Chapter 7

Enabling the private sector to create jobs

Traditionally the largest employer in Africa, the state has to facilitate investment and job creation in the private sector, especially in small and medium-size enterprises (SMEs). SMEs and the informal sector account for about 63 per cent of employment in low-income countries (Ayyagari, Beck and Demirgüç-Kunt 2003). In addition to being labour-intensive, they appear to have the greatest potential for job creation due to the scarcity of capital for large investments (Beck, Demirgüç-Kunt and Levine 2003).

Most African economies have been more stable since the mid-1990s. But the stabilization programmes have done little to increase private investment. Further and deeper second-generation reforms are needed to improve physical infrastructure and the business environment, to prepare the financial market for small-scale lending and to ensure flexible labour markets. This chapter examines the key issues in creating an enabling environment for the private sector, particularly SMEs.

> *“Second-generation reform is needed to ensure progress”*

- ***Promoting good governance.*** Based on a continent-wide survey by the United Nations Economic Commission for Africa (UNECA), governance is getting better in most African countries, though many governance-related constraints on private activity remain. The obstacles: centralized government structures, inefficient government services, corruption, the low integrity of the tax system and the lack of transparency and accountability of civil services (UNECA 2004b).

- ***Ensuring a conducive macroeconomic environment.*** Government policy should continue to concentrate on ensuring a stable macroeconomic environment conducive to private investment. Tax policy remains a key variable, as most firms consider it one of the major obstacles to business growth. Tax reforms in Africa should thus be deepened to simplify the tax system, improve tax administration and reduce tax holidays to a minimum, confining them to projects that meet specific export or employment targets.

- ***Improving physical infrastructure.*** Infrastructure development in Africa has been constrained by a lack of public resources and by the difficulty in attracting multilateral development assistance or foreign direct investment to this sector. It thus seems desirable to promote private participation in the provision of infrastructure–with new funds, skills, technologies and management techniques, as well as continuing funding for maintenance and expansion. The challenge is not just to regulate the private service provider–it is to create an attractive environment for the private investor.

> Single-access points for SMEs encourage registration

- ***Improving the business environment***—rules and regulations, property rights, contract enforcement, networking and entrepreneurship. Governments should simplify registration procedures, encourage informal businesses to register, secure property rights, improve contract enforcement, promote a culture of entrepreneurship and encourage networking among SMEs. It is crucial to streamline registration procedures and abolish unnecessary regulations–creating single access points, reducing paperwork and avoiding involvement of courts in the registration process. Securing property rights can reduce costs for businesses and increase efficiency, especially for female entrepreneurs, whose ownership of land is seriously restricted in some countries. Reforming the contract enforcement system must include the following measures: allow cases of dispute to be brought to court without lawyers, reduce written documents, improve information systems and judicial statistics, as well as introduce summary proceedings and other innovative measures to speed court procedures such as random case management.

- ***Reforming the financial sector***—to secure greater access for microentrepreneurs to obtain formal financial and nonfinancial services. African governments should actively encourage credit-constrained borrowers and enterprises to develop institutional structures conducive to microfinance, persuade informal financial groups to acquire appropriate legal status and promote links between semiformal and formal financial institutions.

- ***Reforming the labour market***—to reduce employment costs, ensure greater flexibility and efficiently coordinate the demand and supply of labour. Worker protection laws–in the form of minimum wages or hire-and-fire regulations–should be carefully designed and regularly revised to minimize any negative impact on labour demand in the formal sector. To hold down search costs, governments should create and support job centres for employers to advertise vacancies and for job seekers to find information on potential employment opportunities. The ability of such centres to foster employment hinges crucially on providing accurate labour market statistics as well as necessary training and advisory services.

Maintaining a conducive macroeconomic environment

Increased private investment requires a stable macroeconomic environment characterized by a low and predictable inflation rate, stable real exchange rate, and current account and fiscal balances consistent with low and declining debt and rising real per capita income. For Africa as a whole the inflation rate declined from 23.3 per cent in 1991–2000 to 10.1 per cent in 2001–04, thanks to better macroeconomic management, especially in curbing fiscal deficits and inflationary finance. On average, fiscal deficits declined from 5.2 per cent of GDP in 1993–2000 to 1.68 per cent in 2001–04. The overall current account deficit also fell, from 3.8 per cent of GDP in 1981–90 to 2.0 per cent in 1991–2000 and 1.0 per cent in 2001–02.

Macroeconomic stabilization and reform programmes often involved several rounds of financial sector reform and liberalization. By the mid-1990s many African countries had gradually abolished interest rate fixing and relaxed controls over bank lending. Since then the real rate of interest has been positive, and generally rising across Africa.

Despite the seeming success of reforms, savings and investment rates are still quite low, showing that macroeconomic stabilization alone is not enough to stimulate private investment in Africa. Second-generation reforms are needed for accelerating investment and job creation in the private sector, notably by improving the physical infrastructure and business environment, increasing firms' access to credit and ensuring labour market flexibility. Particular attention should go to enabling SMEs in Africa to grow and compete in a market-oriented environment in which the state and the private sector play complementary roles. These issues are taken up later in the chapter. The focus here is on tax policy.

Savings and investment rates are still quite low

Five firms in six in Sub-Saharan Africa consider the tax system to be one of the chief obstacles to growth (World Bank 2004a). Many African countries have implemented some tax reforms in the last two decades, and tax rates are now broadly comparable to those in other developing countries, though Egypt and the Democratic Republic of Congo have some of the highest marginal corporate tax rates at 40 per cent, well above the norm of about 30 per cent (World Bank 2004b). Further reforms of tax structure, administration and incentive policies are particularly important (Addison and Levin 2005; Tanzi and Zee 2000).

"Narrow tax bases and weak tax administrations force governments in developing countries to collect a larger share of their revenues from firms and commercial transactions than is the case in developed countries" (World Bank, 2004a, p. 107). This is particularly true in Africa. And tax avoidance, tax evasion and the large informal economy not subject to taxation mean lower tax revenues in Africa.

Typically domestic taxes in Africa include a sales tax, a company tax or profit tax on formal firms, a local tax on informal enterprises and sometimes a proportional duty on buildings and equipment. Inefficient and corrupt tax administrations often harm business operations and reduce revenue collection. Firms indicate that tax incentives and rebates are difficult for them to use in practice because of corruption and lengthy procedures or delays by officials to solicit bribes. A common complaint by firms is inconsistency and nontransparency of methods of assessing sales and profit taxes (World Bank 2004a; Eifert and Ramachandran 2004).

