government as the implementation partner. Partners in the private sector consist of private sector organisations that fulfil requirements in terms of basic organisational structures, democratically legitimated leadership and regular financial reporting.

7 The Approach and Lessons learned

Output 1	Selected public and private institutions are strengthened, enabling them to observe good practice in the formulation and implementation of sectoral policies

Business associations provide services for their members and, even more importantly, engage themselves in a permanent dialogue with governments. The purpose of this dialogue is to improve the business environment for their members. The advocacy of business associations usually requires many contributions from the elected leadership. However, the time the elected leaders spend in numerous meetings, conferences and missions cannot be invested in the development of their own companies. They therefore often tend to promote their own interests and may neglect the general economic consequences of their lobbying activities. If qualified professionals are recruited, lobbying becomes a financial burden for organisations that rely on membership contributions. On the other hand, the entire sector or even the Ghanaian economy as a whole may eventually benefit from such activities (the so-called free-rider problem).

Most private sector organisations are financially weak and more or less depend on donor support. Developing in-house capacity for dialogue is a relatively expensive undertaking for such organisations. Returns in the form of increased membership are only realised after some delay. This is especially true in a country such as Ghana, where private sector organisations have a very short history. In such a situation, the provision of services for members promises faster returns and becomes a necessary survival strategy.

Initially the project concept had envisaged identifying and introducing best practices in respect of relevant sectoral policies into the dialogue process between private sector organisations and the government. The staff of partner organisations were to be sensitised and educated accordingly. In a second step, staff members should be enabled to develop their own proposals and to incorporate these into the process.

A first screening of partner organisations showed that none of them possessed the required personnel resources and the approach therefore had to be revised. Obviously the partner organisations of the PPS project required strategies that could be implemented without additional or specialised staff.

One organisation, the Ghanaian-German Economic Association[4], chose to conduct regular panel discussions on current topics ranging from corporate taxation, the environment and energy, new legislation on health insurance, the public budget, communication and IT to international trade and general economic development. Ministers and chief executives of key agencies usually attend and are willing to debate directly with the members of the business community. After an initially low response on the side of the business community, these events have now become quite popular. Participants usually contribute sufficient entrance fees, so the organisation can also retain a small surplus. However, there is as yet no systematic follow-up on topics discussed and issues raised.

In early 2004, DfID, DANIDA and the US Agency for International Development (USAID) established a new funding tool for private sector organisations engaged in advocacy activities, the Business Sector Advocacy Challenge (BUSAC) Fund. This supports research, workshops, media campaigns and study tours. After a successful pilot phase, the fund has since been expanded, and US$ 10 million was recently made available. These funds can be used by all private sector organisations in the formal and informal sectors.

Consequently, the PPS project intends to review its approach in this area with the aim of strengthening the capacities of consultants and other institutions that provide inputs in this process. Details will be worked out jointly with DPs and stakeholders.

Lessons learned:

- Technical cooperation strengthens the capacity to generate income from services and thus builds the basis for advocacy.
- Donor support for the development of in-house capacity is warranted in view of the free-rider problem that is attached to lobbying and advocacy. Donor support should entail a technical component to ensure that sound economic principles are adhered to and that lobbying for specific interests is avoided.
- Alternative approaches designed to support the public-private dialogue should be included in the project design.

Output 2	GIPC's ability to serve investors efficiently and to attract foreign direct investment is enhanced.

GIPC's mandate is to promote Ghana as a destination for FDI and to monitor foreign investors. It should also provide support services until foreign investors' projects are operational. As GIPC's roots are as a regulatory authority, the monitoring of investors is still perceived as an important part of its mandate.

In 2003 GIPC contracted a consultant with the task of developing a strategic plan for the period 2003 to 2008. The strategic plan describes the necessary steps for the transformation of GIPC into an organisation delivering essential services for investors and actively promoting Ghana as a destination for FDI. In the absence of sufficient funding from the government, GIPC requires

4 This is a membership organisation delivering chamber-like services with the aim of furthering economic relations between Ghana and Germany. Its members are either German investors or Ghanaian exporters.

the assistance of multinational donor organisations for its costly promotional activities. For political reasons, the establishment of a so-called One-Stop Shop (OSS) became the most important project. Hence, GIPC requested support from PPS for this project.

GIPC's initial concept had envisaged involving 14 other organisations in the registration process of foreign investors. After some deliberations, the concept was revised and it was agreed that only four key institutions would delegate staff members to the GIPC OSS office. The PPS project provided some funding for the equipment and organised study tours to other successful investment promotion agencies in east Africa, Asia and Europe. A task force was established to work out operational details for the new OSS, and MoUs were negotiated with the other agencies. However, the process could not be carried forward as the other agencies were unwilling to surrender any authority to GIPC. In the end, only two agencies delegated junior staff, thus forcing GIPC to review the concept again barely half a year after setting up the OSS office. This review is still ongoing.

Do "One-Stop Shops" Work?*

Foreign investors need to obtain a myriad of licences, permits, clearances and registration certificates from different authorities: tax authorities, business registration offices, central banks, Immigration, Customs, export authorities, land registration and/or environmental, safety and health protection agencies, to name just a few. They have to deal with central, regional and municipal authorities, labour offices, etc. A delay in any of these steps will result in additional costs and lost revenue. Any delay in approval, permit or clearance can jeopardise the entire project.

Giving the complexity of this process, the concept of an OSS seems very appealing. An investor would thus have to deal with just one institution to complete all the necessary paperwork.

In practice, however, there is hardly anywhere in the world where such a mechanism exists. All governments that have tried to implement an OSS encountered significant resistance from the various agencies and authorities responsible for the different procedures. Governments therefore instead tend to introduce some form of coordination mechanism and delegate staff from various agencies to establish their offices in the same location, usually an investment promotion agency.

However, even such an approach often faces stiff resistance from involved ministries and agencies, since they fear incursions into their fields of responsibility. Often these authorities only delegate junior staff to the OSS who have no authority to grant approvals. The OSS thus becomes simply a mailbox operation where investors submit their applications. Investors complain that little has changed, except that one more procedural step has been added.

So far as the project is aware, there are only three examples worldwide where the OSS concept works successfully, namely Singapore, Malaysia and Ireland. It is worthwhile noting that these agencies did not receive a strong and all-embracing legal mandate, but instead are fully supported at senior governmental levels. All three countries declared the attraction of FDI to be the cornerstone of their development strategies, and the OSSs enjoyed goodwill and the cooperation of involved agencies. It is also important to note that these countries have reduced the numbers of licences required and have introduced other reforms geared towards eliminating obstacles to investment.

*** Extract from F. Sander, *Do "One-Stop Shops" Work?*, Foreign Investment Advisor Service (FIAS), World Bank, 2003.**

When planning the OSS, both GIPC and GTZ underestimated the degree of resistance within the involved institutions. Although the OSS was a project supported by the President of Ghana himself, this nevertheless did not result in sufficient cooperation from other agencies. This is rather symbolic of the situation in Ghana, where the new policy of a liberal, private sector-driven development agenda still needs to be translated into action. Many staff members in public service institutions are still pursuing their old agendas and seek to maintain the status quo, rather than embracing change.

Lesson learned:

A reform measure involving several institutions that all need to relinquish some authority must ensure the full support of all involved before the project is planned and implemented.

Output 3	Selected providers of business services are supported, enabling them to offer investment and export-relevant services.

The business services market in Ghana is basically split into four segments[5]:

1. International consulting companies.
2. Local consulting companies working with the government and donor organisations.
3. Small professional firms or individuals (accounts and bookkeeping, legal advice, taxation and financial consultancy.
4. Small-scale service providers (copy shops, mobile telephone booths, agencies, brokers, etc.).

International consulting companies tend to charge fees that small and medium-sized enterprises (SMEs) cannot afford. The same applies to local companies working with the government and with donor organisations. There are hardly any qualified business consultants providing affordable services for SMEs. The fourth segment is well developed but does not provide development-relevant services.

For their part, small businesses shy away from procuring external services as they find them too expensive.[6]

Some private sector organisations are however trying to fill this gap and offer specific services. The most frequently demanded ones are market information, access to markets and finance, networking among members, and information about important legal developments. Members are willing to pay services at cost-covering rates, which should be below the usual market rates as they already pay a membership fee.

The PPS project cooperates with several of these organisations in two main ways: a) by supporting the development of the service delivery capacities of these organisations; and b) by providing inputs for the development of new services which are to be delivered by the partner organisation (PO) itself. The following example illustrates this approach:

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5 In addition an unknown number of informal agents or consultants exist who "assist" business people in the processing of licences, permits, etc. This service has emerged as a reaction against time-consuming bureaucratic procedures as well as the generally corrupt practices that prevail in many government offices.

6 A. N. Bentum, *Research on Business Service Markets in Ghana for Micro and Small Enterprises*, May 2005, funded by SPEED Ghana.

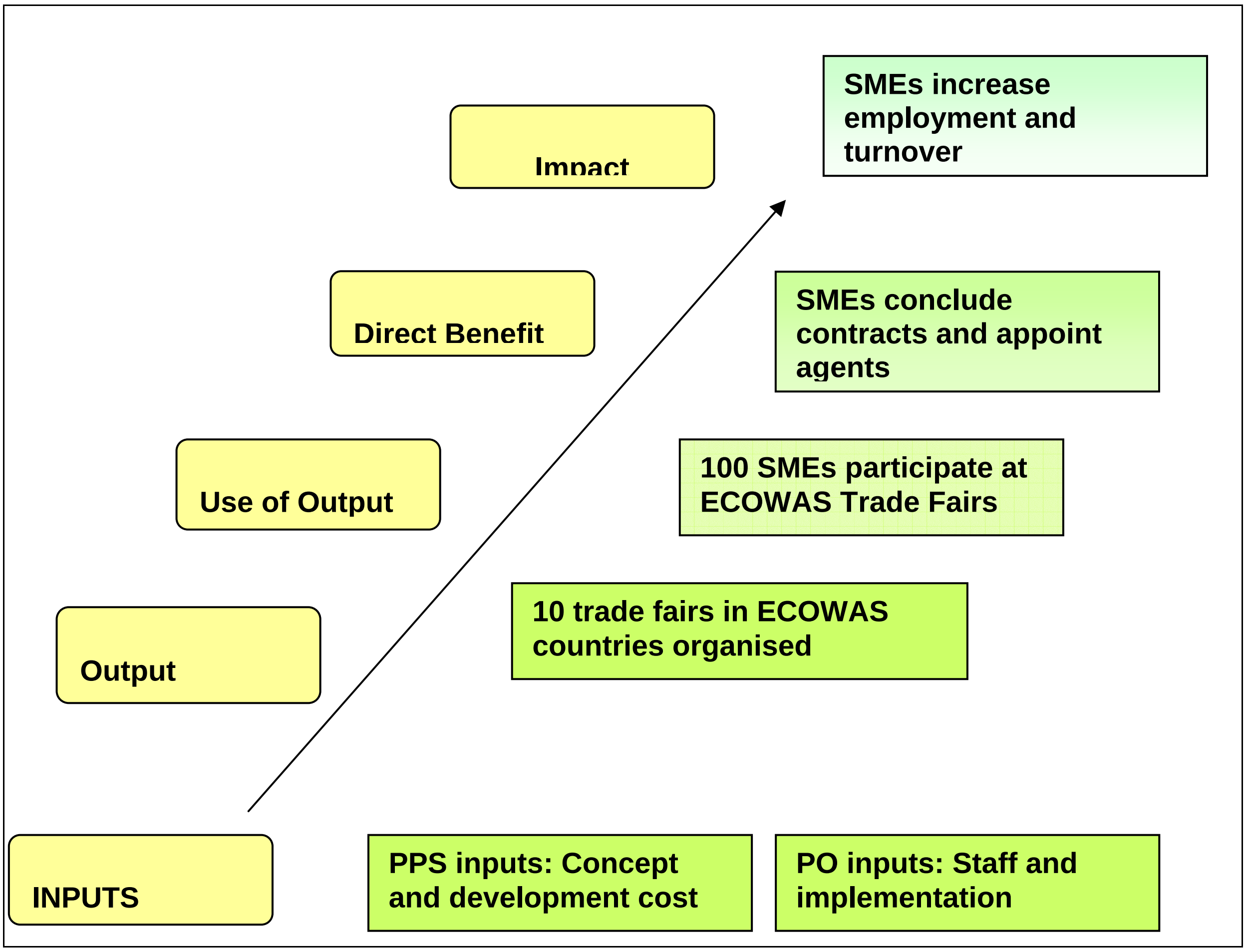

SMEs increase employment and turnover
Impact
Direct Benefit
SMEs conclude contracts and appoint agents
Use of Output
100 SMEs participate at ECOWAS Trade Fairs
Output
10 trade fairs in ECOWAS countries organised
INPUTS
PPS inputs: Concept and development cost
PO inputs: Staff and implementation

