8. Stimulating private participation

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8.1. Introduction

The private sector has emerged as an increasingly important element in stimulating economic growth in developing countries, in response to opportunities for investment and business innovation, created by globalization and technological advances. Consequently, private sector development (PSD) has become a major focus of strategies for economic diversification and transformation, broadly endorsed by multilateral and regional development institutions, donor agencies and governments to foster economic development. Private enterprise is playing a crucial role in transforming fast-growing economies in Asia with significant employment creation and poverty reduction benefits.

In sub-Saharan Africa however, governments have mostly relied on public sector-led development strategies, using state-owned enterprises to drive industrialization. Consequently, in most economies, the private sector remains largely informal and relatively underdeveloped. A recent UNIDO/GTZ[45] study found that "high levels of informality persist throughout sub-Saharan Africa ...[and] informality in general seems to be highest in sub-Saharan Africa when compared with other world regions" (UNIDO & GTZ 2008 p.14). Although the informal sector is the main source of job creation in many countries in sub-Saharan Africa, thereby cushioning unemployment and destitution for millions of Africans, the vast majority of enterprises in this sector seldom grow sustainably. Jobs are usually precarious and earnings are generally very low (Bigsten *et al.*

45. Formerly GTZ, it is now known as GIZ (Gesellschaft für Internazionale Zusammenarbeit).

2004; Flodman Becker 2004; International Labour Organization ILO 2002). Because informality is a major obstacle to economic growth, its transformation into a viable private sector is a pressing development challenge.

8.2. Potential of the African private sector

The private sector and economic growth

Given the existing state of affairs in most African countries, the realization of the potential of the private sector for economic development will require public sector interventions to enhance domestic capacity and capability in respect of physical and social infrastructure, human capital, financial systems, technology and governance. In addition, governments should put in place regulatory frameworks for tackling market failure. Hence, interventions to create an enabling environment for PSD have to be seen in the light of the wider discourse on the respective roles of government and markets in achieving desired development outcomes.

While the business climate in Africa is improving, to judge from the inclusion of Rwanda, Botswana, Kenya, Ghana, Liberia, Mauritius, Tunisia and Egypt among the top ten reformers in the annual World Bank's *Doing Business* rankings over the past five years, the cost of doing business on the continent is still the highest compared to other developing regions, according to the latest report (World Bank 2009d). Entrepreneurs in sub-Saharan Africa continue to face greater regulatory and administrative burdens, and have less protection of property and investor rights than their counterparts in other regions. Doing business in Africa is characterized by high transaction costs, due to small and fragmented markets; protracted and cumbersome administrative procedures and bureaucratic bottlenecks; poor physical and financial infrastructure; and very low transaction volumes. Interventions needed to remove constraints on PSD should be supported by efforts to enhance competitiveness; promote exports and facilitate intra-regional trade. Effective regional cooperation that stimulates increased intra-regional trade will allow African countries to exploit specialization and economies of scale, while attracting increased investment.

There is little doubt that the emergence of a credible private sector in Africa would impact positively on economic growth and poverty reduction in the region. Although African economies are still characterized by a dichotomous structure—typically comprising an underdeveloped rural and urban informal economy (Box 8.1) alongside a relatively small, organized modern sector—this dichotomy does not necessarily represent a major obstacle to realizing the full potential of the private sector. On the contrary, the underdevelopment of the informal economy in Africa—with vast unexploited resources and abundance of labour—provides opportunities for development of the private sector and for attracting private investment. In addition, Africa also offers large untapped markets and all the benefits of emerging economies, such as comparatively high rates of return and attractive possibilities for investment diversification.

Box 8.1: How informal is the African economy?

According to a new study of informality in the global economy (GTZ 2010; Schneider et al. 2010), the 'shadow economy' is estimated to be larger in sub-Saharan Africa than any other region. The median for SSA economies is 40.7 per cent of official GDP followed closely by Europe and Central Asia (40.3 per cent) and Latin America and the Caribbean (40.1 per cent).

The overall average of the shadow economy in 151 countries is shown to have increased to 35.5 per cent in 2007 from 32.9 per cent in 1999. Informality is lowest in Switzerland, US and Austria and greatest in Azerbaijan, Bolivia, and Georgia. Mauritius (23.5 per cent) has the smallest informal sector in sub-Saharan Africa, followed by South Africa with 29.5 per cent, Lesotho (32.1 per cent) and Namibia (32.5 per cent). The largest informal sectors in sub-Saharan Africa are found in the United Republic of Tanzania (60.2 per cent) and Zimbabwe (57 per cent). These estimates understate the real size of the informal sector in Africa, because the Schneider study explicitly excludes the informal household economy consisting of subsistence activities of household production and services. Schneider *et al.* define the shadow economy or informal sector as one that includes "all market-based legal production of goods and services that are deliberately concealed from the public authorities" for reasons such as:

- To avoid paying tax or social security contributions.
- To avoid compliance with legal labour market standards—minimum wages, maximum working hours, safety standards, etc.
- To avoid complying with administrative procedures, such as completing statistical questionnaires or other administrative forms.

According to the study, the main drivers of informality are:

- The tax burden on businesses and households—the greater the gap between the total cost of labour in the official economy and after-tax earnings from formal employment, the greater the incentive is to work in the shadow economy.
- Labour market regulations such as minimum wages or rules governing the hiring and firing of workers and labour market restrictions for foreigners also foster informality because they increase employment costs. Since these can be shifted to the worker, who bears the brunt of the regulatory burden such regulations are an incentive to seek informal employment.
- Where the informal sector is large, state tax revenues are reduced, and as a result, the quality of public goods and services suffers, especially expenditure on human capital (health and education) and public infrastructure. Accordingly, the more informal the economy, the poorer the state of infrastructure and the quality of human capital—both of which are crucial to enhancing agribusiness output and efficiency.
- The state of the 'official' economy also impacts on informality. The weaker it is, as in the case of recession, the more workers and entrepreneurs will try to compensate for 'lost' income from formal activities by seeking to exploit informal opportunities.