To compensate for revenue shortages due to large informal economies and narrow tax bases, tax systems in Africa often have many taxes with different rates. This makes it difficult for firms to understand the tax system and weakens the tax administration. Furthermore, some countries lack coordination between central and local tax authorities, increasing the resistance of firms and individuals to pay (Eifert and Ramachandran 2004). The many different tax rates obstruct market forces, distort resource allocation and create inefficiencies.

Indeed, complicated tax structures, together with corruption and long and complicated procedures, raise the cost of complying with tax regulations, particularly for small businesses. This high compliance cost is a reason for many small firms to remain in the informal sector. Complex tax systems with numerous exemptions and special rules are also costly for the government to administer–and susceptible to malpractice (box 7.1). It is common for governments in Africa to offer tax holidays and distortionary tax exemptions and other incentives to attract foreign firms. But the tax holidays are not always effective in achieving their objectives and domestic investors who do not receive such benefits find it difficult to compete with foreign firms.

Tax reform in Africa has to be deepened to reduce the tax system's disincentives.

- Best-practice examples suggest the need for a lower and uniform corporate tax rate—with a maximum marginal rate of no more than 30 per cent and with limited recourse to special incentives (Kheir-El-Din, Fawzy and Refaat 2000). Reforming the tax structure is likely to improve the incentives for firms to comply with the tax system.

"African economies must deepen fiscal reform"

Box 7.1
Tax reforms and remaining problems

Ethiopia
The maximum wage and profit tax rates were reduced respectively from 85 per cent and 89 per cent in 1991 to a unified rate of 35 per cent in 2003. But the maximum import tariff rate of 41 per cent in 2002 and 35 per cent in 2003, despite a decline from 230 per cent in 1991, remains high even by developing country standards. The lower import tariff rate was associated with a huge increase in covered items, from 1,621 in 1993 to 5,608 in 2003, and a decrease in exempted items, from 327 in 1993 to 179 in 2003 (Getachew 2004).

Burundi
The tax system lacks certainty, simplicity and transparency. It lacks certainty because the government uses its discretion to determine who imports what, while tariff rates change from one year to the next. It lacks simplicity because of the variety of taxes within each of the two broad border taxes: entry taxes and fiscal taxes. Import duty exemptions amounted to 50 per cent of tariff revenue in 1993, and the undefined category of other exemptions made up 42 per cent of total exemptions in 1996. Prone to abuse and corruption, the tax system lacks transparency (Nkurunziza and Ngaruko 2005).

Egypt
Larger firms in Egypt's free zones are not subject to tax and duty laws and enjoy an unlimited tax holiday. Firms outside the free zones are generally subject to various types of taxes, including property tax, sales tax and custom duties. Small firms, especially those in the informal sector, pay high import duties on capital and intermediate inputs, giving them little incentive to use modern technology or grow. The tax holiday programme is largely ineffective (El Samalouty 1999).

- Simplifying and developing a more efficient tax system is one key to reducing the cost of doing business, increasing product supply responsiveness and enhancing employment (Fosu 2004).

- To enhance competition, especially between domestic and foreign firms, tax holidays should be reduced to a minimum, confined to projects that meet export or employment targets.

- Wide-ranging reform of the tax administration with the involvement of the private sector would build mutual trust and increase tax awareness and efficiency.

Poor physical infrastructure hobbles private sector development

Sub-Saharan Africa has weaker infrastructure than other developing regions (figure 7.1).[1] Physical infrastructure—such as roads, railroads, energy supplies and telecommunication—is crucial for the private sector. Without good roads providing access to the markets of larger towns, enterprises in rural areas have only limited market access, constraining the growth of the private sector.

Figure 7.1
Infrastructure in Sub-Saharan Africa is weaker than in other developing regions