Table: Overview of PPS cooperation with private sector organisations

Organisation	Short Description	Details of PPS Cooperation
Association of Ghana Industries (AGI)	AGI is the leading organisation representing the industrial sector. It has about 300 paid-up members and offers a broad range of services from lobbying and advocacy to BDS and consultancy	1. Training for management and various staff members on business/management consultancy, taxation, internet market research, organising of trade fairs, profitable environmental management 2. Setting up of a Trade Information Desk providing market information for ECOWAS 3. Provision of financial support for organisation of ten "Ghana Solo" exhibitions in ECOWAS countries 4. Provision of financial support for one SME joint stand at ECOWAS "Ghana Solo" Exhibitions 5. Creation of a concept for a new technical consulting service for SME (Quality Management, production standards, process management, etc.)
Aid to Artisans Ghana (ATAG)	A Ghanaian non-governmental organisation furthering the development of handicraft producers in Ghana	1. Support of a strategic planning process 2. Development of a Fair Trade Business Concept 3. Support for the implementation of fair trade business
Craft Consortium	An association of furniture producers with good export potential	1. Conduct of a market survey in Germany 2. Provision of marketing consultancy
Federation of Associations of Ghanaian Exporters (FAGE)	An umbrella organisation of approximately 16 exporter associations	1. Development of a concept and business plan for an internet-based trade information system, to deliver up-to-date market and trade information to producers, exporters, institutions and the government

Organisation	Short Description	Details of PPS Cooperation
		2. Implementation will be supported commencing 2006
Ghanaian German Economic Association (GGEA)	**GGEA is a chamber-like business organisation with approximately 55 paid-up members. It was founded by German investors in Ghana and Ghanaians with a business interest in Germany. GGEA aims to further the bilateral economic relations between the two countries**	**1. Provision of office equipment and upgrading of IT systems** **2. Support of strategic planning process and improvement of the constitution** **3. Development of web pages and databases** **4. Creation of a newsletter concept and distribution system** **5. Development of a "Business Guide Germany" and a "Business Guide Ghana"** **6. Support of networking activities in Ghana and Germany** **7. Organisation of fora on current topics** **8. Training of staff**

Inputs provided by the PPS project include: market or demand analysis, concept development and, at a low level, provision of equipment. The strengthening of management capacities and structures represents another important contribution. Also worth mentioning in this regard are strengths, weaknesses, opportunities and threats (SWOT) analysis, stakeholder analysis and strategic planning processes. The skills of staff members may be improved through the provision of tailor-made training. The partner organisations are expected to cover operational and staff expenses in this regard.

The expected direct benefits of the above are either additional income for the partner organisations or increased membership. The expected impacts are increased membership satisfaction, additional exports, cost reductions and improved productivity.

The actual results achieved do of course to a large extent depend on the motivation and qualification of the management and staff of partner organisations. One organisation for example has gone through a complete change of leadership, with extremely negative consequences for the entire organisation as its financial situation deteriorated and qualified staff left, overloading the remaining staff. In a second organisation, key staff left to pursue further studies abroad, while in a third, the withdrawal of support by a major donor for internal reasons triggered a drastic restructuring process.

Lessons learned:

- The provision of business development services (BDS) is an essential strategy for private sector organisations, especially when they represent smaller businesses. Only organisations which can offer services at reasonable quality and fees enhance their status and are able to increase their membership base.
- Most organisations do not calculate the cost of specific services and do not prepare sound business plans. Donor support reduces the risks but can also reduce the need to plan carefully. The donor dependency of private sector organisations in Ghana is high.
- Donor support for the development of business organisations should be based on existing structures. This ensures that absorption capacities are observed. However, it also makes it more difficult to achieve a fast and significant impact. It is often tempting to assume the operational costs of a partner organisation, just to make things happen – yet without sound prospects of sustainability, such an "impact" will not last beyond the lifespan of the project. Significant contributions by partner organisations, on the other hand, ensure ownership.
- The actual achievements depend to a great extent on the motivation and qualification of management and staff of partner organisations. Projects may fail owing to internal problems of organisations. It is important to establish close relations with staff and management and to deal with any future problems as they emerge.

8 Conclusions and Recommendations

Administrative procedures can pose serious impediments, even in countries with a relatively liberal investment climate. Broad policy reforms do not always translate into improvements in the various bureaucratic processes that business people have to undergo.

Cooperation with an institution requires good knowledge about its strengths and weaknesses, especially when these are not related to physical infrastructure or a lack of funding, but instead deficiencies in management and internal communication. In many cases, vested interests are the driving forces within an organisation. Knowledge about these vested interests is therefore key to understanding the situation. Only then may change processes be successfully initiated from within. If the leadership is development-oriented and proper management principles are applied, technical cooperation can deliver good results and support management in the capacity-building process of any public institution or private sector organisation.

Whereas in the past German technical cooperation was usually delivered as a stand-alone project specifically designed to tackle an identified core problem jointly with one partner organisation, technical cooperation today must be embedded not only into a German Focal Sector Program, but must be delivered as an integrated element of national development policies and strategies. Programs need to be aligned with other donor programs.

Some Key Lessons Learned

Administrative procedures can pose serious impediments, even in countries with a relatively liberal investment climate. Broad policy reforms do not always translate into improvements in the various bureaucratic processes that business people have to undergo.

Providing substantial amounts of aid money upfront for public reform programs is a key risk in countries that have poor economic management systems in place and inefficient public sectors where corruption is widespread. Technical cooperation can reduce these risks by building capacity and improving public services.

Without a strong private sector, private sector-driven development is impossible. By building dialogue and advocacy capacity in private sector organisations, technical cooperation can make an important contribution to creating a more conducive or enabling environment.

The strength of German technical cooperation projects is their close involvement with implementing organisations in the public and private sectors. This form of cooperation is indeed greatly appreciated by many partner organisations.

How a business membership organization can contribute to improving the business environment in Northeast Brazil

Martin Wahl and Ralf Meier

The state of Pernambuco in Northeast Brazil belongs to the least developed parts of the country. Its poverty level is similar to Central African countries. With almost 100,000 employees the clothing industry is the second most important economic sector. 120 km west of the capital Recife *a major cluster of garment firms emerged in the cities of Caruaru, Toritama and Santa Cruz. The industry is characterized by a high degree of informal enterprises producing relatively low qualities that are sold at cheap prices. The region is Brazil's major manufacturer of jeans generating a lot of wastewater.*

SINDIVEST-PE is the employers' association of the formal garment firms in the state of Pernambuco. Up to 1996 this association only represented a small group of enterprises in Recife. SINDIVEST-PE had no connection to the cluster region and no office there. Besides organizing wage negotiations with the unions, SINDIVEST-PE offered no business services. In 1997 a new board and a new president were elected and SINDIVEST-PE became more active. It established contact to the Training and Development Centers of the Bavarian Employers' Associations (bfz) and initiated a Partnership Project funded by the German Ministry for Economic Cooperation and Development.

Major achievements of the project have been:

Environmental Protection

As enterprises in the cluster region discharged untreated waste waters into the rivers, an ecological time bomb threatened the whole region and at the same time shortage of water lead to economic problems for the enterprises. The association brought together public authorities, technicians and entrepreneurs and moderated round table meetings. Furthermore, the association mobilized technical assistance from Germany for building up a pilot waste water treatment plant. Up to now, 19 plants (responsible for 70 % of production) have been established by the industry considerably reducing the problem of environmental pollution and enabling the industry to continue its production.

Qualification and Product Quality

Until recently, the garments produced in Pernambuco were of low quality and cheap. With growing competition from Asian producers firms had to improve design and quality of their products. Training for garment technicians, however, was almost unavailable anywhere in the State of Pernambuco. The association lobbied successfully for new training facilities and established contacts to the parastatal National Institution for Vocational Training (SENAI). Today, 3 new vocational training centers have been established adapting its training services to the needs of local enterprises. The association is a member of the advisory committee of the parastatal training provider and supervises the quality of the training as well as the development of new curricula.

Taxation and Regulation

The high percentage of more than 90 % of informal enterprises in the industry was a problem for government in terms of regulation and control as well as for the enterprises in terms of interest representation and access to official support programs. The entrepreneurs named bureaucracy and a high tax burden as major reasons for being informal. The association established contacts with state government in order to discuss this issue. In the end, the association successfully lobbied for a reduction of the sales tax on products of the sector and also established a one-stop shop for registration of enterprises. In the first month after the decision was taken 1000 informal enterprises officially registered.

The project has demonstrated how a business membership organization can act as a successful facilitator for major advances in the framework conditions of a specific sector. The association started with a very general approach by asking itself: "How can we become more attractive to potential members and support the sector to prosper?" From discussions with members and non-members the association identified environment, product quality and regulation / taxation as crucial issues for the further development of the garment industry in the state. It decided on various activities on the micro and macro level to deal with these issues. The German partner supported the association mainly with expertise and staff training.

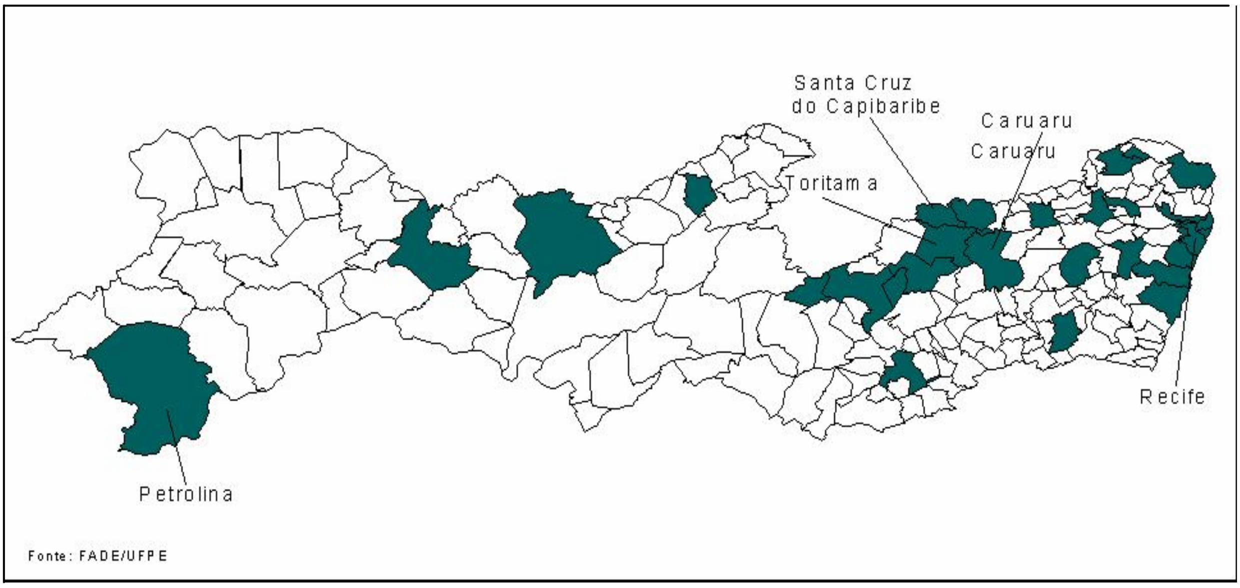
Some lessons learned are as follows:

- A business membership organization can become the driving force for change in a sector.
- Twinning up with an international partner can help a business membership organization to bring about new ideas and to create a constituency for change.
- A committed leadership having social responsibility and open for change is a decisive factor of success when working with business membership organizations.
- Networking between business membership organizations and governmental promotion agencies will result in better and more demand-oriented services answering the industries' needs.
- Governments are interested in communicating and cooperating with business membership organizations if they deliver concrete proposals based on proved data.
- A multi-level approach combining enforced regulations on the macro level with concrete solutions on the enterprise level will often be more sustainable than isolated activities.

2 Background and core problem

The state of Pernambuco in Northeast Brazil belongs to the least developed parts of the country. Its poverty level is similar to Central African countries. Sixty percent of the urban population (75% of the total population) lives at or below the poverty line. With almost 100,000 employees the clothing industry is the second most important economic sector in the state. 120 km west of the capital Recife a major cluster of garment firms emerged in the cities of Caruaru, Toritama and Santa Cruz.

Municipalities with clothing industry in Pernambuco



However, the development of this cluster was (and to a certain degree still is) very unstable. Major problems were:

- Insufficient product quality
- A lack of demand-oriented vocational training
- Unsolved waste-water problems
- Low product diversification

Additional problems were caused by the sector's high informality rate of about 90% (national average: 60%). Informality reduces the incentives and possibilities for companies to invest in personnel and technology. Access to bank loans is blocked and the possibility of taking action against customers who fail to pay is diminished. Moreover, parastatal training and SME promotion agencies, which are financed by taxes paid by the state's formally registered enterprises, were not interested in investing in the informal sector or region.

