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PUBLIC POLICY FOR THE **PRIVATE SECTOR**

Investment Climate in Africa

The Impact of Reform on Sub-Saharan Africa's Growth

This note has been prepared by David Bridgman, Practice Manager, Trade and Competitiveness Global Practice (T&C), and Aref Adamali, T&C Regional Economist, both with the World Bank Group.

The World Bank Group has been working on investment climate reform in Sub-Saharan Africa for nearly a decade, a period characterized by dramatic economic growth on the continent. Establishing links between such reform interventions and economic growth, however, is a complex problem. Although this note finds some connection between investment climate reform and economic growth, establishing more concrete evidence of causation will require greater focus at the country level, as well as on small and medium enterprises. This is where investment climate interventions generate change.

The dramatic change in how the world perceives Sub-Saharan Africa has often been illustrated by the juxtaposition of two cover images from *The Economist*. In 2000, the magazine cover showed a bleary-eyed young man with a rocket-propelled grenade launcher over a map of the African continent with the title, "The Hopeless Continent." By contrast, an issue in 2011 showed a boy flying a rainbow-striped kite in the shape of the continent with a soft glow on the horizon, titled "Africa Rising" (*The Economist* 2000, 2011). Sub-Saharan Africa has gone from being known as home to the majority of the world's poorest billion people to being the newest market opportunity of a billion consumers.

For much of this transformative period, the World Bank Group's investment climate efforts, now managed by the Bank Group's Trade and Competitiveness Global Practice, have helped governments and the private sector expand business opportunities through investment climate reforms covering a range of regulatory and policy issues from starting a business to construction permitting to taxation, agricultural reform, and debt resolution. After years of effort and many millions of dollars of investment, now is an appropriate time to identify what these reform efforts have achieved, and what role they have played in Sub-Saharan Africa's growth trajectory.

This analysis begins with an overview of the story of the region's economic growth and the social and political drivers propelling it. Next, the note examines the Bank Group's investment climate reform efforts in Sub-Saharan Africa followed by an analysis of how the results of reform factor into the story of the region's economic transformation. The analysis concludes that countries in Sub-Saharan Africa that have

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embraced business reform have also attracted domestic and foreign investment and achieved steady growth. Reform efforts have generated beneficial spillover effects, as neighboring countries subsequently embarked on similar reforms.

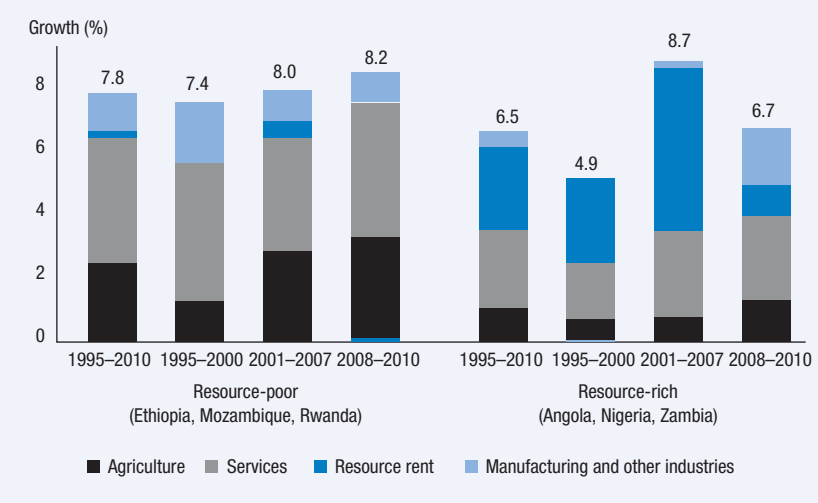
A fundamental break with the past?

The average growth rate of 5 percent per year over the past 18 years across Sub-Saharan Africa marks a stark contrast with the "lost decade" of the 1980s, when growth rates lagged population increases, resulting in citizens growing poorer year after year.