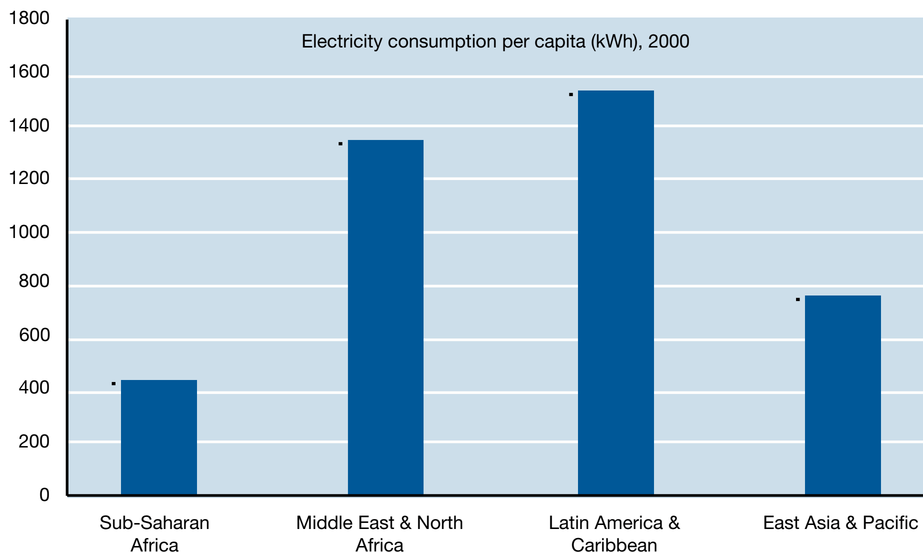
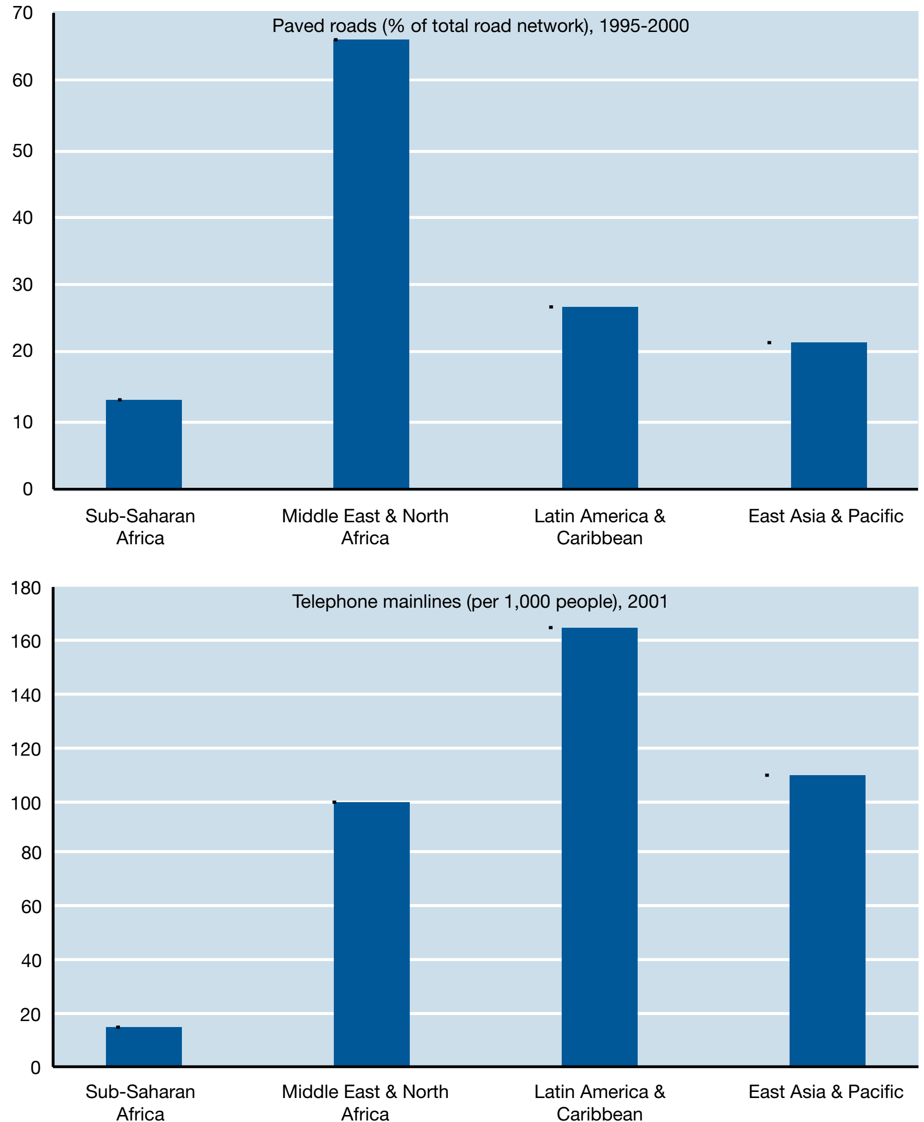


Figure 7.1 *(continued)*



Only 12 per cent of Sub-Saharan Africa's roads are paved

Source: *UNECA 2004a.*

High transport cost discourages the private sector

Poor transport infrastructure accounts for 40 per cent of the cost of transport on average and 60 per cent in landlocked countries (World Bank 2005). Landlocked countries also depend on the infrastructure in transit countries, often vulnerable to political instability countries (Faye and others 2004)

Road density in Africa is estimated at 6.8 kilometres per 100 square kilometres, far below Latin America's 12 and Asia's 18. The road network distribution is very low, at 2.7 kilometres per 10,000 people, resulting in poor accessibility, infrequent service and high transport costs (UNECA 2004a). The freight cost as a percentage of total import value was 13.0 per cent for Africa, 8.8 per cent for developing countries on average and 5.2 per cent for industrial countries (figure 7.2).

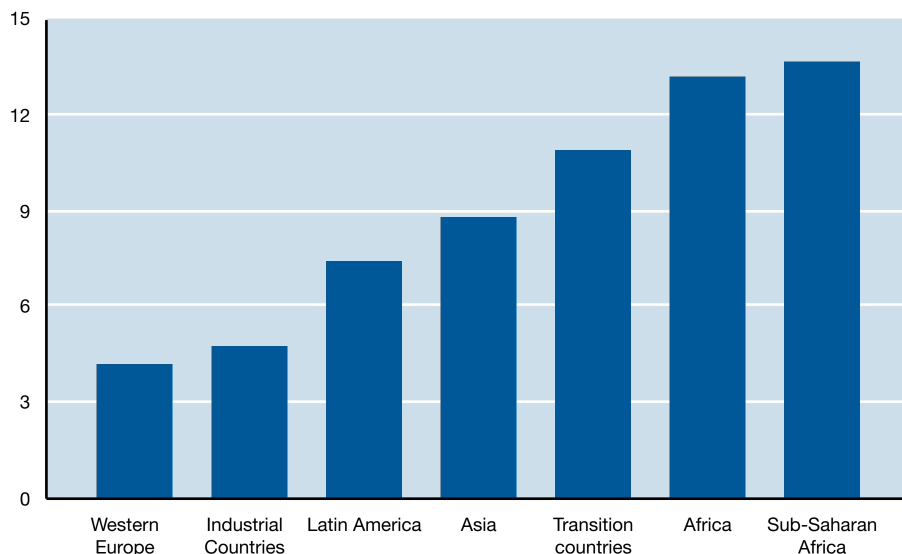
Unreliable energy supply is an obstacle for firms

The poor energy services in most of Sub-Saharan Africa hurt the level and efficiency of private sector investment and lead to much higher production costs than in other parts of the world. For example, a 1999 survey of firms in Senegal cited power failures, transport costs and other infrastructure problems among the top operational problems. Three of the largest companies assessed the costs of power outages (electric generators, operating costs, lost production and deteriorated material) at about 10 per cent of sales. A similar study by the World Bank's regional programme on Enterprise Development in Madagascar in 2002 found poor power supplies to be a major burden on enterprise development (UNECA 2004a).

- In Uganda a survey of 243 firms conducted in 1998 showed that they did not receive electricity from the public grid for 89 operating days a year, on average.

Figure 7.2

Transport costs world regional and country groupings, 2000 (freight cost as a percentage of total import value)



Note: The transport cost rate is the ratio of transport costs as a percentage of the value of imports.

Source: UNECA 2004a.

That led 77 per cent of large firms (in addition to 44 per cent of medium-size and 16 per cent of small firms) to purchase generators, which represented 25 per cent of their total investment in equipment and machinery (Reinikka and Svensson 1999).

- In Malawi and Tanzania firms that bought generators to compensate for the faulty public power supply have been affected by high fuel costs (Privatisation Commission of Malawi 2000; Confederation of Tanzania Industries 2002).