SINDIVEST-PE (Sindicato das Indústrias do Vestuário do Estado de Pernambuco) is the employers' association of the garment industry in Pernambuco. It is the voice of the formal firms in the state. Up to 1996 this association was only active in the capital, Recife, and only represented a small group of enterprises located there. SINDIVEST-PE had no connection to the cities of the cluster region and no local office. Its main task was to conduct wage negotiations with the Sewers and Seamstresses Unions. No other service was effectively offered. Similar, there was no dialogue between SINDIVEST and the two most important public organizations for SME support in Brazil, the training agency SENAI and the SME promotion agency SEBRAE.

Together with 40 other employers' associations, SINDIVEST-PE is part of the Federation of Industries of Pernambuco (FIEPE). The system is financed by contributions of the formal sector. Registered firms pay a percentage of their registered capital. However, the associations' income acquired is insufficient since non-payment of membership rates occurs frequently, and merely serves to maintain a basic infrastructure.

3 The project and the intended development goals

After the election of a new board of directors in 1997 SINDIVEST became more active. The new leaders wanted SINDIVEST to become attractive for all firms in the sector. They decided to change the management of the association, looked for new services to members and potential members and searched for opportunities to make the development of the clothing industry in Pernambuco more sustainable.

To realize these objectives, SINDIVEST looked for national and international help. Through contact with the German development agency GTZ, SINDIVEST came in touch with the bfz in Germany. Bfz are the Training and Development Centers of the Bavarian Employers' Associations. With a permanent staff of 1,800, bfz is Germany's largest training institution on the employers' side. Bfz and SINDIVEST contacted the Bonn-based Foundation for Economic Development and Vocational Training (SEQUA). SEQUA is the development agency of the German chambers and employers’ associations. It mobilizes the know-how and expertise of this network for the benefit of international private sector development.

Financed by the Federal Ministry for Economic Cooperation and Development (BMZ), SEQUA is running the so called Partnership Program. Within this Program German chambers and employers' associations are cooperating with similar business membership organizations in developing countries. The overall objective of these Partnership Projects between the two organizations is contribution to the development of small and medium enterprises in the developing countries. Major issues of the about 40 projects worldwide are:

- Improving business services for small and medium enterprises
- Strengthening organizational capacities of business membership organizations
- Supporting policy dialogue between public and private sector

In 1997 SINDIVEST and bfz initiated such a Partnership Project. During an orientation phase they carried out a first set of activities and tested their understanding and possibilities for cooperation and exchange. Based on a fact-finding mission and a joint planning workshop they started implementation of project measures. The project goal was to improve the framework conditions for the sector's small and medium-sized enterprises and to strengthen SINDIVEST as service and lobbying organization in all centers of the Pernambucan garment industry.

The targeted results were defined as follows:

- SINDIVEST has expanded the scope of its concerns and its services and has increased its representativeness for the clothing industry;

- SINDIVEST's activities are more effective and consolidated and have been extended to the entire state;
- Services, further training for garment technicians, and marketing campaigns for SMEs have been promoted, expanded and receive professional support;
- SINDIVEST's management and organizational structures have been improved and expanded;
- SINDIVEST's capacities for interest representation have been improved and expanded.

Both goals and results were relatively loosely defined, which allowed the project partners to themselves determine the best means and opportunities of achieving their intended results in the so-called “development corridor”. As we will see next, it was possible to identify some strategic areas, methods, and partners for a significant contribution to the sector; sometimes the choice of opportunities followed a strategic plan, at other times it was selected “intuitively” and therefore unplanned.

4 The approach

4. 1 Environmental protection

Background

Normally, the clothing industry doesn't have a strong impact on the environment. There is one exception, however: the production of denim. The process of washing one pair of jeans requires 50 liters of water. Highly toxic chemicals and various washing cycles are necessary to manufacture the different designs. Pernambuco's clothing cluster produces 15% of Brazil's overall jeans output (one million pieces per month). Located in the semi-arid Agreste region, the quantity of water required for the manufacturing process and the resultant price is the decisive economic factor for the jeans factories. Before the project, all industrial waste water was drained into the only river in the area, a stream that also supplies the drinking water for the local population. Public authorities like the prosecutor for environmental affairs did not enforce existing regulations because of the economic importance of the industry for this cluster region. What was worse, the contaminated water flowed into a reservoir that supplies drinking water to more than 80 cities and villages in the region. The water issue was identified as an ecological time bomb. At the same time, the economic survival of the denim plants was threatened by the shortage of water.

Project activities

- Organization of five educational trips to Germany for mixed groups consisting of engineers, representatives from official authorities, associations, development banks, as well as city administrations. These ”AmbiTec” study tours intended to convey know-how and create team spirit. They were covering such topics as integrated ecological solutions, water management, and Agenda 21.

- Informing the media about the imminent ecological catastrophe in the region. (the riskiest part of the activities), and using Bavarian ministry representatives as VIPs to create a public relation effect. Furthermore, talks with the state government of Pernambuco to create awareness on the ecological situation were initiated.
- Selection of a jeans factory with an innovation-oriented entrepreneur for a pilot case in Toritama where most of the jeans laundering facilities are located.
- Development of a pilot sewage treatment and water recycling plant that the selected entrepreneur was able to build with his own capital and local construction materials (20,000.00 USD).
- Regular visits by water engineers from bfz and the Bavarian water resources administration for advice and improvement of the pilot plant until successful operation was guaranteed.
- Counseling of SINDIVEST, the water authority and the public prosecutor for environmental affairs regarding possible measures to improve the situation.
- Initiating a course of environmental studies for engineers at the Federal University of Recife. Organizing a study project (ecological master plan) in Toritama.

Results

- A total of 120 qualified employees and executives from Pernambuco got to know environmental technology and management in Germany. They subsequently founded an alumni group called AmbiTec. The good contacts between them lead to an improvement in the cooperation between state ministries, local authorities, SINDIVEST and engineering consultants in Pernambuco.
- The pilot sewage plant reduced pollution loads by half and recycles 60 % of the waste water which is now reintroduced into the washing process. The pilot plant paid for itself within the course of a mere six months. The selected entrepreneur reports that his business has only been able to survive and expand thanks to this technology. He became president of the city's first employers' association and showcases the sewage treatment facility to many groups of visitors.
- The public prosecutor for environmental affairs demanded that the jeans washing plants in Toritama equip their facilities with sewage technology within one year. The public Technology Institute (ITEP) offered counseling services for implementation. The water authority conducted negotiations with the municipal government and officially acknowledged the water issue for the first time.
- Of the 50 jeans washing plants in the region, the nineteen largest ones—they are responsible for 70% of the production and the resultant environmental pollution—have installed sewage technology. They fulfill all environmental requirements and are now in the possession of official operating licenses.
- Informally run jeans washing plants registered their business and founded a sewage association as well as an employers' association for the city of Toritama, which became a member of SINDIVEST.

- SINDIVEST acts as a mediator between the public prosecutor, the municipal government and the Technology Institute (ITEP). The association recruited new members and is represented in the region.
- The state government pledged the means for a municipal sewage treatment and central water management plant after it was presented with the ecological master plan for Toritama. However, one has to take into account that there are almost no public funds for such kinds of investment in Brazil. SINDIVEST's strategy is therefore more directed towards the mobilization of private funds, especially those of employers. Here the key word is: Social responsibility.
- The environmental impact of the denim-washing plants was scientifically examined to determine possible ways and means of expanding them.

Developmental effects

Environmental legislation in Brazil meets European standards but it is not implemented in the Northeast of the country for several reasons. A lack of control and counseling as well as the absence of credit lines for the introduction of new technologies are just a few of them. Employing professional counseling, the project successfully implemented a customized technology which gave the supervising authorities the means to actively pursue a solution of the problem without having to close down businesses. A new kind of compromise was found (recognition of guidelines by SMEs, based on an agreed schedule of one year for implementation). The success for all sides guaranteed that there were no losers and encourages environmental authorities to finally become active in the hinterland.

Now, the process has begun in neighboring cities without the necessity of an involvement of the German partner. SINDIVEST has found a new role as a voice for the entrepreneurs vis-à-vis the authorities and the state government.

Teambuilding effects created by the AmbiTec study tours to Germany played a decisive part in the co-operation between the bodies involved. Many of the parties committed themselves much more than it is usual.

For the entrepreneurs, the economic advantages of the facility were more important than the ecological aspect.

The state government has yet to fulfill its financial promise.

4. 2 Qualification and product quality

Background

Pernambuco's garment industry was based on the processing of cloth remnants and the production of cheap clothing for the poorer classes of society. 90% of the SMEs were informal and usually copied garments. The seamstresses were trained by the owners who, in turn, did not have formal training either. Only a few businesses in Recife managed to sell their products to São Paolo or other markets in Brazil. Product quality was low and inconsistent. The service portfolio of the training agency SENAI was restricted to courses for seamstresses and served a number of larger formal businesses which were able to pay for the training. The SMEs complained that there were no skilled workers for the middle-management and that business were therefore incapable of expansion or even folded. Quality defects, a lack of experience and know-how on the management level and a lack of independent thinking and creativity where the design was concerned were the chief causes for the fact that almost all manufacturers concentrated on the low-price segment.

Project activities

- Organization of study tours to Germany, in order to acquaint participants with the professional training system at vocational schools and technical colleges. Participants belonged to SINDIVEST as well as to training institutions (SENAI);
- Visits to international trade fairs to learn about quality standards;
- Development of a training program for textile engineering organized by SINDIVEST;
- Supporting SINDIVEST for negotiations with SENAI on the creation of new training offers for the garment industry;
- Advising SENAI for setting-up new vocational training schools for technicians;
- Short term missions of vocational trainers of a German technical college for textile engineering who developed curricula for the training of technicians at SENAI and for design courses at the Recife University (UFPE);
- Supporting SINDIVEST for it's participation in a regional development program.

Results

In 1997 not more than 100 people participated in relevant training courses for the sector. In the year 2002 more than 1,000 people underwent training. The range of courses is broad and includes technical training as well as classes focused on general management issues, human resources, logistics as well as fashion & design. There are one-day seminars and courses lasting several days as well as 18-months training programs. The qualification measures pave the way towards specialization and diversification into different price segments and thus make an important contribution to the stabilization of the sector.

The training institution SENAI set up three technical colleges for textile engineers. The state government founded a technology center offering counseling.

The SME-promotion organization SEBRAE commissioned SINDIVEST to coordinate a regional development program for the clothing industry. SINDIVEST was able to influence the program's objectives and activities. At the same time, the association was able to create additional capacities since it was paid for its tasks by SEBRAE.

SINDIVEST committed itself to increase the importance of fashion & design as an element of competitiveness. Together with other stakeholders, the association launched the "Fashion Committee of Pernambuco" in June 2003, which aims at the creation of its own brand, "Pernambucan Fashion", by mapping a strategy of development and organizing workshops and fashion shows. Clothing companies as well as designers, teachers, and fair exhibitor can join this committee.

Developmental effects

SINDIVEST decided to mobilize existing structures and resources instead of set-up new institutions which would have posed a financial and manpower risk. Aided by its German partner, the association managed to show up technical possibilities and solutions. The already existing educational bodies reacted with an expanded and qualitatively improved range of services.

As "the voice of the clothing industry," the association became active in public promotion schemes and could influence its contents. The public bodies, in turn, were able to name SINDIVEST as a legitimatization of their policies. a win-win situation for the garment sector.

4. 3 Taxation and regulation

Background

With more than 90 %t, the share of informal businesses in the garment industry of Pernambuco was extremely large. It caused significant problems for both SINDIVEST and the municipal and state governments. Only formal SMEs are permitted to become members of the association, pay taxes and are really reachable for the training and promotion agencies, and only they provide social security schemes for their employees. According to the entrepreneurs, it's the high bureaucratic barriers and the high tax burden which cause non-registration of businesses.

Together with the Association of Clothing Wholesalers, SINDIVEST conducted talks with the state government about a marked reduction of the assessment rates for sales tax which were then at 17% in Pernambuco. This measure was supposed to specially concern the clothing industry and strengthen its competitiveness.

Initially, the state government's counter-argument was fear of a ruinous competition between the federal states and a loss of tax income as well as cop-cat industries with similar demands. It was only when a SEBRAE study proved that more than 90% of all businesses were informal—many of them prosperous jeans manufacturers—that the finance ministry gave its consent in the hope that lower tax rates would trigger the formalization of informal SMEs and that overall tax revenues would increase as a consequence. In other words: A larger number of businesses which pay lower taxes might net the country more revenues than a small number of businesses paying high taxes.