The end of the Cold War that had factored into local conflicts across Africa helped reduce the incidence of armed conflict to a third of peak levels. It also ushered in opportunities for democratic expression, which led to greater civic freedom and demands for public accountability. The excesses of the past have given way to more sensible governments that have controlled budget deficits and inflation, leading to greater macroeconomic stability (though government corruption remains a significant issue).

This process was aided by structural adjustment reforms—unpalatable though they were at the time—and, comparatively more agreeable, extensive debt forgiveness through the Heavily-Indebted Poor Countries Initiative (IMF 2013).

Figure 1 **Not only natural resources (Sectoral contribution to total growth for selected countries)**



Source: World Bank, "Africa's Pulse," April 2013.
Note: High-growth, resource-poor countries reviewed by the IMF also include Tanzania and Uganda. Some of these countries have since made resource discoveries and are already or will soon become resource producers.

However, some more traditional growth factors have persisted, including the importance of natural resources in driving many economies. This has raised concerns as to whether current growth is any different than in the past, and what will happen should commodity prices continue their current decline as part of historical commodity price boom-and-bust cycles. The World Economic Forum's *Africa Competitiveness Report 2013* warned that "for many African economies, sources of growth are insufficiently diversified. Mineral exports make up over half of the region's total exports, rendering them vulnerable to commodity shocks" (WEF 2013).

Africa's oil and mineral exporters have reported robust growth rates, but by no means have they been alone in the top growth ranks. Some of the faster growing economies in the world have been Sub-Saharan countries with few if any significant natural resources. As shown in figure 1, analysis by both the World Bank and the International Monetary Fund (IMF) finds agriculture and services to be the major drivers behind a set of high-growth, resource-poor countries, which include Ethiopia, Mozambique, Rwanda, Tanzania, and Uganda (IMF 2013; World Bank 2013).

Doing business differently

The World Bank Group has been partnering with governments, development partners, and the private sector across the continent to build a business environment that supports entrepreneurship, innovation, and competitiveness. Launched in 2006 as a joint World Bank-International Finance Corporation (IFC) program, investment climate work initially focused broadly on topics defined by the World Bank Group's *Doing Business* report. This work capitalized on the high profile of *Doing Business* report rankings among country policymakers and the wider public, with a focus on tangible indicators and the healthy competition that the annual rankings generated.

The program has delivered strong and steadily improving results in the region. *Doing Business 2012* documented reforms in 36 Sub-Saharan Africa countries, with 4 reaching the top 10 of global reformers. *Doing Business 2013* found that one-third of the world's 50 best reforming countries were from the region. Further, *Doing Business 2014* reported that Sub-Saharan African countries accounted for almost half of the world's top-20

reformers. In this context, the star performer has been Rwanda, having moved significantly closer to the highest level of performance in the Doing Business rankings from 2006 to 2014.[1]

Other top performers in the region in recent years have included Botswana, Burkina Faso, Burundi, Cabo Verde, Côte d'Ivoire, Djibouti, Ghana, Kenya, Liberia, São Tomé and Príncipe, Senegal, Sierra Leone, Tanzania, and Zambia. These range from Sub-Saharan Africa's larger and more established economies to those that have only recently emerged from conflict.

If not an end, a fair proxy for reform

In many ways, Doing Business reforms are a reasonable goal in their own right toward which countries can strive. Focused mainly on domestic small and medium enterprises (SMEs), the reform efforts spotlight bottlenecks faced by firms throughout their life cycle, from start-up, to acquiring land and finding financing, and, when necessary, to debt resolution and closure.

As the *Doing Business* reports point out, however, they do not cover all areas of investment climate reform that matter to businesses. This requires an assessment of the relationship between changes in Doing Business and other key indicators of economic change for Sub-Saharan Africa.[2] Thus, the focus is on the impressive economic change that has occurred in the region, and how these changes relate to the rankings. Certain economic indicators are also of greater interest than others. They begin with economic growth, but also include increased investment.