Informality is negatively correlated with *per capita* incomes—with the largest informal sectors in the world's poorest region, sub-Saharan Africa, and the smallest in high-income OECD economies. This underscores the need to formalize Africa's shadow sector to increase incomes, enhance productivity and raise tax-to-GDP ratios.

Source: Schneider *et al.* (2010)

8.3. The private sector and agribusiness development

Nowhere is optimism about the potential of the African private sector as a driver of economic growth more realistic than in agriculture, given the region's huge reservoir of arable land and rural labour. As mentioned in chapter 1, the slow transformation of African economies has forced many countries to continue to depend on agriculture for their economic well-being. The potential of the African private sector for responding to agro-based market opportunities is perhaps best illustrated by the situation of Kenya. Agriculture is the most important sector of the Kenyan economy, and is dominated by a vibrant private sector comprised mainly of small and medium-sized farming and processing operations. About three-quarters of Kenya's population depend on such operations for a livelihood and the sector is the major employer of labour in the country. Taken together, Kenya's farms, farm product processing and agro-industries generate about half of Kenya's GDP, a major proportion of which is derived from exports—mainly tea, coffee, fresh fruit and vegetables and cut flowers. The rate of agricultural growth in Kenya more than trebled from 2.0 to 6.7 per cent annually between 2003 and 2009, and the proportion of the rural population living below the absolute poverty line declined by 5 per cent over the same period (GTZ 2010). Sadly, however, the Kenyan experience is not typical of the continent as a whole.

Economic activity in agriculture is characterized by millions of rural people engaged in subsistence and low-productivity smallholder production and also by excessive dependence on the production and export of unprocessed primary commodities. Structural problems of low productivity, inadequate rural infrastructure, and poorly-integrated markets are serious constraints on the development of agribusiness and agro-industry and on entry to global value chains.

A large proportion of the region's agricultural production undergoes no industrial processing in the countries of origin (chapters 1 and 5). Important issues relating to investment in rural infrastructure, access to international food and agriculture markets, international competitiveness, critical linkages between agriculture, industry and services, and reduction in the vulnerability of smallholder farmers remain to be tackled. Given the enormous scope for expansion of agribusiness and agro-industry in sub-Saharan Africa, there is little doubt that private enterprise has the potential to stimulate growth and diversification if the right conditions exist.

With only about one fifth of Africa's potential cultivable land currently in use, investment in agribusiness and agro-industry would bring more land into sustainable production, while at the same time, continuing efforts to increase productivity in existing farmlands. The Guinea Savannah zone of Africa contains arguably the largest area of underutilized arable land in the world. Low population densities in many areas within this zone mean that there is scope for expanding and intensifying production systems needed to support large-scale agriculture and agro-industry. Enabling the private sector to play the crucial role of bringing international competitiveness and growth to African agriculture will depend on getting policies right, strengthening institutions, and investing in improved physical infrastructure and services that support on-farm production, as well as processing and export marketing.

Interest of foreign investors in African agriculture has been given a boost by the increasing global demand for food and agricultural products, mainly as a result of rising consumption levels in large emerging economies such as China and India and favourable world market prices. Following the sharp rise in the prices of agricultural commodities and food in 2008, some sub-Saharan African countries such as Ghana, Malawi, Rwanda, Senegal and Kenya have recorded strong growth in agricultural exports (UNCTAD 2010b), which suggests that agribusiness could become a primary driver of economic growth and employment, as well as an important contributor to poverty reduction in the region. It should however be noted that higher world food prices for basic staples like rice, cereals, wheat flour, and cooking oil could threaten food security potential in low-income net food-importing countries in the region, such as Benin, Eritrea, Cote d'Ivoire, DRC, Mauritania and Sierra Leone.

8.4. Conceptual framework

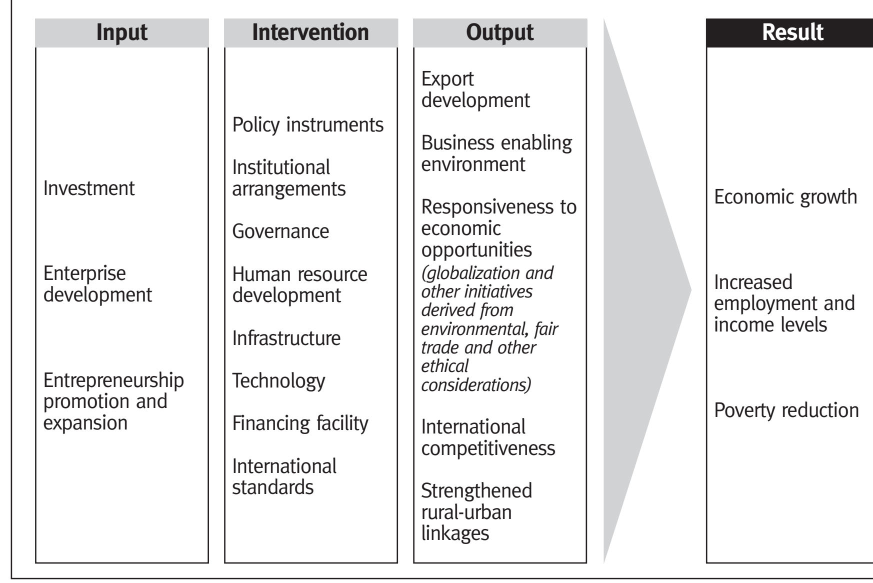
The conceptual framework presented below is based on a result matrix, which shows key input and output factors and the types of intervention required for PSD and investment in agro-industry, in order to achieve results that would impact positively on economic growth, employment and poverty. According to this conceptual framework, development interventions in the following three areas are required: (a) investment; (b) enterprise development; and (c) entrepreneurship promotion and expansion.

Because of imperfections in the market system, there are economic grounds for interventions to restore optimality. The aim is to correct imbalances and weaknesses and remove constraints, thereby providing appropriate conditions for private enterprise development and agro-industrialization. These conditions are linked to an array of critical policy issues and institutional arrangements pertaining to the legal and regulatory frameworks, infrastructure, human capital, technology; infrastructure, financing systems, governance, and partnerships.