Project activities

- Information campaign by the association for the formalization of SMEs in 2003
- Strengthening the association as an important partner in negotiations with the state government through its achievements in vocational training and environment protection and the official recognition as an international project partner.
- All project measures targeted at the regional expansion of the association's activities and increasing its popularity.

Results

At the end of the discussion the state parliament decided to cut sales taxes for clothing manufacturers and wholesalers from 17% to 4%. This was perhaps SINDIVEST's most spectacular success. The more business turn formal, the better for the association and for the industry's image. Formal enterprises are more open towards promotion schemes since they do not need to fear drawing the authorities' attention and being "found out". Moreover, they have to pay social security contributions and thus contribute to the social security of their employees. During the first four weeks following the parliamentary decision, 1,000 SMEs turned formal.

Developmental effects

Until this day, a large-scale SINDIVEST information campaign helped to formalize 1,800 SMEs. Informality dropped from over 90% to 81%. Much remains to be done, however. Bureaucratic red-tape and tax regulations are still too complicated. According to the World Bank the public sector is still Brazil's main development obstacle. Closing down a business alone requires up to 9 years—opening one "just" 150 days. However, the debate about the formalization and sales tax created political awareness on this topic. Thus, it became part of the campaign for the governor's election in 2006.

5 Lesson learned

The importance of networking

Traditionally, industrial associations don't have a strong position in Brazil and Latin America as a whole. On the other hand, there are existing institutions for the promotion of SMEs and for vocational training which, in the case of Brazil, dispose of considerable budgets and therefore constitute a power of their own. They often face problems when it comes to recognizing the needs of the SMEs and provide solutions of sufficient quality. What's important it not the creation of new, or even competing structures. It is the strengthening and qualification of associations which is the most effective way of giving SMEs a voice within the existing structures. Within the system of institutions concerned with vocational training and promotional schemes, associations which have a large number of members and professional structures can directly influence the range and quality of products targeted at SMEs.

The importance of Germany as a role-model

Germany's contribution consisted of three main elements:

- Study tours to best-practice examples in Germany. Especially in the field of environmental protection this instrument was particularly important. Selection of participants and the emotional factor of the group were used deliberately so that networking would be possible between the participants later on. The emotional link to the topic of environmental protection was just as important as the technical aspect. Without the option of hands-on demonstrations and the exchange of experts on site, the subject matter wouldn't have been brought across in a useful manner. The quality of garments and trade fair marketing, too, can only be demonstrated in vivo.

- Short-term visits by German experts, especially textile and water engineers served to develop solutions to specific technical problems. The selection of experts, who worked in and represented German companies or authorities, increased their credibility.
- Permanent counseling by bfz with intermittent field-trips. Credibility and commitment of all partners was an essential factor for success. Another was the direct and long-term cooperation of the two private sector organizations. bfz experts were able to make contributions to specific subject matters over several years and were also available to answer questions later on.

Multi-level approach

Depending on the problem and the goal in question, the project was able to act on the micro-, meso- and macro-level. It was frequently necessary to seize favorable opportunities quite quickly.

This approach demanded a high degree of flexibility. The targets envisioned at the start of the project could not always been fulfilled either because they were too ambitious or because they weren't feasible due to changing conditions in Pernambuco. New targets were added instead. The term 'development corridor' as guiding principle for the project management describes the situation most closely.

Leadership of the business membership organization

It was the election of a new president and board which had made the project possible in the first place. This can be risky if there are further changes. Frequently, projects are tightly linked to particular individuals and are often neglected or even stopped when there is a change in leadership. There is no proper solution for this problem. Those responsible for a program can try, however, to apply certain criteria to the selection of the partners, e.g. the democratic legitimization of the board, a minimum size, quality of staff, etc. to diminish the risk of failure

6 The German contribution

The project had a duration of six years, starting in 1997 and ending in 2003. The annual budget of the project funded by the German Ministry for Economic Cooperation and Development (BMZ) amounts to US$ 170,000. The state government of Pernambuco and parastatal Brazilian agencies contributed an additional US$ 300,000 per year.

There was no long-term expert in the project. Both partners appointed project managers for implementation and monitoring, while the bfz project manager acted as coordinator. He visited the Brazilian partner 3-4 times a year and stayed in regular contact via email and telephone with his counterpart. Additionally, short-term experts were assigned for specific tasks.

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Reducing local Red Tape for a better local business and investment climate - A participatory approach to reducing compliance costs for local businesses

Anja Rücker

Reducing Red Tape has become a prominent topic in Private Sector Promotion in recent years. Responding to the growing demand for practical approaches to address Red Tape, GTZ's Local Economic Development (LED) – Project in South Africa has developed a facilitation model for Red Tape reduction at local level. The model aims at supporting local stakeholders in the reduction and avoidance of bureaucratic costs both for the public and the private sector by facilitating a multi-stakeholder discussion and a joint action process in a locality.

The article provides an overview of this facilitation model by first giving some contextual information and presenting the basic design and the aspired development results of a facilitated Red Tape reduction process. Subsequently, the different steps and dimensions of a Red Tape reduction process are unpacked and enhanced with practical examples from the pilot case of Steve Tshwete Local Municipality in South Africa. Finally, GTZ LED's strategy for rolling-out and anchoring the model in the institutional landscape of South Africa is briefly presented.

1 Background

GTZ LED Project Background and Approach

The GTZ LED Project in South Africa assists local communities in engaging in participatory and competitiveness-based LED processes, which enable the local communities to better utilize their economic opportunities and to increase their region's productivity and competitiveness. The project's interventions in LED are characterized by the LED principles of competitiveness, participation, co-operation and process orientation.

By applying these principles, the GTZ LED Project supports the development, testing and dissemination of several LED approaches and tools which help to facilitate feasible LED processes. In line with international trends, improving the local business and investment climate has become a core topic of South African LED actors in recent years. Within this context, reducing Red Tape in order to increase bureaucratic efficiency and to minimize regulatory compliance costs for local businesses receives growing attention.[1]

Core Problems

Although Red Tape is only one of many dimensions of an unfavourable local business and investment climate, its can produce immense costs both for the local private and public sector – and therefore create serious disadvantages of the locality in comparison with other regions.

Red Tape stands for regulations and rules, administrative processes and procedures which are not or no longer effective in achieving their policy goal, and which therefore produce suboptimal and undesired social outcomes. Many times, it is specifically the small and medium enterprises which have to pay the highest share of these costs[2], as regulatory compliance with administrative rules, regulations and procedures involve important economies of scale.

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[1] In a number of participatory LED processes in South Africa that have been accompanied by GTZ's LED project, Red Tape has been mentioned as one of the major constraints to local economic growth. Although it is mainly the public sector which is associated with these constraints, emerging businesses also point at the problem of a complicated regulatory environment within the private sector itself, e.g. with regard to procurement policies or payment terms.

[2] If measured as percentage of the turnover

In the South African LED context, a reduction of local Red Tape aims at specifically addressing three core problems which hamper local development in South Africa at present:

First, the South African local governments are challenged by a serious capacity shortage especially in the rural areas. By reducing local Red Tape e.g. through streamlining bureaucratic procedures and improving the local government's knowledge management and interdepartmental co-operation, the amount of work for public servants can be significantly reduced. Additionally, an increase in administrative transparency can minimize rent-seeking behaviour of public servants and thus further increase administrative efficiency.

Second, due to the country's recent history, the South African economy is characterized by a serious fragmentation according to social groups, geographical areas and firm size classes. Several policy measures have been designed and implemented by the South African government in order to create a more homogeneous economic and socioeconomic structure. An important element of this policy is the promotion of small and medium enterprises (SME) with a specific focus on previously disadvantaged individuals. For these emerging entrepreneurs, Red Tape produces serious barriers to entry and thus counteracts the above-mentioned policy measures. As the source of a significant amount of present local Red Tape can be found in "old" municipal bylaws and rules of the Apartheid era that have been inherited by the newly formed local municipalities, Red Tape can even directly contradict the development agenda of the new government.

The third core problem that the Red Tape reduction process aims to tackle is also a legacy of Apartheid. Due to the country's history, South Africa is characterized by a very high level of distrust between the public and the private sector, which results in a severe lack of public-private communication especially at local level. The absence of trust and willingness to co-operate produces multiple negative effects for local economic development. Experiences have shown that fostering issue-focused public-private co-operation processes with benefits for all parties involved – such as Red Tape reduction - is the most promising approach to overcoming this problem.

Why local?

Many rules and regulation impacting on LED are not born by local decisions, but by the provincial, national or even supranational regulatory framework. Local responsibility for and influencing power on the impact of Red Tape in the business environment is therefore limited.

Nevertheless, local actors are by no means powerless with regard to the local regulatory environment, especially within decentralized structures. In the South African case, the provincial and national legal and regulatory framework is complemented by a number of local by-laws created by the local council. These local government regulations amount to an average 6 % of the overall recurring compliance costs for businesses.[3]

Furthermore, an important percentage of Red Tape costs are produced not by regulations themselves, but by the inefficient procedures applied in order to implement these regulations, and the suboptimal service interface between public and private sector. Streamlining processes and increasing the service orientation of local officials can therefore play an important role in reducing efficiency costs and compliance costs.

Besides the relevance of the local level for Red Tape issues, the focus on the local level is also motivated by the fact that this level provides a practical and action-oriented sphere for intervention and quick success. While regulatory reforms at the upper levels are often characterized by complex procedures and endless timeframes, Red Tape reduction at local level benefits from the relative clarity of actors and issues, and can thus produce much faster results. These results not only have the direct effect of improving the regulatory environment, but

[3] Small Business Project (2004): Counting the cost of Red Tape for business in South Africa. Headline report, Johannesburg, p. 11.

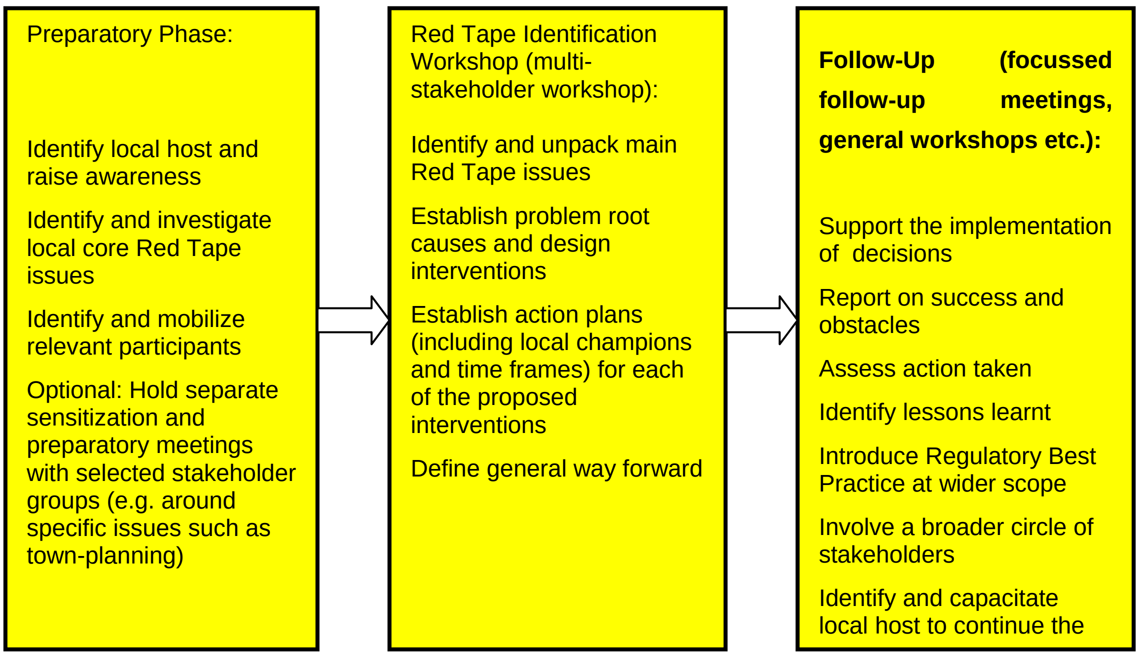
contribute to an atmosphere of trust-building between different stakeholder groups and thus can help improving the local enabling environment on more general terms. Furthermore, if the local interventions are systematically linked with the provincial and national level (e.g. through regular feed back loops), the reform at local level can provide important momentum and inputs for bigger reforms.