- In Ghana as many as 75 per cent of exporters surveyed said that they had suffered financial losses from power fluctuations (Edjekumhene and Brew-Hammond 2001).

Small firms are the hardest hit by inefficient power services. Public utilities provide most electric power in Sub-Saharan Africa—inefficiently, at high cost and with a low degree of reliability. A study of Nigerian firms found that small firms cannot afford to make costly capital investments to meet their power needs (Lee and Anas 1992). Unreliable power thus slows the growth of small firms and their capacity to generate income.

Public-private partnerships can improve infrastructure

Infrastructure development in Africa has been constrained by a lack of public resources, and by the difficulty in attracting multilateral development assistance or foreign direct investment to this sector. It thus seems desirable to promote private participation in the provision of infrastructure—with new funds, skills, technologies and management techniques, as well as continuing funding for maintenance and expansion. The challenge is not just to regulate the private service provider—it is to create an attractive environment for the private investor.

"Private sharing in infrastructure development is halting"

Infrastructure investors have often been disappointed by low returns in developing countries, and investment in private infrastructure projects in developing countries has declined in the last few years (World Bank 2005). Promoting public-private partnerships in infrastructure has to go hand-in-hand with creating a more favourable business environment. Many governments still perceive infrastructure as strategic and do not allow private participation. Where private participation in infrastructure is prohibited by law, legislation has to be changed accordingly. In other countries it is important to change regulations governing the private sector to make private investment in infrastructure more attractive. Insecure property rights and the high costs of regulation, taxation and corruption are major concerns.

Telecommunication and information and communication technology facilitate private businesses

Poor telephone lines still constrain private sector development in Africa, the region with the lowest density of telephone lines and the fewest Internet users. Only one person of 160 people uses the Internet (African Internet Infrastructure Information 2002). Busi-

nesses in Madagascar often have several telephone lines in the hope that one of them will function (Integrated Framework for Trade-Related Technical Assistance to Least Developed Countries 2003). In Bangladesh, China, Ethiopia and India the World Bank's Investment Climate Surveys found that garment manufacturers are more productive, pay higher wages and grow more quickly when telecommunications services are better (World Bank 2005).

Mobile phones can amplify access to telecommunication. The telephone ladies of Bangladesh show how mobile phones can improve access to telecommunication quickly and form a business opportunity at the same time (box 7.2).

Box 7.2
The telephone ladies of Bangladesh

Grameen Bank, a pioneer in microfinance, initiated the Village Phone project in 1997, giving loans to women in distant villages to buy mobile phones. The women then sold telecommunication services to others. Rural areas proved the perfect setting for such a business, because fixed telephone lines do not exist in many villages, and if they do, they are individually owned and not for community use.

The Village Phone project quickly became popular and successful. Mobile phones became a fast way for village ladies to earn an income. Today 60,000 "telephone ladies" supply telephone service in 80 per cent of the villages in Bangladesh.

Source: *Kumar 2004.*

Internet use and exports are positively correlated in developing countries (Clarke and Wallsten 2004). To improve access to the Internet, the network of fixed telephone lines has to be improved in quality and quantity. The African countries with better infrastructure, such as those in North Africa and some in Southern Africa will have larger populations of Internet users. But Senegal and Cape Verde have much higher levels of connectivity than their GDP per capita would suggest. Internet use may be impeded or enhanced by government policy.

Improving the institutional environment

Despite government efforts to improve the business environment in many African countries, more reforms are still needed in many important areas (box 7.3).

In most African countries doing business is constrained by overregulation that leads to high transaction costs to deal with the bureaucracy. High transaction costs, in turn, reduce the productivity of a business and can generally discourage private sector activity.

Box 7.3

Ethiopia's business climate: initial reform success but more needs to be done

UNECA conducted a survey of 36 SMEs in 2004 in the formal sector in Addis Ababa to probe their perceptions of the business environment. Of the businesses surveyed, 80.5 per cent indicated having problems: 31 per cent with the level of taxes, VAT and custom duties, 24 per cent with the bureaucracy and 17 per cent with the high cost of rent and utilities (especially electricity), inadequate infrastructure or the lack of land ownership. For 28 per cent, rent-seeking threatens their activities.

All the businesses were registered, and for 61 per cent of them the registration process took less than a month. The government simplified the registration process in 2003, and five of the firms interviewed reported to have completed the registration process in one day in 2004. About 20 per cent of the businesses operated informally before registering, for a period ranging in most cases from 15 days to a year.

Most firms perceive contract enforcement through the legal system as inefficient and costly. For this reason, 81 per cent of the businesses that encountered contract enforcement problems prefer to resolve disputes informally. Most of them consider a legal follow-up as unpromising. To avoid contract failures, they generally prefer a careful assessment of the business partner. Nine of the businesses have taken a case to court, but three dropped their cases due to the inefficiency of the courts.

"Business is constrained by overregulation"

Only half the businesses belong to a business association, only three to the Chamber of Commerce. Most consider their membership as beneficial to their business, mentioning networking, sharing information and basic resources, finding business opportunities or voicing common problems to the government.

Of all the businesses, 67 per cent had resorted to loans, of which 54 per cent used solely the formal financial sector, 21 per cent used both informal and formal loans, while 17 per cent relied entirely on the informal credit system. Five businesses cited financial sector constraints, such as the need for collateral, as the primary reason for declining to procure a loan.

The formal labour market was unexpectedly important for firms. Only four of the businesses rely entirely on family labour. When hiring, 42 per cent of the businesses rely on the advertisement system (board or newspaper advertising), 28 per cent use only informal channels, and 25 per cent resort to both formal and informal channels.

Businesses expressed the need for reform in the legal system to facilitate contract enforcement, for a better coordination within the bureaucracy and for combating corruption. They also mentioned reforming land policy and the banking sector, to improve access to small loans.

Source: UNECA staff.

Difficulty of registering a business a severe constraint for small firms

Company registration is the first step to formalize a business and enhances the ability of firms to obtain finance, enforce contracts and receive benefits from the state, such as financial support or low cost land and other services. Company registration should be an administrative act and not a major hurdle.