The necessity of intervention for market failures legitimizes the role of the state as an important element underpinning private sector development. From Asian experience, governments can play a pivotal role in ensuring that appropriate policy frameworks and reforms are in place alongside effective institutions to improve infrastructure services and enhance financial mechanisms and management capabilities. The state also has an important role in providing incentives and support for the private sector to stimulate and leverage additional investment. In the specific context of agro-industry, this should be seen as part of the overall strategy to create a business- enabling environment; promote export development; and facilitate responsiveness of business to the challenges and opportunities arising from globalization.

The main underlying assumption of the conceptual framework is that economic liberalization and technological advancement present a new set of challenges for both enterprises and policymakers in sub-Saharan Africa. These challenges are embedded in a new approach to industrial policy as developed by Rodrik and Hausmann (Rodrik 2004a; Hausmann & Rodrik 2003). The new approach seeks to maximize the potential of the private sector for economic growth through investment in business opportunities, while minimizing the risks through the involvement of the public sector in generating policy initiatives for PSD (Sen & te Velde 2007).

Figure 8.1: Result matrix: Private sector development and agro-industry



Source: Authors' calculations, based on UNIDO (2009a)

New paradigms have evolved with this approach to industrial policy, such as the building of value chains, fostering learning strategies and promoting knowledge-based growth, alongside more established ones like investing in people and skills and exploiting economies of scale. Private enterprises in sub-Saharan Africa will assume a greater role for stimulating economic growth and generating productive employment—a responsibility that was almost entirely in the hands of African governments under conventional industrial policy. The new approach emphasizes 'created' competitiveness, in addition to inherited comparative advantages, and sees policy reforms in the business environment as the basis for creating conditions that would enable enterprises to compete internationally.

8.5. Investment

Investment requires savings, but in a significant number of African countries domestic savings are extremely low. Aggregate savings performance in sub-Saharan Africa has consistently fallen far short of Asian levels, and as a result countries have been heavily reliant on foreign capital and aid for investment (see chapter 7). Given Africa's savings deficit, policymakers should prioritize fiscal incentives and macroeconomic consistency to attract foreign direct investment. Global FDI flows have increased substantially since the 1990s, with the biggest increase—nearly six-fold between 2000 and 2007—recorded for net private capital flows to low-income countries (World Bank & FAO 2009).

Private sector investment decisions

In much of Africa in the immediate post-independence period of the 1960s and 1970s, foreign private investment was attracted through import protection, subsidized credit and tax incentives provided by the state, alongside regulations requiring private investors to obtain licences to import raw materials and remit foreign exchange earnings. While this type of industrial policy was effective initially for import substitution, it was inefficient in terms of returns on resources invested, consumer welfare and its contribution to economic growth and employment generation. This was because the investment involved was highly protected, heavily dependent on imported raw materials and with few backward linkages with the rest of the economy. The era of structural adjustment programmes in Africa (the 1980s and 1990s) produced investment policies that relied on market signals. This approach was intended to eliminate policy-induced distortions, such as overvalued exchange rates, high and variable import tariffs and quotas, price controls, and tax incentives and subsidies, in order to promote economic efficiency. In retrospect, it can be judged to have been inappropriate for fostering development and reducing poverty, and on the whole was unsuccessful even in terms of attracting foreign investment. Scant attention was paid to rural areas and the agricultural sector where poverty is concentrated.

The reduction of trade barriers, technological advances and lower transport costs associated with globalization, have provided better prospects and more options for private investors. As analysed in chapter 4, there are new opportunities for investing in agribusiness and for integration into value chains. These range from large-scale commercial cultivation and processing of food crops and energy crops for bio-fuel (UNIDO & FAO 2009), to medium and smallholder production of fresh fruit and vegetables and horticultural products for export to supermarkets abroad (Best & Mamic 2008; Omosa 2002). There are opportunities for stimulating private investment in the so-called 'green enterprise' initiative, which is linked to environmental protection (forest conservation, ecotourism, forest sector products, waste management and biomass renewable energy). There is scope, too, for private investment in 'fair trade' and organic production schemes designed to improve access to international markets for excluded or disadvantaged small producers and provide niche markets for certified products. Promising examples include the participation of local cocoa farmers in Ghana as co-owners of the 'Divine' chocolate business, and organic smallholder coffee producers in Uganda that offer farmers better prices and longer-term trading relationships.

A recent World Bank study, *Awakening Africa's Sleeping Giant* analysed prospects of sub-Saharan Africa for stimulating investment in agribusiness, based on comparison with a large agricultural region in Thailand and a similar one in Brazil. It concluded that the potential of Africa's Guinea Savannah zone to produce and process food and other agricultural products for global markets surpassed those of the two regions in Asia and Latin America respectively at a similar stage of development (World Bank & FAO 2009). This conclusion was based on the inherited comparative advantages of the Guinea Savannah zone, which are based on favourable physical, climatic and geographical factors including proximity to major markets[49].

Several countries in the region with large areas of arable land and in climatic zones that are watered by regular and reliable rainfall, such as Nigeria, Mozambique, Uganda, Ghana, Zambia, Zimbabwe and Sudan, are well placed to attract foreign private investment for large-scale production and processing of food and energy crops for biofuels. What is required for this potential to be realized are improvements in basic infrastructure and the overall business climate, which underscores the importance of providing a business enabling environment to stimulate investment. Some West African coastal countries—Senegal, Guinea-Bissau and Mauritania—and those that share Lake Victoria in East Africa—the United Republic of Tanzania and Uganda—have taken advantage of their location and created conditions for the processing of fresh fish and fish products for export to the EU. As mentioned in chapter 4, the export of Nile perch fish from East Africa, which began in the early 1990s, has evolved from artisanal operations into large-scale enterprises, including filleting and freezing plants which employ over 300 workers (Gibbon 1997).