2 General approach and desired development results

The Red Tape reduction approach is based on a sequence of interviews and workshops which aim at facilitating the discussion and solution finding around Red Tape at local level. The core idea beyond the sequence is to stimulate joint discussion and solution-finding processes between municipality and private sector and to create visible success stories in the reduction of Red Tape, leading to an enhancement of long-term public-private cooperation and, more specifically, to a long term Red Tape alert.

Basic design

The facilitation process builds on a series of different steps in order to create a lasting sensitisation for Red Tape issues and to build the necessary capacity to tackle Red Tape at local level. While the Red Tape Identification Workshop clearly forms the core element of the sequence, it will only be able to take off if enough care is given to the preparatory phase and the feedback and follow-up phase. The following scheme depicts the general design of the facilitation process.

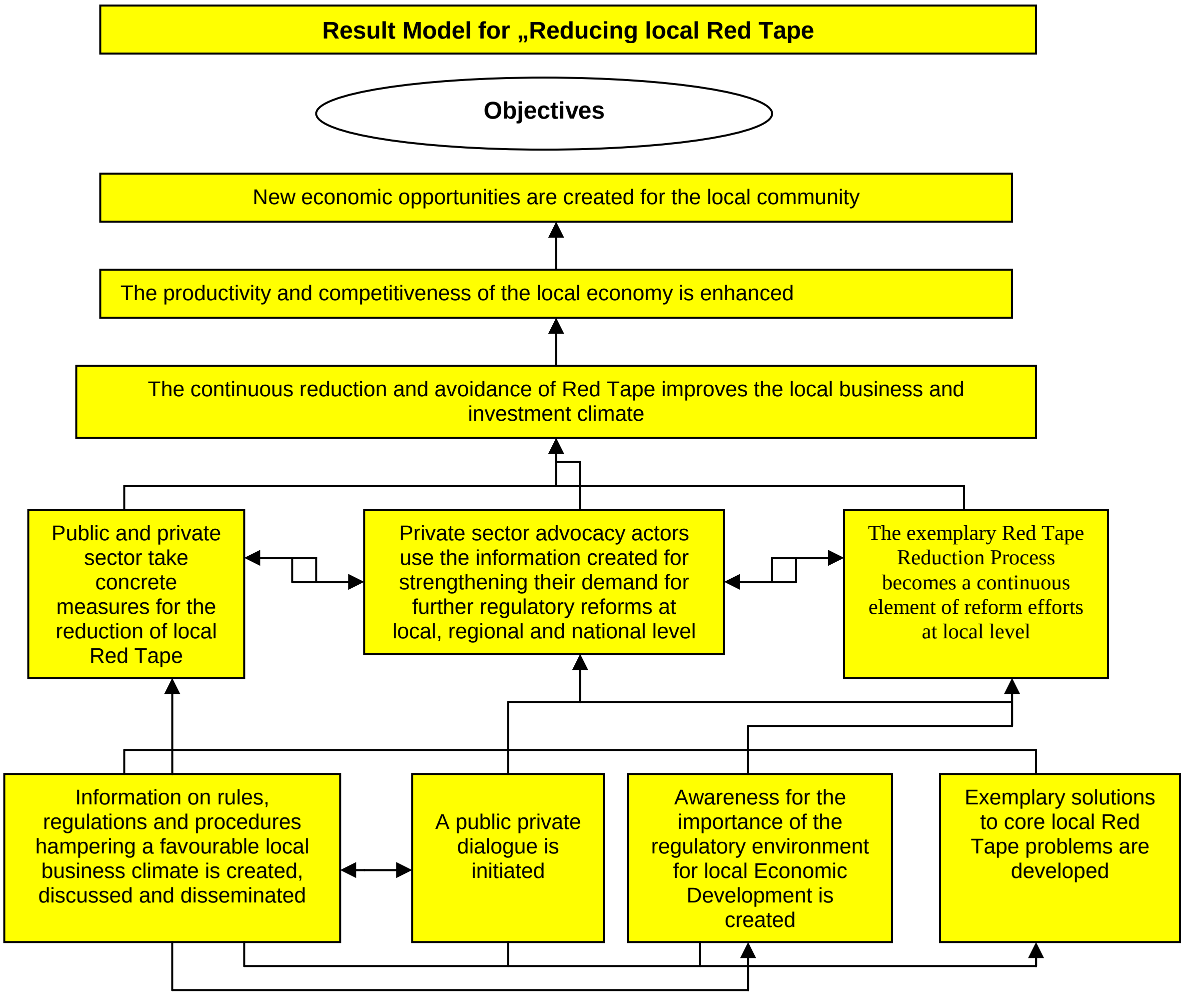


Aspired development results

Following this process through will have the immediate effects of tackling several specific local Red Tape problems, investigating others further and communicating issues that lie beyond local control to higher levels.

However, the instrument does not only aim at some ad-hoc interventions, but at producing results of a much broader and long-term character. As reflected in the result chain below, the *direct benefit* of the Red Tape facilitation process is formulated as "the continuous elimination and avoidance of Red Tape" to "improve the local business and investment climate". The facilitated interview and workshop series functions as a trigger for kick-starting catalytic interventions, increased advocacy activities and a continuous public-private dialogue around the reduction of local Red Tape, which result in a continuous and on-going local process around the reduction and avoidance of Red Tape beyond the time limit and topical focus of the external interventions.

The reduction of local Red Tape contributes to the improvement of the local business and investment climate by reducing the monetary and time costs of doing business in the locality. Resources are released and incentives are created for new investments. As a result, the reduction of Red Tape helps increasing the local efficiency, productivity and competitiveness, leading to the creation of new economic opportunities for the local community.



3 Methodology and tools

The Red Tape Reduction series is strongly based on the use of action-oriented and participatory methodologies and facilitation tools, and requires an experienced facilitator familiar with local development. An external facilitator has the advantage of being perceived as neutral in comparison to a local facilitator (e.g. a public official or a chamber representative). The facilitator, however, needs the collaboration of a local host such as the local municipality or the local chamber. The host is responsible for supporting the facilitator in identifying issues and actors and in providing the necessary local knowledge in all four project dimensions of analysis, design, implementation and monitoring of the Red Tape initiative. It is crucial that the host embraces the Red Tape reduction process publicly in order to give it the necessary credibility, and to show clear commitment to carry on the process beyond the timeframe of the external facilitator's intervention.

In the following section, the methodology and tools will be further unpacked by referring to a real case, the Red Tape reduction process in the local municipality of Steve Tshwete, South Africa. This process was led by an experienced South African LED facilitator in collaboration with the local municipality and the GTZ LED Project.

Local Red Tape Analysis

Different to a pure assessment tool (e.g. a Local Business Climate Survey), the Red Tape reduction process does not require an extended period of desktop research or a representative number of sample surveys, but addresses the collection and processing of relevant information in an action-oriented and issue-focussed way. For this purpose, the lead facilitator identifies prominent Red Tape issues and key stakeholders via a number of preparatory interviews both with public and private sector, including representatives from different firm size classes, in order to capture different perspectives. Dependent on the complexity of issues that are brought forward in these preparatory interviews, the facilitator can also rely on tools such as a "process mapping" (see neighbouring graphic) in order to capture specific details on certain issues and processes. In case that the perceptions of different stakeholder groups differ with regard to certain issues and processes, this tool can help to stimulate discussions and identify possible stakeholder conflicts already in the preparatory phase.

Issue: Starting a Business in Middelburg							
Procedure		Time (days)					
What?	Where?	0	1	5 to 10	11 to 20	21-50	>50
1. Reserve a company name							
2. Register name and articles of association							
3. Register for VAT, skills levy, indicating the relevant SETA, Paye, income tax							
4. Register with Unemployment Insurance Fund, Regional Services Council							
5. Register as employer for Workman's compensation							
...							
...							
...							

As a result of the preparatory interviews, the facilitator is equipped with a good oversight over the main Red Tape issues and their specifics in the locality. Where necessary, this information can be investigated further. In case of very complex or conflictive issues coming up during the preparatory phase, the facilitator can e.g. rely on preparatory mini-workshops with selected stakeholder groups in order to further unpack certain issues and identify all relevant decision-makers.

All the gathered information is then packaged as an input for the multi-stakeholder workshop. This multi-stakeholder workshop represents the core element of the Red Tape reduction sequence, as it provides a platform for all interested local stakeholders to put their complaints and perspectives forward and participate in the solution finding to the issues raised. A good representation of the different stakeholder groups and the presence of key decision-makers especially from the local municipality's side are therefore crucial for the initiative's success. Please see the attached stakeholder map as an example for multi-stakeholder representation in the Steve Tshwete workshop.

Stakeholder Map of the Multi-Stakeholder Workshop in the Steve Tshwete Municipality, South Africa

Sector	Function	No of participants
Steve Tshwete Local Municipality	Municipal, Manager, LED Officer, Manager of Town Planning, Technical Manager, Financial Manager, Corporate Services Manager, Public Services Manager	7
Members of the Mayoral Committee		5
Private Business	Business Owners	3
Local Chamber of Commerce	Executive Liaison Officer	1
LED Fund	Chair of the local LED Forum (also local business owner)	1
NAFCOC (National African Federated Chamber of Commerce)	Member of NAFCOC	1
Office of the Premier (Province)	Deputy Director, Adviser to the Deputy Director	2
Department of Agriculture	Technician	1
Small Business Project (national-level NGO)	Senior Adviser	1

Design of specific interventions

During the multi-stakeholder workshop, the Red Tape reduction process enters the phase of identifying solutions to the problems raised. As a first step, the preparatory findings are fed back to the participants, and the group is given the opportunities to raise further Red Tape issues which have not come up in the build- up to the workshop.

When facilitating the solution-finding process, it is important to apply a filter to the issues raised in order to give the design of solutions a clear focus. We suggest the following filtering criteria:

1. Is the issue a real Red Tape issue, that is, does it refer to suboptimal regulations, procedures or service delivery? (as opposed to political arguments or broader LED topics such as lack of finance etc.)
2. Can the problem be solved at local level in a reasonable time period?

The aim of this filtering process is to identify Red Tape issues which can be tackled relatively easily and where improvement can be observed rather instantly by local stakeholders. The filtering process can be expanded through a simple prioritization exercise, which gives the participants the opportunity to rank the issues raised according to their importance.

The further unpacking of the selected key Red Tape issues consists of two main steps: The identification of the problem's root cause(s), and, in the case of dealing with more complex Red Tape issues, the identification of the right problem level(s). These two steps aim at the concrete determination of where and how an intervention should be directed. It is advisable to break into smaller working groups under certain subheadings (e.g. "internal municipal issues") at this point in order to be able to work on a number of Red Tape problems at a time. There are different approaches of how to facilitate the unpacking of the single Red Tape issues in these working groups, which depend on their context and the specifics. One possible sequence of facilitation steps is displayed in the neighbouring box.

<u>Identifying root causes and problem levels: an example for the group work</u>

1. Develop a clear problem statement, including the main symptoms (How does it impact on us?)
2. Map the problems in terms of separate steps to deepen the understanding of the issue
3. Develop a "problem tree", starting from the symptoms and deriving the root causes
4. For each root cause, establish the problem level: Is it a regulation that sits at the core of the problem, is it the implementation of a regulation (procedure) or does the problem lie at the interface level (e.g. in case the relevant information is not communicated properly to the customers)

The formulation of the exact problem causes (and, where necessary, problem levels) assists the workshop participants in jointly defining the "desired end state" for the problem to be tackled. Determining such an end state has two functions: First, it helps to create alignment and consensus amongst the different stakeholder groups with regard to politically sensitive issues. Second, the desired end state serves as the benchmark against which all proposals for improvement of a certain issue can be measured.

The development of suggestions for solutions and the design of concrete proposals are left mainly to the participants, with catalytic inputs on Regulatory Best Practice by the facilitator where required, and the evaluation of the proposals is done against the desired end state. Testing the proposal on unintended consequences and investigating the possibility of other alternatives can round off the participatory assessment process if necessary. The following box reflects the output of one of the working groups of the multi-stakeholder workshop in Steve Tshwete municipality, which focused on the issue of town planning, as an example.

Output of a working group on townplanning in Steve Tshwete Local Municipality, South Africa

Group II: Internal municipal issues	
Issue:	Townplanning
Problem Statement:	Building plans approval takes too long
Symptoms:	Documents not processed efficiently
	Waiting period of over 2 months
	To get feedback from government on progress is difficult
Root causes:	Many decision points, as many departments are involved in approval
	Understaffing of town planning department
	Unsatisfactory building plans are handed in due to lack of information
Desired end state:	Make the approval process more transparent
	Minimize decision-making time
	Provide sufficient information on correct applications to the applicants
Proposals:	*General:*
	Map the process according to its different steps in order to clearly identify bottlenecks
	Policies and Regulations:
	Local municipality pledge to minimum service levels (Batho Pele)
	Attach time limits for each approval step
	Procedures and Processes:
	Escalate documents that are stuck for too long
	Service and Interface:
	Develop information brochure on different steps involved and decision time required
	Develop check-list to ensure basic compliance before acceptance of plans

The absence of detailed quantitative methods of a Regulatory Impact Assessment (RIA) in this assessment process is not only due to the fact that a quantitative RIA would require a very high input in time, costs and expertise. Furthermore, a comprehensive quantitative assessment would exceed local capacity in many cases and bears the risk to counteract the consensual, action-oriented and participatory character of the approach.