Table 7.1
Starting a business

Region or economy	Procedures (number)	Duration (days)	Cost (% of GN per capita)
East Asia and Pacific	8	52	48.3
Europe and Central Asia	9	42	15.5
Latin America and Caribbean	11	70	60.4
Middle East and North Africa	10	39	51.2
High-income OECD	6	25	8.0
South Asia	9	46	45.4
Sub-Saharan Africa	11	63	225.2

Source: *World Bank 2004a.*

"Lengthy registration and licensing procedures obstruct business"

In most African countries registration and licensing are serious obstacles to formalizing a business, and 7 of them are among the world's 10 most difficult countries to register a business. The registration cost in Africa far exceeds that in all other regions, and the number of procedures and the registration time are among the highest in the world, with Angola, Chad, the Democratic Republic of Congo, Togo and Guinea the most difficult for formalizing a business (table 7.1 and figure 7.3).

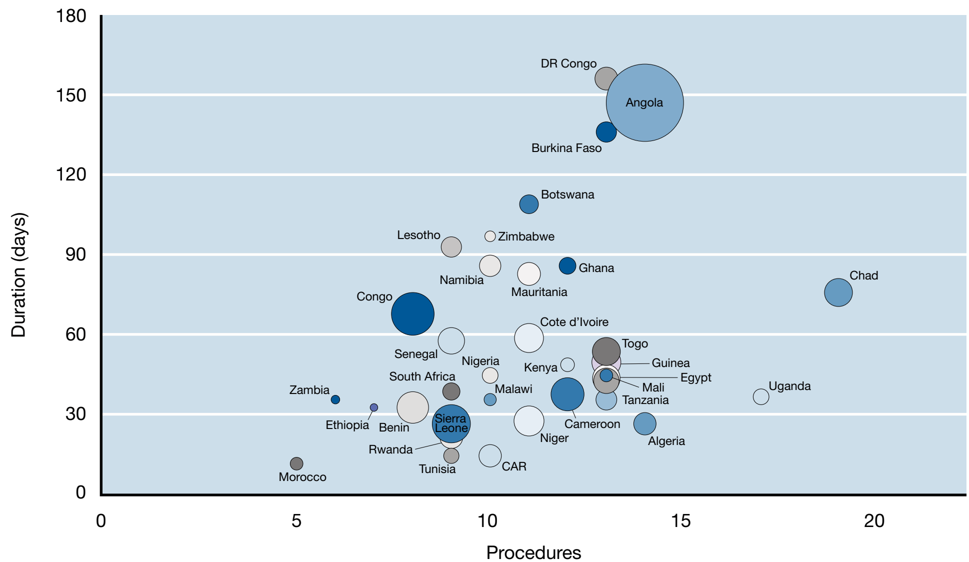
Africa also has positive examples, even world benchmarks, with Morocco, Ethiopia, Zambia and Tunisia performing better than many dynamic Asian or Latin American countries. For example, in India the registration process takes 89 days and costs $265. In Vietnam it takes 56 days, close to the African average of 59 days. Morocco is the best in Africa, with five procedures to register a business, a duration of 11 days and a cost of $195. In Tunisia the process needs 9 procedures and 14 days and costs $277.24.

In absolute terms the registration costs in all African countries are higher than those in countries with GDP per capita many times those of Africa. In Denmark a business can be registered with no fees, and in New Zealand, the world's second most efficient system, the cost is $39. In Africa the average cost of registering a business is $785, with Ethiopia the lowest at $74 and Angola the highest at $6,621 (World Bank 2004a).

The nature of procedures in Chad, the country with the most procedures in Africa, differs greatly from that in Morocco, the country with the lowest number (table 7.2). And the total cost in Chad is more than four times that in Morocco, not even counting the opportunity cost.

Figure 7.3

Registering a business in Africa: number of procedures, duration and cost



Note: The bubble size reflects the absolute cost in dollars.

Source: World Bank 2004a.

It's easiest to register a company in Morocco

Simplifying business registration

Worldwide differences in registration procedures show that the registration process need not entail high costs or long durations. Ethiopia shows what can be done with simple measures. In 2003 the cost of registering a business was reduced by 80 per cent simply by abolishing the requirement to publish notices in two newspapers. The requirement to publish notices in a journal or newspaper takes 90 days in Angola and accounts for 52 per cent of the total cost in Egypt. The countries with the easiest registration procedures—such as Morocco, Ethiopia, Zambia and South Africa—do not require the publication of a notice (World Bank 2004a).

The most efficient way to reduce the number of registration procedures is to create single-access points. In some countries nominating an existing agency to be the single point and bringing together representatives of various other agencies works well, as for Kenya since 2003. Front-line officials should speak the first language of the people they serve, removing a constraint for many informal businesses to deal with bureaucracy. Morocco has a one-stop shop, reducing the number of registration procedures to five. Reform experience in Mozambique that includes the introduction of a one-stop shop is illustrated in box 7.4.

Box 7.4
Improving the institutional set up for Mozambique's SMEs

The public sector environment in Mozambique was characterized by inefficiency, lack of transparency and corruption, particularly in such potentially dynamic economic areas as trade and tourism.

The provincial governments of Zambezia and Inhambane launched two initiatives in 2001, the Balcão Único and the Loja de Negócios, to streamline licensing and setting up commercial enterprises.

Both initiatives are meant to increase transparency and efficiency. A one-stop shop directly under the governors' offices informs clients about necessary forms, licences, fees and regulations. It also forwards completed proposals to the responsible municipalities, provincial directorates or, if required, national ministries.

The civil servants' understanding of the requirements and administrative structures has improved significantly in the course of a year. The average time to register and start a business has significantly been reduced, and allegations of corruption and gross negligence have diminished.

But some administrative barriers and a general lack of an entrepreneurial-friendly attitude and professional commitment have not yet disappeared. Many civil servants and investors still do not have a full understanding of the legislation, especially crucial laws governing land tenure and title rights. A serious constraint is the prevailing perception of many provincial directors that the new institutions would reduce their influence, responsibility and income opportunities. Further improvements need a strong commitment from all stakeholders.

Source: *Johannsen n.d.*

Standardization of paperwork further simplifies the procedure. With standard forms the entrepreneur does not need legal services to fill in the forms. Moreover, it is easier for employees to process documents.

Involvement of courts in the registration process makes the procedure costly and long. In Guinea, for example, the execution of the notary covers 74 per cent of the total cost of registration, and takes at least 12 days. Notaries usually perform a simple verification service that could be done elsewhere. The African countries where business registration is easiest do not involve courts in the registration process.