The present weakness of the private sector in sub-Saharan Africa is due to a variety of factors, including lack of physical infrastructure, underdeveloped financial systems, an inappropriate macroeconomic policy stance, and the absence of a supportive legal and institutional framework. Overcoming these problems is intrinsically linked to the role of the public sector in providing an enabling environment for PSD. This role is illustrated by the successful examples of Ghana (Government of Ghana 2003; Arthur 2006) and Senegal (World Bank 2004b; Ofosu-Amaah 2000), both of which have made PSD an important element in their overall development strategy.

Public sector investment

The poor quality of rural infrastructure in most of sub-Saharan Africa constitutes a major obstacle to investing in agribusiness (chapter 9). In the past, public sector in Africa has traditionally accounted for most of all vital infrastructure investment in the region, although recent Chinese investment in SSA, mainly in mineral resources, in some sub-Saharan Africa countries has been accompanied by investment in associated infrastructure. Investment in infrastructure in remote rural areas, dependent on agricultural or agro-industry production to recover capital and operational costs, is unlikely to offer the kind of risk-adjusted returns required by private entrepreneurs.

Although governments are chiefly responsible for infrastructure investment, few African governments are in a position to finance the huge capital outlays necessary to eliminate the region's infrastructural deficit. They will continue to depend on

46. The study compared the potential of Africa's Guinea Savannah Zone (GSZ) for the growth of commercial agriculture with two relatively underdeveloped and landlocked agricultural regions in the developing world—the Cerrado region of Brazil and the northeast region of Thailand. The findings were that even though the GSZ has inherited comparative advantages with respect to good soil and climatic conditions and geographical location in terms of access to seaports, it has not been able to achieve the degree of international competitiveness in commercial agriculture that the two comparatively disadvantaged regions have achieved over the past thirty years. The main difference has been the lack of investment and technological input, which has prevented the GSZ from becoming internationally competitive and, hence, realizing its enormous potential as a major commercial agricultural producer and exporter. GSZ data used in the study were mainly for Nigeria, Mozambique and Zambia; the zone as defined by the World Bank covers several other countries, including most of West Africa and Angola, Sudan, Burundi, Malawi and U.R.Tanzania.

multilateral and regional development finance institutions as the main source of funding for this purpose. The African Development Bank (AfDB), in collaboration with Agence Française de Développement (AFD), the Alliance for a Green Revolution in Africa (AGRA) and the International Fund for Agricultural Development (IFAD), recently established an African Agriculture Investment Fund with a startup capital of 200 million Euros, specifically to finance rural infrastructure investment. The AfDB is also in consultation with UNIDO, FAO and IFAD, regarding an initiative by the three UN agencies to establish a financial facility for boosting investment in agribusiness and agro-industry, including rural infrastructure (see chapter 7).

Public-private partnerships

Public-private partnerships (PPPs) represent one possible—albeit partial—solution, but private sector participation is constrained because investment in rural public infrastructure is often costly and high-risk. An important challenge is to know when and where PPPs are value-adding propositions for infrastructure in market-oriented agro-industry development, and how best to formulate the financial and institutional arrangements for such collaboration. The use of PPPs for the provision of vital infrastructure should be approached from the perspective of state-business relations and wider development objectives, in which the partnership between the public and private sectors influences economic growth and poverty reduction through investments that promote economic efficiency and returns that reduce uncertainty and minimize the risk of business failures (Sen & te Velde 2007).

Beyond the provision of vital infrastructure, PPPs can be applied to agro-processing facilities. Since these are run as strictly commercial business operations, it is unlikely that the raising of capital for investment could be entrusted or transferred to a public body. The public sector is more likely to contribute in the form of land and physical structures through concessions or capital grants. The assumption is that private interests will assume the main commercial obligations and risks, leaving the state with the responsibility to ensure, so far as it is possible, that such projects will have a positive impact in job creation and poverty reduction.

Regional cooperation

Africa's infrastructure challenges in the areas of transport and energy should also be tackled at regional level. The North-South Corridor, involving several African countries and the Beira Agricultural Growth Corridor, which connects Mozambique with the wider region, is likely to reduce cost of production for countries involved. Similarly, cross-border transmission of hydroelectricity by high-tension power lines from Ghana to the neighbouring countries of Togo and Benin and from Mozambique to South Africa and other countries in region, are examples of regional cooperation that benefits infrastructure development. The Infrastructure Project Preparation Facility of the African Union/NEPAD, which is hosted and managed by the African Development Bank, supports the execution of large cross-border and regional infrastructure projects, which allow for pooled risk and lower net cost, as a strategy for encouraging the development and expansion of internal and regional markets and improving international competitiveness. Greater cooperation and harmonization of economic policies within the region would enable African countries to enjoy more specialization and economies of scale than is possible in the small economies of several countries in the region.

Human Capital

Investment in human capital is highly relevant to PSD, overall economic development and industrial capabilities and competitiveness (UNIDO 2009b). Generally, the public sector plays a crucial role in the provision of education and basic technical and vocational training, and sees this as a necessary social sector investment linked to the attainment of development objectives, including poverty reduction. Investment in human capital in the SSA is relatively low, according to the United Nations Educational, Scientific and Cultural Organization (UNESCO) data which show that sub-Saharan Africa lags behind other developing regions in terms of school enrolment and availability of and access to training facilities. The human capital problem of low enrolment rates is further compounded by skill outflows through emigration of qualified African professionals and technicians to developed countries. Lessons from Asia suggest that fundamental to policies for attracting capital, were the availability and retention of an efficient and skilled workforce. Attention should be paid to both the quality of labour and the extent of labour market segmentation, which can affect the scale and location of private investment decisions.