Implementation and Follow-up

The multi-stakeholder workshop has the objective of producing a precise way-forward strategy with the clear definition of time-bound tasks and responsibilities. Therefore, champions should be identified for each issue who show a strong motivation, but also the capacity to drive the implementation of the respective proposals. Also, the overall responsibility for driving the way-forward should be clearly assigned to the senior level of the local host structure (e.g. the Municipal Manager) in order to increase the local credibility and ownership of the process.

During the follow-up process, additional mini-workshops can be facilitated by the external facilitator in case certain topics require further collective discussion and problem solving. Also, all participants of the main multi-stakeholder workshop and newly interested parties should be invited to a follow-up workshop once the first success stories have been achieved in order to give feedback on the progress, to identify obstacles and lessons learned and to discuss options on further action. Such future action can take the form of repeating the cycle of identifying and tackling Red Tape problems with the help of the external facilitator if required. However, it is at this point where the question should be raised of how to institutionalize the process locally. Several options for the institutionalization of the process are possible, including the formalization of the process via a formal council resolution and the further capacitation of the local host. It forms part of the external facilitator's responsibility to prepare and moderate a discussion of these options with the local key stakeholders. Furthermore, possibilities of linking the process with other initiatives and institutions in the country should be thoroughly assessed. The neighbouring box depicts the different strategies that Steve Tshwete Municipality has envisaged to institutionalize and embed the process.

The external facilitator is required to accompany this process and to give catalytic inputs as well as motivational impulses, but should subsequently reduce his/her involvement in order to increase local ownership.

Institutionalization of the Red Tape Reduction process in Steve Tshwete Local Municipality:

- Achieve Local Council Resolution as a commitment to a permanent Red Tape reduction and avoidance
- Capacitate local chamber to play a permanent advocacy role in Red Tape issues
- Capacitate local LED Forum to host the permanent process of Red Tape identification and elimination
- Link up with national anti-corruption initiative to introduce the development of a code of conduct and staff training in the local municipality
- Strengthen ties with SBP (national NGO active in the field of "Business Climate") to strengthen SBP's advocacy role at national level with local data

Monitoring

Monitoring the results of the process is a crucial element of this approach in order to constantly identify lessons learned and to be able to communicate success stories to the greater public.

At the beginning, monitoring will be reduced to the level of activities monitoring, a task that can be easily undertaken by the host and the external facilitator. Once the first proposals have been implemented, monitoring the impact of the interventions in terms of reducing administrative and compliance costs can rely on the a-priori process mapping during the analysis phase both as a tool and as a base line. If the project achieves to institutionalize the process within the locality, the ongoing public-private dialogue will provide an automatic control and monitoring mechanism with regard to Red Tape issues.

The development of a more complex monitoring system which also covers the evaluation against the desired development results can be done along the result chain presented above. However, the installation of such a system should be embedded into the general monitoring framework of the locality or in a bigger LED process to avoid un-proportional monitoring costs. As an alternative, the terms of reference of the external facilitator can include the task of undertaking and documenting an assessment of the process against the result chain in the form of a case study.

4 Sustainability and outreach

In South Africa, the GTZ LED project aims at developing a market for LED facilitators which can competently assist a large number of local and district municipalities in engaging in successful LED processes. The Red Tape reduction approach is one of several tools that these facilitators are being equipped with.

By building the capacity of South African LED experts (private consultants, chambers, parastatal support institutions, etc.) in competently using approaches and tools like the Red Tape reduction approach, the GTZ project follows a clearly defined exit strategy by anchoring the relevant knowledge within the South African context and South African actors from the very start.

At the same time, the GTZ project supports the stimulation of the demand for these expert services via policy dialogue and capacity building at micro, meso and macro level. In the case of the Red Tape reduction process, GTZ closely co-operates with InWEnt (Capacity Building International) to integrate Red Tape Awareness Building modules into InWEnt's LED training for local municipalities. Also, the topic plays an important part in GTZ LED's policy dialogue with and policy advice to its partner at national level, the Department for Provincial and Local Government. Via its close collaboration with GTZ's Public Service Reform Program in South Africa, the embedding of the initiative in the country's broader initiative of public sector reform is guaranteed, and the collaboration with several non-governmental institutions such as chambers and NGO's strengthens the advocacy role of these institutions with regard to Red Tape reduction in South Africa.

The German contribution to the development and roll-out of the Red Tape reduction approach in South Africa therefore consists of the following elements:

Service	**Costs as measured in person days**
Product development and refinement	15 person days
Design and implementation of facilitator training	10 person days
Backstopping of facilitators	5 person days/local Red Tape reduction process
Awareness raising, national dissemination, knowledge management etc.	1 expert month/year

eGovernment to improve the local business environment: Case Study from Latin America – Met@logo

Ilka Buss and Hannes Karkowski

Donors who are interested in conducting local business environment (BE) reforms should consider the use of eGovernment approaches. Using eGovernment solutions helps governments to lower the costs of corruption, to reduce red tape significantly, and to increase the predictability and credibility of policies. Furthermore, the use of information and communication technology (ICT) can act as a door-opener to change, allowing organisational cultures to be changed and processes to be redesigned. Even the use of rather simple eGovernment tools – in comparison to fully-fledged eGovernment programs, which offer a much greater potential for substantial improvements – allows local administrations to offer useful services to entrepreneurs on a timely basis.

1 Executive Summary

This paper argues that donors who are interested in conducting local business environment (BE) reforms should consider the use of eGovernment approaches.
Using eGovernment solutions helps governments to lower the costs of corruption, to reduce red tape significantly, and to increase the predictability and credibility of policies. Furthermore, the use of information and communication technology (ICT) can act as a door-opener to change, allowing organisational cultures to be changed and processes to be redesigned. Even the use of rather simple eGovernment tools – in comparison to fully fledged eGovernment programs, which offer a much greater potential for substantial improvements – allows local administrations to offer useful services to entrepreneurs on a timely basis.

In order to illustrate how local BE reform programs can successfully work with eGovernment solutions, this paper outlines the experiences made in the Met@logo project.
Met@logo is co-funded by the European Commission (EC) and the German Federal Ministry for Economic Cooperation and Development (BMZ)[1], within the EC cooperation program @LIS - Alliance for the Information Society, and was set up to provide 14 local administrations in Chile, Colombia, Honduras and Peru with an open-source software tool enabling them to build and maintain a e-local governance portal designed for the benefit of local small and medium-sized companies (SMEs). The project seeks to build standard and widely applicable tools and methodologies that can redesign internal processes of the pilot municipalities. An e-local governance portal will also be set up. The overall aim is that the results of the project can be passed on to other municipalities and/or countries.

The Met@logo project (Meta e-Local Governance) was initiated in January 2004 and will come to an end in June 2006. So far, the needs of SMEs have been thoroughly analysed regarding their administrations and the processes related to starting up and operating a business. Furthermore, the most important identified processes have been redesigned to be more efficient in terms of time and costs. In the current project phase, the new processes are being implemented in the municipalities, and the eGovernment software will be installed for further developments in the coming months.

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1 The EC contributes with 80% of all the funding. The GTZ (BMZ funded) and the project partners (European and Latinamerican) cover the missing 20% of their own costs.

Some of the most important lessons learned so far are summarised below:

- Knowledge about local processes is required.
- Reforms can only succeed if there is strong political back-up.
- Reforms need change agents within the municipalities.
- Local administrations need to be empowered to develop their own targets (beyond project-end).
- Strong participation of the municipalities and businesses during the redesigning of administrative processes is key.
- All those involved need to grasp fully Met@logo's eGovernment approach, which involves changes in internal processes, the integration of the eGovernment portal into daily working processes, changes in attitude, and the learning of new skills.
- Identification and cooperation with related national, regional and/or local activities.
- Development of flexible and widely applicable methodologies.
- Availability of local support infrastructure for the technical aspects of the eGovernment reform.

2 The Rationale behind Prioritising eGovernment for Local Business Environment Programs

The potential of eGovernment approaches to improve the local business environment depends on the governments' general ability to influence enterprises' investment decisions. According to the World Bank Development Report 2005: "A better investment climate for everyone", governments do have a strong influence on the following factors (see Table 6):

- Costs that arise through corruption, taxes, regulatory burdens, red tape, infrastructure and finance costs and labour market regulation
- Risks regarding to policy predictability and credibility, macroeconomic stability and property rights
- Barriers to competition such as regulatory barriers to entering and exiting the market, competition law and policy, the functioning of finance markets, and the infrastructure.

Using eGovernment helps governments exert an even stronger influence on at least three of the mentioned factors:

- Lower the costs of corruption: The use of ICT allows programs to bypass intermediaries by automating processes and by making required services, procedures and documents widely and directly accessible, so that opportunities for corruption are reduced (see McNamara, K. S.: "ICT and Poverty Reduction", 2003).

- Significantly reduce red tape: The digitalisation of public services can lead to large savings in time, as entrepreneurs can now transmit data electronically, while data can be used by several administration departments at the same time. Furthermore, digitalised data allows process steps to be automated. In order to fully grasp the potential of using ICT in administrations, it is first necessary to analyse the administrative processes, improve those processes and integrate ICT in a way that reduces unnecessary administrative steps more effectively (see European Public Administration Network, "Does eGovernment Pay off?").

- Increase the predictability and credibility of policy: The modelling of workflows with software systems requires clearly predefined process steps. Once the workflows have been implemented and entrepreneurs know these procedures, it is more difficult to use power arbitrarily.

Table 6: Government policies, behaviours and investment decisions

	Factors that shape opportunities and incentives for firms to invest	
	Government has strong influence on	Government has less influence on
Costs	▪ Corruption ▪ Taxes ▪ Regulatory burdens, red tape ▪ Infrastructure and finance costs ▪ Labour market regulation	▪ Market-determined prices of inputs ▪ Distance to input and output markets ▪ Economies of scale and scope associated with particular technologies
Risks	▪ Policy predictability and credibility ▪ Macroeconomic stability ▪ Rights to property ▪ Contract enforcement ▪ Expropriation	▪ Consumer and competitor response ▪ External shocks ▪ Natural disasters ▪ Supplier reliability
Barriers to competition	▪ Regulatory barriers to entry and exit ▪ Competition law and policy ▪ Functioning finance markets ▪ Infrastructure	▪ Market size and distance to input and output markets ▪ Economies of scale and scope in particular activities

Source: World Bank Development Report 2005, p. 22.

Consequently, The World Bank report on "The costs of doing business 2005" and the World Bank Development Report 2005 recommend the use of electronic registration and other instruments, which can be labelled as typical eGovernment activities, in order to make business registration quicker and more efficient, thus helping to improve the business environment.

Of course, the use of ICT is not a panacea, as McNamara notes: "ICTs do not, of themselves, change organizational cultures and practices […] Nor, more generally, do ICTs of themselves create broader institutional reform and the redesign of government processes and procedures. "("ICT and Poverty Reduction",2003 , p. 68). However, the Met@logo project shows that the use of ICT can act as a door opener to change organisational cultures and to redesign processes. It seems to be more acceptable for municipalities to modify their administrative procedures due to "demands and possibilities of modern technologies" than to "inefficiencies, corruption and mismanagement".

Therefore, donors who are working on the municipal level in developing countries should integrate eGovernment solutions into BE programs. In more developed municipalities, eGovernment will be a prerequisite for modern institutional reform programs, which aim at improving government processes and at making procedures more effective.

However, the use of eGovernment approaches is also recommended in municipalities which are poorly equipped and in situations of disadvantage. Even rather simple eGovernment tools (in comparison to fully fledged eGovernment programs, which offer a much greater potential for substantial improvement) allow local administrations to offer useful services to their entrepreneurs on a timely basis. For example, in one of Met@logo's pilot municipalities in Colombia, it was necessary to travel to another municipality just to get a certain form. Simply being able to download this form from the eGovernment portal and to print it already saves entrepreneurs time and the cost of transport.

3 Case Study: Met@logo

The Met@logo project is a good example of how eGovernment solutions can be used in order to improve the local business environment, not only by increasing the efficiency of administrations, but also by reducing corruption, red tape and enhancing the credibility of governments through increased transparency. The following sections provide an overview of the framework of the Met@logo project, as well as details about its individual activities.