Table 7.2

Registering a business in Chad and Morocco, 2004

Procedure	Procedures (numbers)	Duration (days)	Cost (dollars)
Chad			
Deposit the legally required initial capital in a bank	1	1	0
Check the uniqueness of the company name	2	1	0
Notarize the company deeds	3	4	559.55
Obtain criminal record for directors	4	2	23.98
Procurement of a medical certificate	5	1	19.98
Register by-laws with the Ministry of Finance	6	2	0
Get an authorization from the Ministry of Industry and Commerce	7	4	28.78
Registration with the Commercial Registry	8	3	88.05
Register with the court	9	2	0
Publication in a legal journal	10	3	71.94
Register for tax	11	1	0
Inscription on the tax rolls	12	3	0
Register for the statistics code	13	3	0
Notification to the Ministry of Labour	14	1	0
Submission of the Internal Regulation Code to the Labour Inspector	15	30	0
Registration with Municipality of Asucion	16	2	90.00
Register for social security	17	2	0
Court authorization of commercial books	18	3	0
Make a company seal	19	7	28.78
Total	19	75	$911.06
Morocco			
Certificat negative	1	1	17.14
Deposit capital at a bank	2	1	0
Legalize statutes at Mayor’s office	3	1	24.00
Register at the one-stop shop	4	7	154.29
File a declaration to labour inspector	5	1	0
Total	5	11	$195.43

Source: *World Bank 2004a.*

Corruption hampers small enterprises

Bribes add a substantial cost to doing business, and having to pay bribes to speed up a process is equivalent to imposing a tax. About 70 per cent of the firms interviewed for the World Bank Investment Climate Surveys see corruption as an obstacle to the growth and operation of their business (Hallward-Driemeier and Stewart 2004). According to a study of Ugandan firms, corruption reduces the short-term growth of firms, with an effect much greater than that of taxation (Fisman and Svensson 2002). Firms there pay an estimated average of $8,300 a year in bribes, roughly 8 per cent of their total costs. In Algeria and

Kenya 75 per cent of the firms surveyed reported that they paid a bribe, averaging more than 5 per cent of sales in Kenya (Reinikka and Svensson 1999; Svensson 2003).

Small enterprises are affected more by corruption than are large enterprises, which often have specialized departments to deal with aggressive bureaucrats and have individuals that have acquired special skills on how to cope with the large number of regulations. Large enterprises can also use their political power to influence people in the public administration or pursue rent-seeking activities to obtain benefits not available to others (Tanzi 1998).

Overregulation is commonly cited as one of the major causes of corruption: in an overregulated state procedures take too long, so individuals bribe bureaucrats to speed up the process. Overregulation is positively correlated with a larger unofficial economy and with a larger incidence of corruption (Svensson 2003; Djankov and others 2001). However, 70 per cent of the firms in Zambia and 40 per cent of firms in Uganda report that the problem is not always the regulation, but the interpretation, often perceived as unpredictable (Hallward-Driemeier and Stewart 2004). So regulations lead to corruption when they are not transparent and are open for arbitrary interpretation. The argument that bribes are an efficient way to deal with extreme red tape (Campos, Lien and Pradhan 1999; Khan 2002) is not helpful in fighting corruption.

Corruption is generally connected with the activities of the state and especially with the monopoly and discretionary power of the state. But it is not the size of the public sector that generates corruption. It is the way the state operates and carries out its functions. Tackling corruption thus requires reforming bureaucracy, paying decent salaries, creating credible institutions to prosecute corrupt activities and raising awareness that corruption undermines the system (Collier 2000).

"Raising the stakes can help hinder corruption"

Simplifying the registration process and reducing regulation would reduce the incidence of corruption, especially for SMEs. Regulations with fiscal implications should be replaced, when necessary, with more credible and reliable taxing and spending policies, and tax incentives with nontransparent approval procedures should be minimized (Tanzi 1998).

Increasing the risk of punishment is important in combating corruption. Since the two corrupt parties are unlikely to report the case, the probability of detection is relatively low, so it is necessary to create institutions that make corruption visible (Collier 2000). Establishing citizen watchdog groups has been successful in fighting corruption in Paraguay, once perceived as the most corrupt country in Latin America. The network of watchdog groups quickly expanded to 25. With their help in providing evidence on corrupt activities, bureaucrats were arrested and prosecuted (USAID n.d.).

Since corruption has two sides, blacklisting firms offering bribes can be another robust measure. Blacklisting worked in a large World Bank dam project in Lesotho in 2004. Uganda also started blacklisting corrupt firms and sales staff. Blacklisting and stigmatizing may also improve the general attitude towards corruption.

Security of property rights encourages the private sector

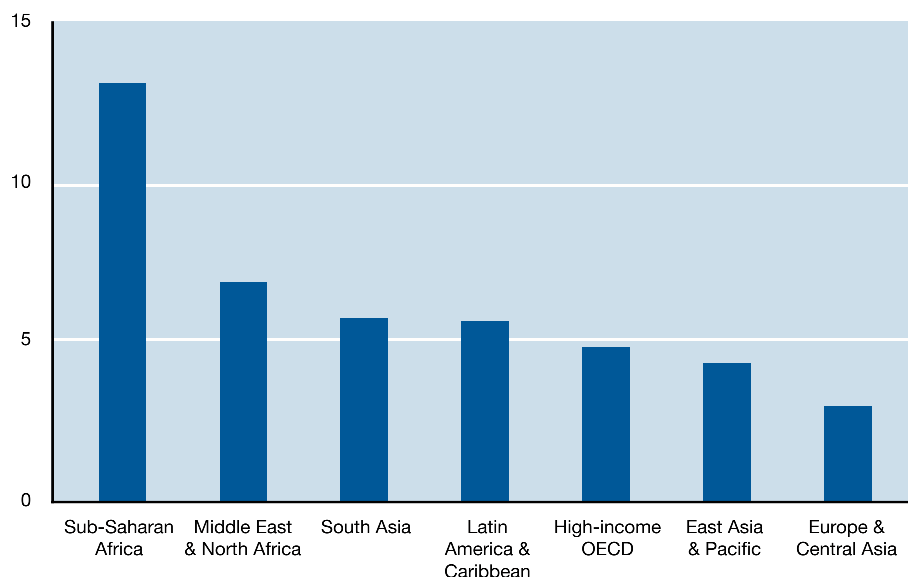
The way property rights are defined and enforced affects the efficiency of resource use and the levels and types of investments. For example, a firm that has acquired the right to establish a plant on a piece of land, and has the private ownership of a machine, still needs access to water, electricity and the labour of others to realize the full potential of these resources.