8.6. Enterprise development

In the conceptual framework presented earlier, the enterprise is the basic organizing unit for economic activity in the context of the symbiotic relationship between PSD and economic growth. Enterprise development can have two important outcomes: it will generate employment opportunities for the poor, who live and work in rural areas, while also leading to the extension of basic social services to rural communities that are most in need[47]. Promoting enterprise development in the region entails the removal of constraints on the transition from informal to formal, as well as appropriate measures at both policy and institutional levels to attract private investment. In addition, markets in many African countries have remained highly concentrated and protected, which acts as a disincentive for private investment and innovation. Examples of this tendency can be found in countries like Mozambique, Cameroon, Ethiopia, Eritrea, Uganda and Nigeria, among others where state-owned monopolies dominate their respective sectors and markets and even receive preferential treatment, which impedes entry of new enterprises.

Enabling Environment

Enterprise development in sub-Saharan Africa needs an overall enabling environment, which attracts private investment and allows enterprises to expand and operate efficiently. In the context of the complementary role of the public and the private sector in PSD, the assumption is that the state performs specific enabling

47. The expansion of enterprises can lead to increased investment in vital infrastructure, such as roads, water and electricity, which has public good qualities, providing benefits for surrounding communities. Furthermore, large rural agro-industry projects have sometimes included the provision of basic health and education facilities for (rural) workers and their families.

and regulatory tasks to encourage and facilitate enterprise development, without jeopardizing the functioning of the private sector. The significance of public sector support in creating an enabling environment for industry and business is widely recognized, and in this context, UNIDO is providing technical assistance to developing and transition economies for business development (Yumkella & Vinanchiarachi 2003; UNIDO & OECD 2004; UNIDO & GTZ 2008).

The International Labour Organization (ILO) has defined the role of government in this context as essentially three-fold (ILO 2003a):

- Government as a *regulator*: designing and implementing policies and laws and regulations that govern the activities of private sector enterprises—for example, private sector development and specific enterprise promotion policies, business registration procedures, industrial policy, taxation policy, trade and competition policies, labour and industrial relations policies, etc.
- Government as a *facilitator*: providing specific conditions and facilities that are conducive to private sector investment and enterprise development and bringing key stakeholders together—for example, the provision of business development services, including business parks and industrial estates.
- Government as a *promoter*: intervening directly through the allocation of (human, financial and physical) resources to achieve specific outcomes, such as encouraging entrepreneurship and innovation.

In performing these inter-linked functions, it is important for government to aim at integrating private enterprises into the overall economic and social development framework, so as to optimize the impact on employment creation and poverty reduction. The report of the Commission for Africa (2005) recommended that strategies for PSD and enterprise development should be presented as a coherent package of problem-solving instruments. The report recognized the importance of the public sector as the framer of policies and laws and the provider of support services for enterprise development. In addition to specific policies and institutional arrangements, the creation of an overall enabling environment for enterprise development requires favourable business environmental factors that are not determined by the internal capabilities of the enterprise. The most important of these business environment factors are:

- **Macroeconomic stability:** an analysis of data from the World Bank's Investment Climate Assessment (ICA) for Africa carried out in the early 2000s noted that most countries in the region "have a long way to go in building macroeconomic environments conducive to private sector development" (Eifert & Ramachandran 2004, p.23). Although the situation in the region has improved overall in recent years, inappropriate policies and poor economic management result in distorted factor prices, high inflation and exchange rate volatility—all of which create uncertainty and increase transaction costs.
- **Global market** conditions drive the demand for and prices of Africa's export commodities and influence inflation and price stability through volatile food and energy prices. Adverse terms-of-trade effects, as experienced during the global recession (2008-2010) contribute to slower output growth while volatility in capital flows of all kinds hinder economic development.

- **Financial system and institutions:** an efficient financial system is important for economic development and in mobilizing resources for investment. Shortfalls in the formal banking and financial systems, which deny or limit access to affordable working capital and suppliers' credit constitute a barrier to PSD and entry into the modern economy (see chapter 7). Analysis of the World Bank's Investment Climate Assessment data for nine African countries revealed that inadequacies and shortcomings of the financial system in countries such as Mozambique, Nigeria, Uganda, Eritrea and Zambia, were an obstacle to enterprise expansion (Eifert & Ramachandran 2004). The involvement of smallholders and small-scale producers in agribusiness is hampered by difficulties experienced in accessing reliable and inexpensive financing.
- **Political and social stability:** generally, a stable political and social environment is conducive to an enabling environment for enterprise development. This is evident from the effects of political instability in countries such as Sierra Leone, Liberia, Uganda, Ethiopia, DRC and Eritrea, all of which experienced a slowdown in their economy and downturn in business when they were affected by conflicts (Fosu 2003). On the other hand, countries like Botswana, Mauritius, Senegal and Ghana with stable political situations and institutions have been more successful in attracting FDI and promoting private sector development. The proper functioning of institutions, such as the judiciary, public administration and social services, is crucial for the creation of a politically and socially stable society that provides an enabling environment in which private investment can be attracted and enterprises thrive.
- **Governance:** political stability is closely related to good governance, and governance issues cover virtually all areas of the investment climate, including the direct interactions of the public and private sectors. Corruption, transparency, unclear or volatile regulations and nepotism can damage a country's investment climate. Some governments in the region have voluntarily subjected themselves to the governance peer review process, the African Peer Review Mechanism (APRM), established by the AU/NEPAD. Governance-related indicators compiled by Transparency International (Corruption Index) and the World Bank Group (Doing Business and Investment Climate Assessment indicators) point to shortcomings of a number of sub-Saharan African governments in terms of corruption, lack of transparency and accountability, poor quality regulation (World Bank 2004c; World Bank 2009d; Transparency International 2009). Improvements in governance can be pursued through cooperation between private and public sector actors, grounded in an institutional system based on formal and impersonal rules and respect for the rule of law.
- **Land tenure:** the communal ownership of land and lack of freehold tenure is common in many parts of Africa, and this can be problematic for private investment in agriculture and agribusiness, including for foreign investors, if not properly addressed. Analysis of World Bank investment climate survey data, which covered 9 countries in Africa—Eritrea, Ethiopia, Kenya, Mozambique, Nigeria, Senegal, the United Republic of Tanzania, Uganda, and Zambia—found that access to land is "almost universally a problem in the countries....surveyed" (Eifert

& Ramachandran 2004, p.43). The same study observed that accessing land can take up to a year in some countries and can be very expensive, even in the case of state ownership. The situation would be even more challenging in the absence of an adequate legal framework to facilitate transactions and protect property rights.

