

AFRICA'S PRIVATE SECTOR

*What's Wrong with the
Business Environment
and What to Do About It*

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CENTER FOR GLOBAL DEVELOPMENT

Washington, D.C.

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1776 Massachusetts Avenue, N.W., Washington, D.C. 20036

www.cgdev.org

*Africa's Private Sector: What's Wrong with the Business Environment
and What to Do About It* may be ordered from:

Brookings Institution Press, c/o HFS, P.O. Box 50370, Baltimore, MD 21211-4370

Tel.: 800/537-5487; 410/516-6956; Fax: 410/516-6998; Internet: www.brookings.edu

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Library of Congress Cataloging-in-Publication data

Ramachandran, Vijaya.

Africa's private sector : what's wrong with the business environment and what to do about it / Vijaya Ramachandran, Alan Gelb, Manju Kedia Shah.

p. cm.

Includes bibliographical references and index.

ISBN 978-1-933286-28-0 (pbk. : alk. paper)

1. Privatization-Africa. 2. Business enterprises-Africa. I. Gelb, Alan H. II. Shah, Manju Kedia. III. Title.

HD4338.R36 2008

338.96'05-dc22

2008044171

9 8 7 6 5 4 3 2 1

Printed on acid-free paper

Typeset in Minion and Univers Condensed

Composition by R. Lynn Rivenbark

Macon, Georgia

Printed by Versa Press

East Peoria, Illinois



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Foreword

Gross domestic product in Africa has risen steadily over the past few years and is now growing at an annual rate of 6 percent. Economic growth in several non-oil exporting countries has also reached a robust annual rate of more than 5 percent, as those countries have seen significant improvement in the diversification and management of their economies. Macroeconomic reforms and improved political stability are producing significant results in terms of economic growth, and policymakers across the continent have better tools for combating inflation. Moreover, foreign direct investment in Africa has increased significantly since the early 1990s.

Yet there is much to be done, particularly in the area of *domestic* investment. In this book, Vijaya Ramachandran and her coauthors, Alan Gelb and Manju Kedia Shah, investigate the obstacles that Africans in the domestic private sector must deal with on a daily basis. Analyzing data from the World Bank's Enterprise Surveys, they argue that lack of infrastructure is one of the most serious constraints to the growth of Africa's private sector. In particular, the lack of a reliable supply of electricity significantly affects the productivity of businesses, especially those that cannot afford generators. The lack of a road network, resulting in the total absence of overland trade between Africa's two largest economies—Nigeria and South Africa—is also a serious problem. Finally, the authors argue that entrepreneurial capacity is constrained by the absence of broad-based, competing business networks, which further limits the ability of domestic investors to grow and thrive.

The authors present several solutions to these issues. One is that Africa has tremendous potential for the production of renewable energy: its reserves of renewable resources, including hydro, geothermal, wind, and solar power, are the largest in the world. There is scope for harvesting those resources, in both small- and large-scale projects. The authors make a strong argument that the time has come to make a real push toward helping Africa get on a carbon-free path to power generation by using the best available renewable energy technologies. And there is potential to address the transport bottleneck as well. A network of roads connecting all sub-Saharan capitals, along with the African Development Bank's proposed corridor network, would go a long way toward improving intra-African trade. And finally, investments in education, including nonformal methods of building entrepreneurial capacity and business networks, would help to create a broad-based private sector.

In 2003, I chaired the Commission on Capital Flows to Africa. We produced a report that argued that "increased capital flows can contribute significantly to Africa's development and that the U.S. government, together with the G-8 and OECD nations, could do much to stimulate and facilitate these flows." We said that the proposals in the report "would pay major dividends in terms of advancing U.S. humanitarian, foreign policy, and national security interests." Those statements are perhaps even more relevant today. Given the current global turmoil and the headwinds that the continent is likely to face going forward, the conclusions in this book are all the more important. A strong, vibrant private sector in Africa is central to creating jobs and economic growth in the region, and it also will create demand for goods and services from countries around the world.

JAMES A. HARMON
Chairman
Caravel Management

New York
December 2008

Preface

At the Center for Global Development, we are concerned primarily with rich-world policies on aid, trade, and other issues that shape the chances for poor countries and poor people to improve their well-being. Among regions, Africa has the largest number of countries that are highly dependent on aid, and from our inception seven years ago, we have worked on reform of the donor aid system and on debt relief programs that matter immensely for Africa. However, the reality is that sustainable growth in Africa depends less on aid than on global and domestic policies and investments that support the creation of businesses and job growth.