Security of property rights is one of the features most cited for promoting investment. Insecurity discourages investment because investors live in the fear of confiscation, fraud or theft. When the risk of expropriation is high, businesses are reluctant to invest in fixed assets, preferring activities that can be easily moved, do not depend on a certain location and do not require costly and heavy machinery. This hurts resource allocation because entrepreneurs choose not the most economically attractive type of activities but the activity with the least risk of expropriation (Saleh 2004).

To secure property rights, the registration of property, still a long process in many African countries, needs to be facilitated. In Ghana, Rwanda, Côte d'Ivoire, Angola, Nigeria, Togo and Egypt, it takes more than six months to register a property, with Ghana the longest at 382 days (World Bank 2004a). The average cost to register a property in Africa far exceeds the average in other regions, while the number of procedures is in line with other regions (figure 7.4). Most African countries have to revise their bureaucratic fees, which seem excessive. But, in three African countries (South Africa, Namibia and Mozambique), however,

Figure 7.4

Cost to register property (% of average value of property to be registered)



Source: *Doing Business 2005 database, World Bank.*

property registration is even faster than the Organisation for Economic Co-operation and Development (OECD) average.[2] Africa can therefore learn from best-practice examples on the continent (World Bank 2004a).

Secure property rights can significantly reduce costs for a business. The ability to use property as collateral is usually a requirement for credit, and without land titles the search for collateral becomes difficult. Formal property titles lower the cost to lenders of determining the creditworthiness of borrowers. Many countries still do not allow land ownership for foreigners, discouraging foreign direct investment. Protection of property rights also means that the state has to take effective measures to prosecute and punish theft of property rights. The transferability of property is also important. Individuals must be able to acquire property rights through sale or any other legal means. If land titles cannot be transferred, their use for collateral is limited, because the bank could not take over the land in case of default.

Women are particularly affected by insecure property rights. In many countries women's land ownership is severely restricted. In Ethiopia the legal framework has improved this, but men still consider their wife's property as common property, and banks expect the husband to sign a loan agreement with his wife, especially when collateral is needed.

Difficulties in contract enforcement hamper business activity

Contracts are of value only if they can be properly enforced. If contract enforcement is not possible, businesses will be reluctant to enter a contract with businesses they do not know, reducing the scope of economic activities. They will operate only on a cash-and-carry basis—or even ask for advance payment. Improving contract enforcement is therefore crucial to encourage private sector activity.

Enforcing contracts in Sub-Saharan Africa is among the most difficult in the world, with an average of 35 procedures and 434 days required to enforce a contract. In South Asia, where contract enforcement is easiest among the developing regions, it requires only 29 procedures and 375 days (table 7.3).

"Positively, Tunisia leads the world in contract enforcement"

Table 7.3

Contract enforcement in regional comparison

Region or economy	Procedures (number)	Time (days)	Cost (% of debt)
East Asia and Pacific	27	325	87.5
Europe and Central Asia	29	412	17.6
Latin America and the Caribbean	35	463	23.3
Middle East and North Africa	38	437	17.9
High-income OECD	19	229	10.7
South Asia	29	375	39.7
Sub-Saharan Africa	35	434	42.9

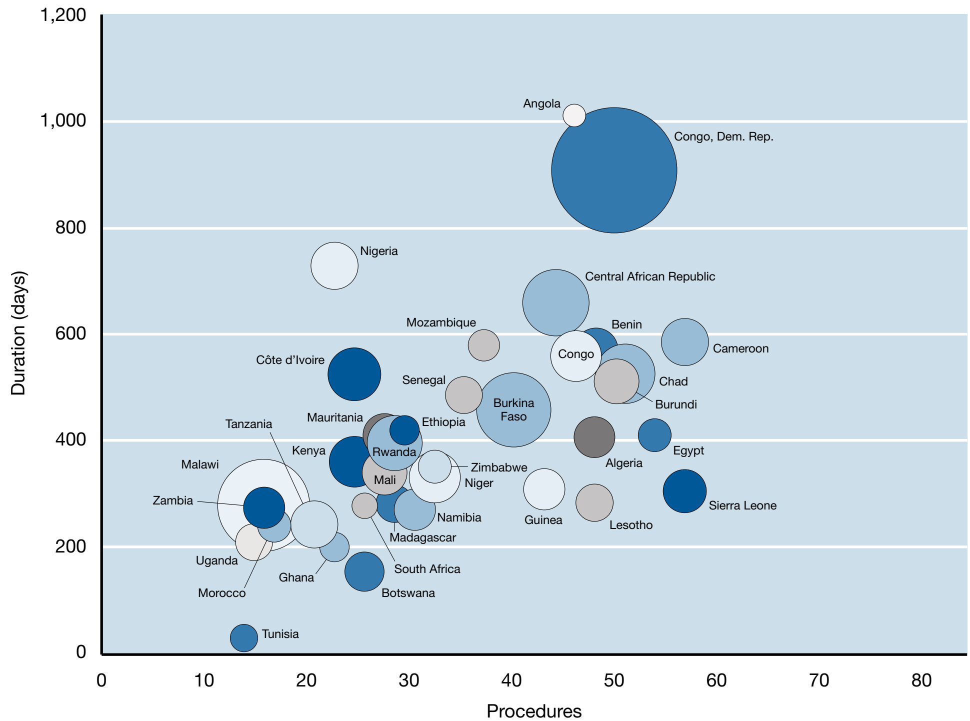
***Source:** Doing Business 2005 database, World Bank.*

After reform, Tunisia has become the world's best-practice example with 27 days to enforce a contract, the fastest worldwide. In the second fastest country worldwide, the Netherlands, it takes 48 days. In some other African countries contract enforcement takes so long and is so costly that many firms do not consider it worthwhile to even start the procedure (World Bank 2004a). In 18 African countries contract enforcement takes more than a year (figure 7.5).