3. 1 The @lis Program

@LIS is an EC strategic cooperation program aimed at extending the benefits of the information society to all citizens in Latin America, and at reducing the digital divide by supporting dialogue and cooperation among all information society users in Latin America and Europe.

Table 1: Synopsis of the @LIS Program

<table>
<tr><td colspan="7"><u>@LIS PROGRAM</u></td></tr>
<tr><td colspan="7">ACTIONS</td></tr>
<tr><td colspan="3">Dialogues</td><td colspan="4">Networks</td></tr>
<tr><td>Policy and Regulatory Dialogue</td><td colspan="2">Dialogue on Norms</td><td colspan="2">Latin America Connected with Europe</td><td>International Stakeholders' Network</td><td>Latin America Regulators' Network</td></tr>
<tr><td colspan="7">DEMONSTRATION PROJECTS</td></tr>
<tr><td colspan="2">e-Government
(4 projects, including Met@logo)</td><td colspan="2">e-Inclusion
(5 projects)</td><td colspan="2">e-Learning
(6 projects)</td><td>e-Health
(4 projects)</td></tr>
</table>

Source: Morganti et al., "@lis: a New Cooperation Model for the Development of the Information Society", 2005.

The @LIS Program has a total budget of 77.5 million euro, and consists of networks, dialogues and demonstration projects. The @LIS program supports five horizontal actions, covering:

1) a policy and regulatory dialogue;
2) a dialogue on open and global standards;
3) an exchange and support platform for Latin American regulators, operators and companies;
4) an infrastructure network that reinforces the interconnection between research and development communities across Europe and Latin America;
5) an international stakeholders' network designed to stimulate dialogue and collaboration among policy makers, the civil society and research communities, and to build an active community of stakeholders around the @LIS program.

Moreover, @LIS supports 19 demonstration projects that cover e-local governance, education and cultural diversity, e-public health and e-inclusion (see Morganti, L. et al.: "@LIS: a New Cooperation Model for the Development of the Information Society", 2005).

Met@logo is one of the four @LIS eGovernment demonstration projects, and aims at improving the business environment for SMEs and at helping to bridge the digital divide through eGovernment.

3. 2 Selection of the intervention areas

Pilot countries

The regional scope of Met@logo was determined by the @LIS program, which focuses exclusively on Latin America. Met@logo chose Chile, Colombia, Honduras and Peru as its pilot countries.

The Met@logo pilot projects work in very close cooperation and make use of strong synergies with four existing German cooperation programs that focus on decentralisation and the strengthening of good governance in Chile and Colombia; on SME promotion in Honduras; and on rural development in Peru. The degree of variety offered by these projects is an advantage as it provides useful knowledge about the impacts of using eGovernment to improve the local business environment in several different scenarios. The counterpart organisations have been cooperating very closely with Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) GmbH in the context of these programs, so the initial orientation and confidence-building required at the start of any project could be largely leapfrogged at the national level.

Pilot municipalities

The fourteen municipalities were chosen on the basis of the following criteria:

- Size
- ICT literacy of staff
- Political support (from mayors)
- Local and regional dynamics
- Existing working relations between GTZ and the local administrations
- Interest of SMEs in the planned activities.

A sound mix of small (around 11,000 inhabitants) and rather large municipalities (up to 350,000 inhabitants), covering a broad range from small municipalities in Honduras with almost no ICT knowledge up to well-equipped and highly ICT literate staff in other municipalities (e.g. Temuco in Chile), allows Met@logo to gain interesting insights on how to tailor eGovernment solutions, taking into account different local starting conditions.

The overall conclusion reached is that it is recommended to use a solution which is flexible enough to work in different contexts. Met@logo assures this kind of flexibility through the use of a modular software system. This allows Met@logo projects to respond to different local needs. For example, a rather basic version of the Met@logo solution, which includes information and communication modules, is applied in the case of Honduras, whereas in Chile and Colombia, more sophisticated functionalities such as automatically generated responses via short messages to mobile phones and workflow management are envisioned.

Assuring constant political support is crucial to the sustainability of the project. When mayors are committed to the project and externalise this commitment to the other functionaries of the municipality and the public, processes will be adopted and followed by employees. Since reform processes are usually not internalised very quickly, the continuity of political support is a key aspect. Therefore, Met@logo deliberately chose municipalities where the possibility of a major political change, i.e. a change of party (which usually also means a radical change of staff), are quite low.

Two other important eligibility criteria were applied. Firstly, the existence of strong relationships between the GTZ and the local administrations established through past or current working experiences was favoured. Secondly, municipalities were chosen where SMEs had explicitly expressed their interest in the project and its approach. Both these criteria are solid preconditions for a sustainable project outcome.

3. 3 Background information on the intervention areas

The following section provides a brief overview on the current state of the investment climate[2] in the pilot countries, and examines the gap between the chosen project countries and best practices in Organisation for Economic Co-operation and Development (OECD) countries. In order to improve understanding of the project context, the main characteristics of the pilot municipalities are described below.[3]

Colombia

a) Investment climate

The investment climate in Colombia was found to be very favourable compared to the rest of the continent, although it is still far from reaching the level of the developed countries.
Considering that the number of procedures that have to be followed in order to open a business in Colombia (14) is higher than the Latin American mean (11), this entails significantly lower time requirements and related costs(see Table 2). The number of days required to open a business in Colombia stands at 43, compared with a mean in Latin America and the Caribbean of 70 days. Moreover, unlike in the other countries in the region, no minimum investment capital is prescribed. Of the 14 procedures required, only three (1: registration of new employees; 2: fire safety certificate; and 3: hygiene certificate) are relatively time-intensive.

Table 2: Indicators of the investment climate, Colombia

Geographical area / Indicator	Colombia	Latin America and the Caribbean	OECD
Number of procedures	14	11	6
Time (days)	43	70	25
Costs (% of income per capita)	27.4	60.4	8
Minimum capital (% of income per capita)	0.00	28.9	44.1

b) Municipality context

[2] Information on the investment climate has been taken from the World Bank's report: "The Cost of Doing Business 2005".

[3] Background information on the pilot municipalities was extracted from SMEs' needs analyses conducted by one of Met@logo's partners, NOMISMA: "Met@logo: Análisis Final de las Necesidades de la PYMES", 2004.

The four pilot municipalities in Colombia (Tuluá, Buga, Bugalagrande and Ginebra) have different characteristics. While commerce is the most important sector in Tuluá and Buga, the main economic activities in Bugalagrande and Ginebra are manufacturing and agriculture, respectively. The sectors with the highest development rates are commerce in Bugalagrande and Tuluá, services in Buga, and tourism in Ginebra. Generally speaking, the effects of the developing sectors on the economy are positive (employment generation, etc.).

Honduras

a) Investment climate

Honduras' investment climate is, compared with other countries of the region, slightly unfavourable, largely owing to the high number of procedures (16) entrepreneurs have to face (see Table 3) compared to the rest of the countries. Additionally, the costs that have to be incurred for operating a business are 16% higher than the regional mean, and there is moreover a minimum level of capital required which also exceeds the regional mean.
An application for an operational licence and registration in the commercial register are time-intensive processes (30 and 25 days respectively).

Table 3: Indicators of the investment climate, Honduras

Geographical area / Indicator	Honduras	Latin America and the Caribbean	OECD
Number of procedures	13	11	6
Time (days)	62	70	25
Costs (% of per capita rent)	72.9	60.4	8
Minimum capital (% of per capita rent)	37.0	28.9	44.1

b) Municipality context

The three pilot municipalities in Honduras are Choluteca, Comayagua and Choloma. In Choluteca the economy relies on the agricultural and agro-industrial sector; Coamyagua is mainly characterised by an industrial economy and commerce; and the main economic activity in Choloma is textiles. Development is mainly recorded in agriculture in Comayagua, especially with regard to non-traditional fruit, although the textile industry, as well as commerce and tourism, are all making steady progress.

Chile

a) Investment climate

Chile has the most favourable investment climate in Latin America and is very near to reaching the OECD country mean. The number of procedures required to open a business amounts to just nine, and the number of days required to carry out these procedures (27) is just two days over the OECD mean (25), and considerably higher than in the Latin American region (70 days). In addition, the cost of starting a business is six times lower (10% of per capita rent) than the regional mean (60.4% of per capita rent), and no investment minimum is required.
The most time-intensive processes are the acquisition of a municipality patent and the inclusion of a company in the commercial register(14 days).

Table 4: Indicators of the investment climate, Chile

Geographical area / Indicator	Chile	Latin America and the Caribbean	OECD
Number of procedures	9	11	6
Time (days)	27	70	25
Costs (% of per capita rent)	10	60.4	8
Minimum capital (% of per capita rent)	0.00	28.9	44.1

b) Municipality context

Araucania[4] is characterised by being relatively underdeveloped compared with the national economic situation (lying 65% under the Chilean mean). This is mainly due to the fact that the predominant economic activity is a somewhat unproductive form of agriculture. Export activities in this region, mainly of wood, fruit and cellulose, are the lowest in the country (amounting to just 0.2% of Chilean annual total exports). Nevertheless, since 1990 Araucania's three municipalities have seen a slight but continuous rise in public investment.

Peru

a) Investment climate

Peru's investment climate is slightly better than the regional mean. The same is also true for the number of procedures required to open a business. Although at 98 days the time needed to open a business in Peru is considerably higher than the mean, costs on the other hand are lower (slightly over half the regional mean), and there is no fixed minimum investment capital.

Table 5: Indicators of the investment climate, Peru

Geographical area / Indicator	Peru	Latin America and the Caribbean	OECD
Number of procedures	10	11	6
Time (days)	98	70	25
Costs (% of per capita rent)	36.4	60.4	8
Minimum capital (% of per capita rent)	0.00	28.9	44.1

b) Municipality context

The three pilot municipalities in Peru each have different structures: one urban (Chiclayo), one rural (Ferreñafe), and the third an area with both urban and rural characteristics (Lambayaque). Chiclayo does not have any agriculture of its own, and its main economic activities are predominantly in the commercial sector and in the processing of agricultural products imported from neighbouring communities, especially rice and coffee. Lambayeque's economy is mainly driven by tourism, commerce and some industry. Finally, Ferreñafe is almost exclusively an agricultural area, especially producing and processing rice.

It is worth mentioning that the level of informality is considerably high in all three municipalities. In Chiclayo, for example, 80% of established businesses operate without a licence, while a further

[4] The four Chilean project municipalities (Curacautin, Temuco, Traiguen and Nueva Imperial) are all located in the Araucanian region.

10% have obtained their licences in a somewhat doubtful manner (i.e. despite not meeting all the requirements). According to surveys of entrepreneurs, formality is not seen to be as advantageous as "it means paying tributes".

3. 4 Project set-up

Objectives

The Met@logo project aims at achieving the overall goal of improving the business environment for SMEs in the chosen pilot municipalities in Peru, Honduras, Chile and Colombia. More specifically, it seeks to create a service mentality in the local governmental administrations and to redesign those administrative processes which are related to the licence to operate a business, e.g. procedures for registering a new business and for obtaining all relevant permits and/or certificates (such as permits for land use, environmental certificates, sanitary certificates, etc.) needed to operate SMEs. The project also aims at encouraging greater efficiency and transparency, at creating a more favourable business climate, and at supporting investment and legalisation. These administrative reforms will be supported by the establishment of an open-source portal containing not only all information relevant to entrepreneurs, but also permitting administrative processes and transactions to be carried out. Improved government-to-business (G2B) communication via the internet will also be supported.

After the project-end, the methodologies and the software solution developed will be available for roll-out to other municipalities and other countries at low cost.

Strategic partnerships

A crucial feature of Met@logo is its international consortium, which consists of the partners listed in Figure 5[5], according to their role in the project. GTZ Head Office in Germany is responsible for overall project coordination, while the execution of project interventions is the responsibility of the local GTZ offices in the project countries and the respective local partners.