As this book goes to press, growth rates in the developing world—and the reductions in poverty that accompany growth—are at risk due to a global financial crisis and economic downturn that began in the United States. The prospect of a global recession raises the question of whether Africa’s growth, at an average annual rate of between 3 and 5 percent over the past five years, is adequately rooted in a thriving domestic private sector or whether it is instead the outcome of external factors, including the commodity boom driven by growth elsewhere (such as in China) and the increase in foreign private inflows helped along until late 2008 by low global interest rates.

Vijaya Ramachandran and her coauthors address that question and many others as well: Can African firms compete against the Chinese manufacturing juggernaut? How do government regulations and the lack of infrastructure

affect their costs and competitiveness? How well do local financial markets provide credit, especially to indigenous firms?

Using carefully gathered and unusually thorough survey data, the authors describe the state of small businesses and the obstacles facing them, and they point policymakers toward the investments in infrastructure and education that would help unlock the vast potential of the African people. The authors' investment in practical evidence shines in their careful approach to its analysis, which comes to life through the many examples of the difficulties that businesspeople in Africa face. A firm in the Democratic Republic of Congo must resort to airlifting cement to avoid poor roads. Manufacturers in Kenya have been asked to operate at night to reduce the load on an overburdened electrical grid.

Finally, the authors show that sparse and fractured markets in Africa make trade less profitable and economies of scale more difficult to achieve. In this already difficult business environment, large indigenously owned firms are few in number and lag behind their non-indigenous counterparts. Supporting indigenous firms must be a focus of policymakers in order to create a broad-based private sector.

Jim Harmon's foreword calls attention to the implication of this work for the global community, including the incoming administration in the United States. Indeed, the analysis in this book expands on the policy recommendations in CGD's *The White House and the World: A Global Development Agenda for the Next U.S. President*, and it also builds on our earlier work on the future direction of the African Development Bank.

The work that led to this book is part of the Center's portfolio of policy research on weak and fragile states, which benefits from the financial support of the Australian Agency for International Development. We also are very grateful to our board member, James Harmon, for his support of this work and for his deep commitment to development and poverty alleviation in Africa. Finally, we thank Edward Scott Jr., the chairman of our board, for his ongoing support of the Center's work.

NANCY BIRDSALL
President
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Washington, D.C.
December 2008

Acknowledgments

We are grateful to several people for sharing their knowledge, insights, and expertise on the issue of private sector development in Africa. Nancy Birdsall gave us sound advice and encouragement throughout the writing process. Dennis de Tray, Kim Elliott, Enrique Rueda-Sabater, Ted Moran, Todd Moss, Phil Keefer, Gaiiv Tata, George Clarke, Arvind Subramanian, David Wheeler, Michael Clemens, Steve Radelet, and David Roodman provided valuable comments and suggestions. George Clarke, Jorge Rodriguez-Meza, and Alvaro Gonzalez generously helped us with the sampling methodology and the use of the Enterprise Surveys database. Benn Eifert coauthored earlier work on enterprise productivity and provided valuable insights on various parts of the analysis. Robert Bates reviewed the manuscript and provided us with very helpful comments.

We also gained many insights from presenting various parts of this book to audiences of policymakers, academics, and private sector businesspeople at the University of Cape Town; the African Development Bank; the Private Investors for Africa Group; the Africa Advisory Council of Heineken N.V.; Georgetown University; Cornell University; the South African Economics Association; the World Bank Annual Conference in Development Economics (in Dakar); the Millennium Challenge Corporation; the Development Economics Research Group of the World Bank; the Trade, Aid and Security Coalition; the Society for International Development; and the National Bureau of Economic Research. In particular, we would like to thank Dave Kaplan, Alan

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Hirsch, Olu Ajakaiye, Benno Ndulu, John Nellis, Marilou Uy, Peter Timmer, Demba Ba, Melanie Mbuyi, Giuseppe Iarossi, Jean Michel Marchat, Ivan Rossignol, Jim Emery, Michael Klein, Guy Pfeffermann, Devesh Kapur, John Nellis, James Habyarimana, Mary Hallward-Driemeier, Taye Mengistae, Ritva Reinikka, Jeri Jensen, and Nicolas van de Walle.

Sina Grasmann, Nicole Smalls, and Sarah Rose provided excellent research assistance, as did Robin Kraft, who went above and beyond the call of duty in getting this manuscript ready for publication. Lindsay Morgan and John Osterman guided the manuscript through publication. We are grateful for their help.

This analysis is based on surveys of thousands of African businesspeople who are trying to keep their businesses running despite all sorts of obstacles. We are deeply grateful to them for their time and effort, and we hope that the solutions proposed in this book will be of use to them. We are thankful as well for support from the Australian Agency for International Development, which has helped make this work possible.