Business climate

The business climate is a complex of policy, legal, institutional and regulatory conditions that govern business activities—a subset of the enabling environment which, in addition to investment in basic infrastructure, includes the provision of incentives to encourage enterprise development, entrepreneurship and job creation. It essentially concerns the ease of doing business as measured, for example, by the World Bank/IFC's annual publication, *Doing Business*, which ranks countries accordingly. Only eight sub-Saharan African countries—Mauritius (ranked 17), South Africa (34), Botswana (45), Namibia (66), Rwanda (67), Zambia (90), Ghana (92) and Kenya (95)—are among the first 100 in the 2010 Ease of doing Business World Bank/IFC rankings. Another thirteen African countries—Ethiopia (107), Swaziland (115), Nigeria (125), Lesotho (130) the United Republic of Tanzania (131) Malawi (132) Madagascar (134), Mozambique (136), the Gambia (140), Cape Verde (146), Burkina Faso (147), Sierra Leone (148) and Liberia (149)—are ranked between 100 and 150, with the remaining 25 or so SSA countries appearing among the bottom 33 in the global ranking (World Bank 2009d).

Improvements to the business climate are clearly needed, especially where inappropriate regulation, delay in starting a business and registering property, excessive taxation, lack of fair competition and an unstable domestic policy environment restrict investment all combine to frustrate the development of markets and market access, and stifle entrepreneurship. Taken together, these factors not only pose severe obstacles to businesses, but also undermine international competitiveness.

Policy and institutional reforms to improve the business climate should therefore cover a wide range of issues, such as trade, finance and credit, taxation, industrial, labour and employment; regulations and procedures for starting and operating a business; and the administration of policies, laws and regulations are managed and monitored. Business climate reform can be politically challenging, and it is important as such for governments to take the lead and own the process. This process not only includes the creation of favourable overall policy and legislative base for investment, but also the decentralization of facilities and support services and measures for encouraging the participation of civil society in development, especially in rural areas. Local level participation in business could be particularly relevant in the reform of land laws and land tenure systems aimed at protecting customary rights, while at the same time opening opportunities for security of tenure for private investors.

The Viet Nam case in Box 8.2 highlights the need for planned action to improve the business climate, rather than relying solely on market forces and factor endowment to stimulate private investment. In business environments with high levels of risk and uncertainty, and where capital is scarce and costly and technology backward—as in many African economies—reliance on the market alone is unlikely to

result in investment in novel products and processes in response to new market opportunities. The appropriate role for industrial policy is to help fill the gap caused by the incompleteness of the market through improvements in the business climate mainly as a result of public action. This reflects Rodrik's conceptualization of industrial policy as a 'process of economic self-discovery', which involves cooperation between the public and private sectors with the aim of informing on business opportunities and providing policy initiatives to respond to those opportunities (Rodrik 2004a). The notion of 'discovery' relates to the process of finding out where action is needed and what type of action can optimize the response to prevailing business opportunities. The implication is that governments in sub-Saharan Africa should seek to provide a favourable business climate, by identifying feasible areas for policy intervention, and adopting policies that can facilitate desirable structural changes, without marginalizing the private sector or constraining enterprise initiatives.

Box 8.2: Viet Nam's case of business environment reform

The case of Viet Nam illustrates how the business climate can be improved, based on planned interventions that are linked to outcomes at different levels and aimed at creating jobs and reducing poverty. In 2003, the Vietnamese government set out to revise the existing policy and legal framework for business by combining all existing laws relating to the regulation of all types of businesses into two comprehensive laws, aimed at streamlining regulatory and administrative procedures and harmonizing the overall framework for investment and business. This involved eliminating the many distinctions between domestic and foreign investment, and ensuring that Viet Nam complied with relevant international agreements to facilitate its application to join the WTO. The two comprehensive laws—the Enterprise Law and the Investment Law—were enacted in December 2005 and technical assistance for their implementation was provided by the International Finance Corporation of the World Bank and channelled through the government-sponsored Mekong Private Sector Development Facility, in partnership with the business community and other development partners. There was an explicit focus on policy reforms and on changing the mindsets of stakeholders—investors, policymakers, lawmakers and the media—while also facilitating the legal framework for reform. The relevant new laws were passed on schedule and are being monitored with respect to impact on enterprise development and investment as well as on employment. In a related move in 2005, the government announced that it wanted to double the number of private sector enterprises from 250,000 to 500.000 by 2010, with the expectation that these new enterprises would create 2.7 million new jobs and help increase the quantity and quality of exports by the SME sector. With the assistance from UNIDO, the Agency for SME Development (ASMED) in the Ministry of Planning and Investment undertook a highly participatory and consultative process as the basis for preparing a Development Action Plan 2006-2010 aimed at improving the regulatory and administrative environment. The reform of the business environment has resulted in the establishment of a computerized one-stop business, tax and statistics registration system and the establishment of the Government Business Portal (www.business.gov.vn) that have greatly reduced the time and cost of business procedures and substantially lowered the cost of doing business in the country.

Source: Donor Committee for Enterprise Development (DCED) 2008

Business advisory and support services

Traditional approaches to enterprise development have emphasized strengthening the business sector, by building the capacity of individual enterprises through the provision of specialized services to support management and operational activities. UNIDO's extensive research and technical cooperation engagement in this important area have shown that enterprise development in sub-Saharan Africa and other developing regions could benefit immensely from more broadly-conceived and demand-driven 'business advisory and support services' (Kennedy & Hobohm 1999; UNIDO & OECD 2004; UNIDO 2006c; UNIDO & GTZ 2008). These services can be delivered to enterprises through a mix of government or government-related agencies, commercial-oriented intermediaries and business membership organizations, such as business associations, chambers of commerce and industry, and cooperatives. The services provided relate to day-to-day operational activities, as well as to the more strategic capabilities needed by enterprises to address medium and long-term issues associated with improving access to markets and the ability to compete (UNIDO & FAO 2009; UNIDO 2010a).