The consortium partners can be divided into four categories:

1) **Methodological partners:** The following partners contribute with their specialist know-how to the design and implementation of the project:

- The Stanhope Institute, which is specialised in the analysis of the policy framework for the application of modern ICT (United Kingdom)
- The Technical University of Vienna (TU-Vienna), which conducts teaching and research in distributed computing with particular emphasis on software architectures, software components, and programming languages and paradigms for distributed systems. The TU-Vienna focuses on development methodologies for worldwide web applications, information services based on push technology, information access services based on mobile code systems, and security for distributed (internet) applications, especially e-commerce applications. (Austria)
- Transparency International, a non-profit organisation that is devoted to fighting corruption in public interest issues by the implementation of preventive tools. (Germany/Columbia/Peru, Chile)
- Nomisma Spa, a public stock corporation that specialises in work methods (applied research, operational analysis and development, targeted consulting, and a problem-

[5] For more information on the partners, see www.metalogo.org.

solving approach); human resources (the interdisciplinary nature of its professional staff, a broad range of national and international experts, and experience in working as a team); and networking (businesses, financial institutions, and local, national and international agencies and governments). (Italy)

- Institute for e-Government - Competence Centre, which seeks to support the successful progress of eGovernment and public sector reform in Germany by the use of modern technologies and methods by integrating various actors and areas of eGovernment, in order to develop and coordinate interdisciplinary solutions between politics, administration, science, economics and society. (Germany)
- Webagency/Consileon, whose aim is to develop customer-oriented, sustainable solutions. Webagency supports the customer with courses regarding several e-business topics, workshops designed to identify specific customer needs, as well as training courses for developed solutions. (Germany)
- Universidad de las Américas, which offers educational services in order to contribute to community members' personal and professional growth (Ecuador).

2) **Counterparts,** which are direct stakeholders in the reform process in the pilot countries at a national level. These are

- Chile: Subsecretaría de Desarrollo Regional (Subdere), part of the Ministry of Internal Affairs
- Colombia: Federación Colombiana de Municipios (FCM), an association of municipal governments
- Honduras: Secretaría de Industria y Comercio (SIC), part of the Ministry of Economy
- Peru: PRODUCE, the Ministry of Production.

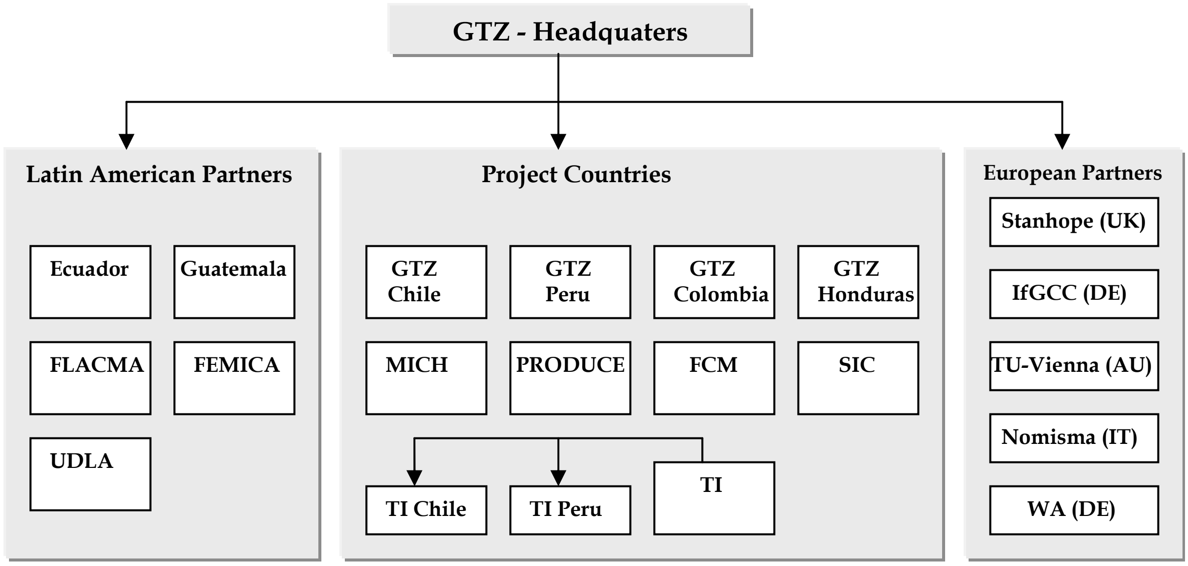
3) **Roll-out partners,** whose role is to promote Met@logo beyond the duration of the project. These are FLACMA (Federación Latinoamericana de Ciudades, Municipios y Asociaciones) and FEMICA (Federación de Municipios del Istmo Centroamericano), both Latin American associations of municipal governments.

4) **Local technical partners**

The local technical partners are responsible for hosting the Met@logo solution, adapting extensions and local implementation. These are as follows:

- Chile: Universidad de la Frontera (UFRO)
- Colombia: Colnodo
- Honduras: Icoms
- Peru: Prohipotecas.

Figure 5 - Met@logo Consortium



3. 5 Met@logo Interventions – how to integrate eGovernment tools into administrative reforms at the local level

It is recommended that every project dealing with the restructuring of processes within governmental administrations at the local level undertakes a *framework study* on the national, regional and local legal framework conditions, in order to identify where there is potential for change and where legal restrictions would limit the possibilities for reform. Once these potentials and restrictions have been identified, they will serve as a basic tool enabling the project to assess whether an intervention makes sense, or whether the law impedes significant reforms.

In this type of project, where success largely depends on the satisfaction of the users (administrations and SMEs), it is highly recommendable to opt for a *participative approach*, i.e. to avoid imposing a pre-conceptualised standard approach, but rather to make a deep analysis of the local conditions and needs and to elaborate the approach in collaboration with the parties involved.[6] This ensures local ownership and also that reforms really take place where they are most needed. In the case of Met@logo, the approach consists, on the one hand, in a thorough *analysis of the needs* of the SMEs with respect to their municipalities, and in the identification of the main communication channels between SMEs and the local governments. On the other hand, the specific *processes*/services offered by the municipalities are closely mapped and *assessed* focusing on their quality in terms of complexity (e.g. the number of forms needed, the number of contact persons needed within the municipality, etc.), of time-efficiency (how long does a specific process take?) and cost-efficiency. The overall goal of the process analysis is to provide a formal description (diagrams) of the processes and procedures within the local administrations identified through the analysis of the SMEs' needs.

Based on the results of these two analyses, it is possible to *redesign administrative processes* in such a way that they are rendered more attractive to the SMEs and less cost and time-intensive. The

[6] A recent study on e-Government in local municipalities states that many projects at the municipal level in Chile and Peru are more driven by the interests of software vendors than by the interests of the target group. (Hilbert, M.: "Local e-Government: Digital Municipalities in Latin America. With Empirical evidence from Chile and Peru", 2005).

focus of the redesigned process is on reducing the number of steps required for each process, the number of sub-processes required, and the amount of personal interaction requirements and the role of the entrepreneur as a link between sub-processes.

When ICT is used to support reform, the next logical step is to adapt these technologies to the new processes to be implemented. To increase still further efficiency in terms of costs and time, Met@logo aims at *implementing an open-source portal* that will allow users to carry out transactions over the internet, as well as to automate internal work flows within the governmental administrations. In the first instance, the choice of software should, among other more technical aspects, be based on the following criteria:

- open-source software: implies no purchase costs and low development costs
- easy to operate
- potential for further development.

Once the software has been chosen, it has to be assured that the solution offered to the administrations reflects the reforms that have been undertaken. It is therefore recommended to split **the implementation of the software into two phases and to use an iterative approach**. In the first phase the software, after being installed and in operation, is tested (in form of e.g. user surveys with the administrations' employees, as well as with the entrepreneurs), in order to identify possible future technical and/or conceptual problems. This allows modifications to be made, which are again installed and tested in a second phase. This approach ensures a higher level of satisfaction with the software solution.

A summary Met@logo's main interventions and its responsible counterparts can be found in Table 7 below:

Table 7: Project interventions and the role of partners

Status	**Intervention**	**Short Description**	**Executer**
Completed	Framework Studies	A best practice reference model was developed; framework conditions were analysed	IFGCC, Nomisma, UDLA, Stanhope
	Analysis of SME Needs	Which municipality services are the most used and most sought after by the SMEs?	Nomisma, local partners
	Analysis of Processes in Municipalities	Analysis of the conditions SMEs have to fulfil to obtain these services, considering complexity, time intensity, etc.	TU-Vienna, GTZ, local partners
	Redesign of Processes	Redesign of the identified processes, simplifying them and making them less time-consuming and more cost-efficient	GTZ, Transparency International, local partners
Ongoing	Software Development	Development of extensions for the CMS Typo3 according to the results of the process redesign	TU-Vienna and local technical partner
To be completed by June 2006	Installation & Implementation Testing Modifications **2X**	Software implementation in two phases, which allows for testing and modifying according to the software performance in the first phase	
	Monitoring	Are the redesigned processes being applied, and is the software solution being used?	GTZ, Webagency, local partners
	Documentation	Compilation of project results	TU-Vienna
	Development of a Project Starter Kit	A starter kit that will allow other municipalities to adopt the Metalogo approach in a simple and low-cost way	GTZ

4 Conclusion and Lessons learned

There are a number of lessons that have been learned throughout the Met@logo project in using an eGovernment approach to improve the local business environment, the main ones of which are examined in more detail below.

Despite available country studies and assessments, knowledge about local processes is vital

The use of national documents, assessments and studies about local processes can be quite helpful in providing an initial impression of the framework conditions. Nevertheless, it is highly recommended always to carry out a detailed analysis of the processes in the target area. In some cases, for example, national legislation aimed at improving the business environment by reducing bureaucratic obstacles is not applied at a local level. For example, in Colombia, an "anti-bureaucracy law decree" dating back to 1995 had still not yet found its way into the operational reality of most pilot municipalities by 2005.

Another interesting finding is that the processes required to open a business differ significantly between the municipalities, not only in terms of their duration and cost, but also regarding the responsibilities and the degree to which the entrepreneur has to involve himself or herself.

Reforms are only successful if backed by so-called political champions
It is crucial to assure the commitment of the political leadership at the local level. A change of political leadership involves a significant risk for the program. Where it is unavoidable, involving possible candidates in the program before the elections has proven useful in the past.

Change agents need to be identified right from the start
Change agents – persons who work inside the administration and who support changes – should be identified right from the program's start. They support the program's activities and help to convince those employees who are less keen on reform.

Helping the local administrations to develop a roadmap for further work on BE
While Met@logo provides start-up help for all activities designed to improve the local business environment, it is absolutely necessary to empower the local administrations to develop their own targets on how to improve conditions further for SMEs after the project's end.

Involving local stakeholders in the redesign process
Strong participation of the administrations in the redesign process has proven very valuable in creating buy-in and facilitating implementation. In order to avoid the programs being instrumentalised by the administrations for their own purposes, it is recommended that the business community should be closely involved beyond the analysis phase.

Local decision-makers need to grasp the full potential of eGovernment approaches
It is essential to communicate effectively to people what eGovernment is about. In many cases, people tend to think of eGovernment as a simple website that provides some information about the municipality. A true eGovernment approach like the one adopted by Met@logo, on the other hand, involves changes in internal processes, the integration of the eGovernment portal into daily working processes, changes in attitude and the learning of new skills.

Identification and cooperation with related national, regional and local initiatives
Governmental and donor activities that are relevant to the planned project should be identified early on, in order to avoid duplicating efforts. The project should also aim to cooperate with these activities, thus taking advantage of any potential synergies.

A flexible project approach, able to react to local demands

It is recommended to develop approaches, tools and methodologies that are not only applicable to different scenarios, but are also flexible enough to react to local changes and to adapt quickly and with the same quality results. The approach should also provide the scope for future changes and developments.

Availability of local support infrastructure
No matter which eGovernment tool has been chosen, a local support infrastructure is in any case needed to provide help for local administrations at a relatively low cost. Additionally, local support structures can expand the software solution according to local needs.

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Contact informations:

German Technical Cooperation (GTZ) Economic Development and Employment– Economic Policy and Private Sector Development	Dr. Sonja Kurz: Sonja.Kurz@gtz.de Julius Spatz: Julius.Spatz@gtz.de
A critical assessment of the „new minimalist approach"to private-sector development	Dr. Tilman Altenburg Tilman.Altenburg@die-gdi.de
The GTZ economic Reform and Market Development Program for Mozambique	Dr. Friedrich Kaufmann Friedrich.Kaufmann@gtz.de
Designing Local Business Environment Reform Programs – A case study from the Philippines	Martina Vahlhaus Martina.Vahlhaus@gtz.de
Human Resource Development for a Market Economy (HRDME) GTZ Program in Lao PDR	Dr. Manfred Matzdorf Manfred Matzdorf@gtz.de
Improving the Quality of Business Environment Reforms - Vietnam	Le Duy Binh office.sme@gtz-vietnam.com.vn
Barometer "Programme de Mise à Niveau » in Tunisia	Detlev Jahn bmn.gtz@gnet.tn
The regional Business Climate Survey for SADC Countries	Kara Rawden Kara.Rawden@gtz.de
Reforming the Business Environment in Afghanistan	Carlo Hey pps@gipc.org.gh
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eGovernment to improve the local business environment: A case study from Latin America – Met@logo	Hannes Karkowski Hannes.Karkowski@gtz.de