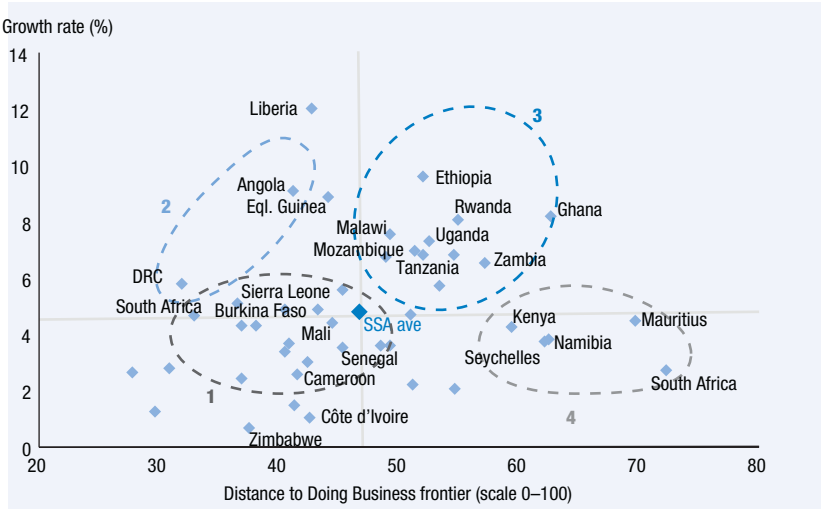
Success as growth

Figure 2 shows the relationship between the reform status position of Sub-Saharan Africa economies (as measured by their distance to the Doing Business frontier) and their individual growth rates. Some broad clusters of countries emerge. Group 1 represents the average regional economy, positioned slightly below left of the actual average. These countries are only about 40 percent of the way toward the frontier and have been growing at roughly 4 percent per year. Group 2 is a cluster of countries with the advantage of possessing natural resources. Although they are positioned in roughly the same place along the reform axis as Group 1, their resource-based economies have enabled them to achieve much faster growth.

Group 3 consists of a mix of countries that are fast growing and positioned above the average on Doing Business performance. It includes resource-rich countries, such as Ghana and Zambia, as well as the fast-growth, non-resource endowed countries—Mozambique, Rwanda, Tanzania, and Uganda.

Group 4 comprises countries that are well past the 50-percent mark on their Doing Business journey toward the frontier, but which have had growth rates below the regional average. This

Figure 2 **Broad mix of countries (Position on Doing Business frontier and growth, 2007–11)**



Sources: World Bank Doing Business data, www.doingbusiness.org; World Development Indicators, www.data.worldbank.org .
Note: SSA ave abbreviates Sub-Saharan Africa average.

group is comprised of some of the region's more diversified economies, as well as some of the more globally integrated ones, such as Mauritius and South Africa.

However, this is a comparatively static image, at least on the Doing Business front. The more interesting aspect of the Sub-Saharan Africa economic story relates to change. Figure 3 shows the region's growth against how its countries have advanced toward the Doing Business frontier. The clusters move and merge in interesting ways.