Global value chains

Global value chains clearly provide unprecedented opportunities for producers in developing countries to become part of a complex chain that exists between local suppliers and global buyers for turning sourced raw materials and intermediate inputs into retailed products (chapters 4, 5).

The phenomenal growth of global agro-food business and the internationalization of the food retail sector in recent years augurs well for the participation of agro-producers and processors in sub-Saharan Africa in global value chains. This, of course, will depend on upgrading of local enterprises' capabilities with regard to product quality, cost-effectiveness and efficiency of delivery and on improving employment, safety and ethical trading standards—for which the public sector has a crucial role to play in terms of providing advice and support services in the overall context of an enabling business environment.

Cooperatives

The potential of cooperatives in agro-industry is particularly relevant for encouraging economic efficiency and social welfare at local level, which could be useful for helping the rural poor to move out of poverty and creating wealth in their communities. Cooperatives have a long history on the African continent and have been a significant part of agricultural production in many African countries. The structure of cooperatives fits well with the communal cultures of rural Africa and is amenable to addressing concern for communal welfare at the local level.

During the colonial period, cooperatives were government-sponsored and served as a strategic tool to group rural producers into clusters, so that essential export commodities, such as coffee, cocoa and cotton, could be collected more cost-effectively. In the post-independence era, the cooperative movement in many countries suffered a decline and is not as active as it used to be in the region as a whole.

More recently, there are signs of a revival of cooperatives in sub-Saharan Africa, based on a realization among both donors and national policymakers that this type of producer organization can play an important role in supporting rural development objectives including poverty reduction.

Already, there is evidence of cooperatives scaling-up and diversifying their activities and membership to take advantage of the opportunities created by globalization, and some are becoming viable private enterprises in the agribusiness sector. Case studies of cooperatives in 12 African countries—including Kenya, Uganda, Ethiopia, Ghana, Nigeria, Senegal, South Africa, Niger, Cape Verde, Rwanda, and Egypt —covered by an ongoing ILO project, 'CoopAfrica', funded jointly by the UK Department for International Development (DFID) and the Swedish International Development Cooperation Agency (SIDA) (Box 8.3), point to this revival of cooperatives and highlight an emerging pattern, based on horizontal networks of small farmers and producers with solid vertical linkages with private sector agribusiness structures (Develtere *et al.* 2008).

Some of the cooperatives in the ILO study have become vehicles for the production of high-value food crops and fruits and vegetables, cut flowers, fisheries and aquaculture, along the lines of similar activities now well-established in Kenya (Omosa 2002). Becoming organized into cooperatives can also be useful for the development and upgrading of agricultural value chain, serving as a practical way through which rural producers and entrepreneurs can be involved and empowered by being part of the management of value chain operations at local level (UNIDO 2001; Gibbon 2001; Humphrey 2005; ILO 2006). The ILO study concluded that cooperatives in Africa are about to enter a new phase of renaissance, in response to opportunities in global and regional markets.

Box 8.3: The revival of cooperatives in Africa

Under a joint DFID and SIDA-funded technical cooperation project 'Cooperative Facility for Africa—CoopAfrica', the ILO is providing support for cooperative revival and development in about a dozen countries in Eastern and Southern Africa. The ILO project works with other UN organizations, such as FAO and UNIDO, and closely associates cooperative internationals like the International Cooperative Alliance and the Committee for the Promotion and Advancement of Cooperatives (COPAC) with its activities. There are already signs of a revival in the form of a number of viable cooperative enterprises in agriculture on the continent—ranging from coffee producers in Ethiopia and Rwanda, cocoa farmers in Ghana, tea producers in the United Republic of Tanzania and South Africa to dairy, fish and other food marketing businesses in Kenya, Senegal and Egypt, as well as rural savings institutions in Uganda and Rwanda. Most of these are demand-driven and market-oriented businesses and some have found market niches and developed marketable products in response to opportunities in the global and regional economies. There are good reasons to believe that with support and the right conditions, cooperative enterprises in Africa can play an important role in creating sustainable employment and in reducing rural poverty through their activities as service providers and producers in agro-industry.

Sources: Develtere *et al.* (2008); ILO (2009)

Export processing and free trade zones and investment parks

Export processing and free trade zones (EPZs) have been used to varying degrees of success by countries in Asia (Thailand, Malaysia, Indonesia, China, Sri Lanka, Taiwan, Rep.of Korea, Philippines), Latin America (Costa Rica, Dominican Republic, Panama), the Middle East (Bahrain, UAE, Qatar) and in Africa (Mauritius, Kenya, Senegal) for attracting foreign investment and diversifying their export base (ILO 2003b). If EPZs are to play a major role in driving agribusiness, significant and tangible backward linkages to domestic agriculture in operations, such as the clothing industry must be developed. Unless and until such linkages are developed the EPZ model is unlikely to play a significant role in boosting agro-processing activity in SSA.

The provision of infrastructure and common services by government in the form of industrial estates and business parks, together with fiscal incentives and similar inducements, can nevertheless be applied to labour-intensive agro-industries as part of an export-led growth strategy. The significance of the investment park model for industrial development hinges on the combination of internal linkages, through the provision of local business services, and external linkages, through integration into the world trading system.

A sophisticated example of the industrial estate/investment park model is the Bahrain International Investment Park, which is an initiative established within the framework of the Gulf Cooperation Council (GCC) to provide good quality facilities and business services to foreign investors, who want to have access to various GCC and regional markets. With easy access to the airport and seaports, the Bahrain Investment Park offers unique incentives, including 100 per cent foreign ownership, exemption from all taxes for ten years, no restrictions on recruitment and repatriation of capital, and has its own dedicated customs services and on-site management team within the industrial estate. While the possibility for replicating such a Bahrain upmarket version of the investment park in most of SSA may not be feasible, the principle of the approach is nevertheless relevant for stimulating private investment in agro-industry.