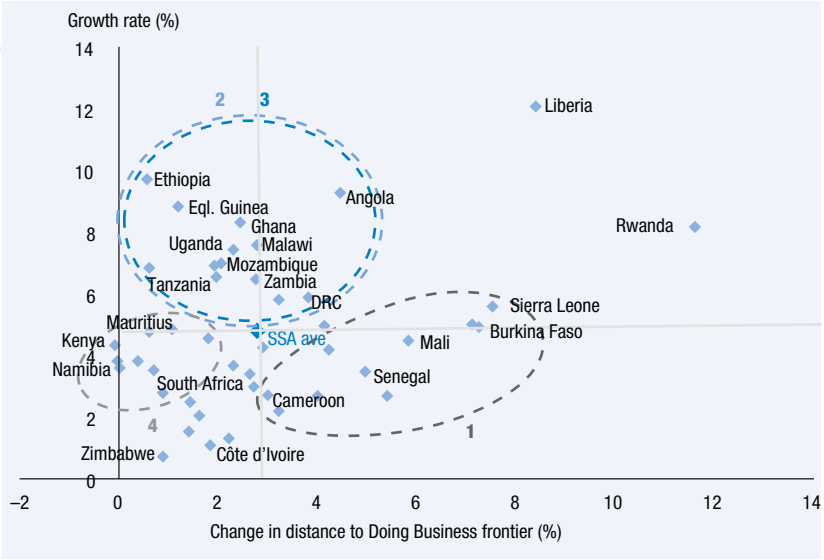
Group 1, the somewhat lackluster group that was ranked below average in figure 2, moves above average in terms of change (as opposed to position) on the reform scale, indicating a level of desire to address business environment and growth constraints. On this scale, the Group 1 cluster of countries shifts from seeming under-achievers to being serious reformers with aspirations for growth. This group includes some of the most active clients of the Trade and Competitiveness Global Practice (see table 1, Annex).

In figure 2, the high growth, resource-rich and non-resource rich countries, Groups 2 and 3, are partially separated from each other by their position on Doing Business. However, when analyzed in terms of their movement on Doing Business rankings, the two groups merge into a cluster characterized by above-average growth, but merely average reform performance. This implies that Group 3 begins to take on some of the characteristics of Group 2, whereby high levels of economic growth may dampen the appetite or perceived need for investment climate reform.

The countries in Group 3 are above average in the Doing Business rankings, but only when compared to the regional average. They fall far below average when compared to a global pool of countries, and they could be overtaken by other countries in the region that are pursuing reform. There remains an incentive, therefore, for the countries in Group 3 to pursue an aggressive reform strategy, even though their recent economic growth may have a tendency to obscure that incentive.

The countries in Group 4 have been largely disengaged from Doing Business reform despite the fact that they are not experiencing high growth. In some cases, this may be because they are sufficiently well positioned in the reform rankings,

Figure 3 **Varied reform enthusiasm (Change on Doing Business frontier and growth, 2007–2011)**



Sources: World Bank *Doing Business* data, www.doingbusiness.org; World Development Indicators, www.data.worldbank.org .
Note: SSA ave abbreviates Sub-Saharan Africa average.

and so they do not prioritize additional reforms on this front. With the exception of Kenya, countries in this group can be considered to have graduated beyond improving performance on the Doing Business indicators as the main focus of their investment climate reform efforts.

Finally, Liberia and Rwanda, both of which are high performers in figure 2, emerge as exceptional performers in figure 3, where movement up the Doing Business rankings is considered. Despite experiencing strong growth in the case of Rwanda and remarkable growth in the case of Liberia, neither country exhibits signs of relaxing its reform efforts. Indeed, they undertake reforms year after year as they try to move closer toward the reform frontier, exhibiting the same aspirational characteristics as Group 1 but with the added benefit of fast growth.

The bottom line: investment

After a decade of experience with investment climate work in the region, patterns and linkages are emerging between Doing Business reform and economic growth. However, the drivers of growth—the abundance of natural resources is just one of these—are too numerous and varied to establish simple causation. A country with a reasonably sound investment climate may still experience severe growth challenges—a circumstance to which many European countries could currently attest.

Investment levels may stand as a better measure of the success of the Bank Group's Africa interventions. They serve as a gauge of the effect of business environment reforms on private sector decision making, as marked by the most important decisions that entrepreneurs make: where and how much to invest.

Encouraging investment is the subtext of all the business life-cycle reforms promoted by the Bank Group in Sub-Saharan Africa. Trade and Competitiveness work in the region focuses explicitly on investment generation, often including program performance targets that specify minimum investment levels that interventions are expected to generate.