8.7. Entrepreneurship promotion and expansion

Entrepreneurship is essentially about human creativity and innovation. The promotion of an entrepreneurship culture or spirit in a society concerns efforts made by governments and private institutions to stimulate and enhance the capacity of individuals and business to create, innovate and expand. The culture and institutions of a society can, therefore, determine the degree of entrepreneurial spirit. Looking at entrepreneurship in terms of people taking initiatives or seizing opportunities to set up and manage their own businesses, there is indeed a long and strong tradition of entrepreneurship culture in many parts of Africa—as typified by the great markets of West Africa. Ironically, by most measures, it is in Africa that entrepreneurs face the biggest obstacles to setting up formal sector enterprises. While the informal sector meets an important need, sustaining the majority of poor families in sub-Saharan Africa, it is clear that the benefits of economies of scale and access to services are missing for local entrepreneurs who are unable to grow and move their businesses into the formal economy.

The challenge of promoting entrepreneurship in Africa may therefore relate more to the removal of legal, financial and structural obstacles affecting the development of entrepreneurial capacity, than to provision of formal training per se. This is not to underestimate the importance of entrepreneurship education and training programmes, such as those that have been developed and successfully implemented by the ILO, UNIDO and other technical assistance agencies in many countries in the region since the late 1960s, but rather to recognize that capacity to make effective and timely business decisions may be stifled by bottlenecks other than lack of entrepreneurial skills and knowledge. In stimulating enterprise development, governments should therefore pay equal attention both to the removal of obstacles to entrepreneurship and to the provision of basic public goods that are indispensable for promoting and reviving the entrepreneurial spirit. Measures to overcome obstacles to private sector growth and entrepreneurship were identified by the UN Commission on the Private Sector and Development (UNDP 2004).

In the typical scenario of high unemployment among school leavers and young people found in many African countries today, there is a need to impart entrepreneurial knowledge and skills as part of the transition from school to the world of work. The expectation is not that young people will immediately start a business after leaving formal education or become self-employed; rather, the purpose of entrepreneurship education is to motivate youth to consider and explore the possibility of becoming an entrepreneur as a career option. In this regard, the ILO's Know About Business (KAB) programme, which is now being implemented in over 40 counties in Africa, Asia and Latin America and the Caribbean, is linked to the organization's wider technical and vocational education and training and enterprise development programmes (ILO 2007). Through interactive and participatory teaching methods and adaptations linking entrepreneurship education to general secondary and higher education curricula, KAB aims to develop entrepreneurial skills, attitudes and mindsets among young men and women.

8.8. Conclusions

Investment in agribusiness and agro-industry has the potential to be a powerful driver of sustainable pro-poor growth in African countries, if the growth and employment benefits from investment in the sector are broadly based and widely shared. For this reason, close attention should be paid to the policies and institutions used in the transformation of low-productivity, subsistence-oriented farming systems to efficient market-oriented production systems. It is equally important to focus on the factors that affect the size and distribution of employment and income benefits generated as a result of the participation of private sector enterprises in the transformation process.

The expansion of agribusiness and agro-industry in Africa, whether by small-scale producers or large-scale businesses, will affect poverty reduction in three main ways:

- Employment opportunities and incomes of those either directly involved in the process or through associated value chains.

- The price of food and other basic needs in the consumption baskets of the poor.[48]
- The collection of tax revenues that can be used to deliver basic social services to the poor.

The experiences of countries like Brazil and Thailand in agribusiness development and promotion show that a number of factors are critical in determining the extent to which the participation of the private sector in agro-industry will contribute to poverty reduction. These include the macroeconomic environment; the land-tenure system; the willingness and capacity of government to invest some of the growth revenues from agro-industry in the provision of basic social services in rural areas; and the impact of growth on the political and social integration on regions previously isolated from the rest of the country (World Bank & FAO 2009).

There are grounds for optimism regarding the achievement of pro-poor growth through enterprise development and investment in agribusiness in sub-Saharan Africa. With the opening up of new fast-growth markets particularly in China, India and other parts of Asia, and the adoption of new technologies and products, Africa has the opportunity to achieve agribusiness-driven growth. However, longstanding challenges facing the region—low levels of human resource development, poor rural infrastructure, weak market linkages and vulnerability to external shocks—along with more recent ones linked to political issues and economic conditions brought about by globalization, such as fragility of the public sector and unfavourable and inequitable trade regimes, must be resolved. Improved investment and a conducive business climate should go a long way towards addressing these challenges, and creating the right conditions for the private sector to play the driving role in the exploitation of Africa's untapped potential in agribusiness. At the same time, public sector policymakers should continue to play an active role by providing the vision, the strategy, the long-term commitment and the enabling environment needed to foster private sector investment.

48. See earlier comment in this chapter on impact of rising food prices for net food-importing countries.

9. Improving infrastructure and energy access

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9.1. Introduction

Infrastructure enhances the competitiveness of an economy and generates a business environment that is conducive to agro-industrial growth and development. Good infrastructure efficiently connects agro-industrial firms to their customers at the market end and suppliers from the production end and enables the use of modern production technologies. The level of infrastructure development greatly influences trade flows, costs, and competitiveness. Access to reliable and appropriate infrastructure is an essential enabler in the agribusiness value chain. On the other hand, deficiencies in infrastructure create barriers to productive opportunities and increase costs for all levels (small, medium or large-scale) and types of agro-industrial firms.

The relevant infrastructure for agro-industrial development includes energy, transport and water supply. They are considered vital social capital and because of their broad availability, it is expected that national governments should provide such infrastructure from its national income or foreign direct investment to accelerate industrial development and improve standards of living. In the recent past, information technology (IT), telephones, and internet facilities have also been considered as essential aspects of infrastructure required for agro-industrial development. However, it is more realistic to expect different impacts from the different types of infrastructure investments, and under different investment circumstances, because the size of opportunity costs varies according to the types of infrastructure engaged and circumstances concerned, such as geography, economic and institu-