Investment also serves as an important measure of perceived stability, with entrepreneurs and their families forgoing consumption now to make medium- to long-term commitments to an economy in the belief that their investments will offer a greater pay-off in the future. The willingness of Sub-Saharan African entrepreneurs to take the long view of investment prospects is a fundamental element of the larger story of economic growth on the continent, enabling the region to attain average investment levels of 22 percent of GDP—equivalent to China in the early 1960s and India in the early 1980s (World Bank 2013).

Part of the challenge in looking at linkages between investment climate reform and actual investment in the region is reflected in the characteristics of the period under review: Doing Business reforms in Sub-Saharan Africa started gaining momentum just as the global economic downturn of 2008 launched the world into the "great recession," which dampened investment levels globally. More fundamentally, too many factors drive investment decisions, making it difficult to isolate the impact of Doing Business reforms from the aggregate data.

Establishing these linkages with greater precision requires a more detailed look at the level of investment in each country. This would include attempting to count the investment generated by each individual reform, or for an aggregate of reforms where they positively reinforce each other. Without this analytical level of granularity, the potential investment impact of investment climate reforms will be subsumed by a handful of large investments that have less to do with a country's business environment than with the presence of valuable sub-soil resources or of positive macroeconomic conditions. National-level investment data also insufficiently captures changes in how local SMEs—the main beneficiaries of investment climate reform—invest and grow.

Conclusion

Sub-Saharan Africa today is a very different place than it was only a decade ago. It has achieved greater stability and growth, and some parts continue to grow rapidly. Pockets of fragility and unrest remain and at times expand. There is also concern that economic growth remains too heavily tied to natural resource endowments.

However, across most of the continent, investment has been rising and businesses are increasingly making long-term bets. The Bank Group supports this process in Sub-Saharan Africa by helping governments in their efforts to cut red tape for SMEs and to establish legal, regulatory, and procedural frameworks that encourage entrepreneurs to take risks.

The Bank Group's efforts with client countries have made the region one of the fastest reforming in the world. However, not all of this reform has translated directly into increased growth and investment for all countries. Some economies in the midst of strong growth, whether resource-driven or otherwise, may see little need to engage in extensive reform. Other countries trying to exceed average growth rates look to change this by embarking on above-average business environment reforms. Investment data in smaller economies, of which the continent has many, tends to be too heavily influenced by a few large deals for meaningful trends to be identified.

Further work will be required at the country and SME levels to determine the impact of investment climate reforms on investment and economic growth. In this context, the Trade and Competitiveness Global Practice is undertaking analysis at the country and enterprise levels to determine impact. This is especially important as the Bank Group and its developing country partners in Sub-Saharan Africa and elsewhere around the globe embark on the next generation of investment climate reforms.

Annex

Table 1 Active reformers (T&C investment climate reform count by country, FY 2008–14)

Country	Number of investment climate reforms
Rwanda	27
Burkina Faso	22
Liberia	16
Mali	14
Sierra Leone	13
Burundi	11
Mozambique	10
Côte d'Ivoire	10
Democratic Republic of Congo	9
Senegal	8

Source: Trade and Competitiveness Global Practice data, World Bank Group.
Note: This reform count is based on a methodology used by the Trade and Competitiveness Global Practice by which a reform must achieve a minimum, pre-determined level of change (often time and cost savings to private firms) to be formally counted as a reform.

Notes

1. The Doing Business indicators measure a country's reform progress in terms of distance of each economy to the "frontier," which represents the best performance observed on each of the indicators across all economies in the Doing Business sample since 2005. A country's progress toward the Doing Business frontier is represented as a higher percentage of the total distance.

2. Doing Business notes that there is a high correlation (0.83) between Doing Business rankings and the rankings on the World Economic Forum's Global Competitiveness Index, a broader index that measures factors from macroeconomic stability and institutional development to technology and innovation.

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