> *Mandatory legal aid can slow-down cases*

Figure 7.5

Difficulty of contract enforcement: number of procedures, days to enforce and cost



Note: *Cost is reflected by bubble size.*

Source: *Doing Business 2005 database, World Bank.*

The first reform step is to review the legal system to identify the bottlenecks. In some countries the filing process is extremely long. For example, in the Democratic Republic of Congo it takes 245 days (or 33 per cent of the time of the total procedure) before the case comes to the judge. In Angola, however, cases come to the judge fairly quickly (86 days) but judgement is extremely slow (484 days).

Best-practice examples and prominent reform experiences reveal that successful reform must include the following measures (World Bank 2004a):

- ***Bring the case to court without lawyers***. Abolishing mandatory legal assistance and the requirement that the complaint must be legally justified would facilitate the process significantly and reduce the cost. In Tunisia the creditor files a claim in court, and the court issues a summon to the debtor without a requirement to appoint a lawyer.

- ***Reduce written documents***. Introducing new oral procedures can reduce the average time of cases significantly. In countries with a high illiteracy rate, still the case in Africa, oral procedures would give a stronger sense of fairness to many plaintiffs.

- ***Information systems and judicial statistics.*** The lack of reliable information systems and workflow statistics in many courts limits the ability of judicial reformers to identify bottlenecks and hinders the monitoring of progress in a case. An electronic system of recording and following up on cases from the time they are filed to the time judgement is issued would contribute to settling cases. In Mexico such a system revealed that more than 60 per cent of the cases do not go beyond the initial filing of the claim.

- ***Summary proceedings.*** Many countries have introduced summary proceedings for small debts and stricter deadlines for each procedure. Botswana uses an expedited court proceeding that does not require a trial. The creditor can apply for a summary proceeding when the defendant is unable to raise credible opposition to the plaintiff's complaint.

- ***Random case management.*** Random case management can speed the process and reduce corruption. This reform measure was successful in Slovakia, where cases are now sent to whichever judge has the lightest load. This ensures faster service and makes it more difficult to know which judge to go to for a favourable ruling.

Specialized courts are often recommended, but they can be a double-edged sword and are likely to be premature in countries where the judiciary is still developing. To be successful, reforms should go hand-in-hand with the training of judges as currently undertaken in Malawi, Sri Lanka and Uganda.

In countries with a weak judicial system out-of-court resolution mechanisms such as mediation can be a short-term solution. However, this is not desirable in the long run because of the lack of transparency.

Harnessing the power of networks to promote SMEs

Economic interest groups are important in the growth of SMEs because they can help reduce transaction costs. Since SMEs have disadvantages in markets because of their size, they need the support of network contacts, because strategic alliances can

compensate for the lack of scale. In some instances, economic interest groups take the form of clusters of enterprises or services (OECD 2004). Networks can better engage in collective action, which would be too costly for a single firm. So, supporting networks can be more efficient for government and donors than providing assistance to individual enterprises.

Another asset of networks is the common trust among network members. Once built up, it reduces costs because members need less time for careful assessments and contract negotiations and save on the cost of legal assistance. Networks are found to have a strong effect on building trust and on information-sharing among agricultural traders in Benin, Madagascar and Malawi (Fafchamps 2003).

"Small-scale lending is an immediate priority"

Building networks is important for women entrepreneurs. Firm surveys revealed that women have only limited networks, because of their domestic roles and responsibilities paired with constraints on mobility and the possibility of interacting with men. Many male entrepreneurs were employed before they decided to start a business, whereas most women start the business to support the family and did not work previously. Chambers of commerce are often perceived as male-dominated or elitist, not fully meeting the needs of female members. Women's membership in formal business organizations in Africa is so far very low, but they should be encouraged to participate in them (Richardson, Howarth and Finnegan 2004).

Many SMEs in Africa owe their existence to deliberate public policies and institutions that promote and coordinate their activities. These institutions could be much more effective if they did not suffer from persistent underfunding. SME promotion has been successful in Kenya and Tanzania, where policies have been comprehensive enough to address the critical areas of concern to SMEs. In Kenya, for example, the leather goods manufacturing industry was nurtured by the Kenya SME promotional agency (UN-ECA-SA 2005).

Promoting an entrepreneurship culture

To harness the job-creating potential of SMEs, it will be necessary to promote an entrepreneurship culture where starting a business is not a second-best solution to finding employment in the public sector.

Firm surveys in Tanzania, Uganda and Zimbabwe show that the entrepreneurial attitude was the key to successful businesses (Trulsson 1999). Most of these businesses were started because the business owner saw a good business opportunity. In fact, many entrepreneurs descend from an entrepreneurial family. Most mentioned their entrepreneurial attitude and the skills and commitment of their workforce as success factors. Many others mentioned operating in a market niche as an important success factor.

Entrepreneurship can be promoted by incorporating entrepreneurial skills in high school and university curricula. Many universities in industrial countries offer courses in entrepreneurship. For example, the University of Southampton, United Kingdom,

offers a nine-month postgraduate course for graduates wishing to start a business. African universities could offer similar courses. Rhodes University in Grahamstown, South Africa, invites practising entrepreneurs to talk to students, to share their experiences and provide hands-on advice.

Entrepreneurship training also contributes to enterprise development. The United Nations Development Programme launched a project to develop entrepreneurship in the Mexican region of Chiapas, a poor region without a clearly established entrepreneurial class (UNIDO 2004). In the programme 100 entrepreneurs were trained in production, entrepreneurship and marketing. As a result of the training, many businesses moved their operations from the informal to the formal sector and improved their marketing abilities.

Profit-oriented entrepreneurial training has been successful in Malawi, although Malawi has neither an enabling environment for SMEs nor a large enterprising society. Local trainers confirmed that the income they received as trainers was attractive to them. Participants were highly satisfied by the training skills they acquired, and more than half of them increased their profits after the training. This type of training contributes to a better performance of businesses and can improve the entrepreneurial attitude (Bärenz and Rösch 2003).

Getting the financial sector ready for small-scale lending

In most African countries, banks are not ready to lend to SMEs because small-scale loans bear high transaction cost and risk, while the return for the bank is relatively low. Supervisory and capital adequacy requirements often discourage serving small borrowers, who lack conventional forms of collateral. Extensive evidence from Africa confirms that the smaller the firm, the less likely it is to obtain formal loans, whereas a large firm's access to credit depends mainly on expected profit (Bigsten and others 2003). So, promoting small-scale lending is an immediate priority area that requires a number of institutional and policy reforms in the financial sector in Africa. Best-practice examples indicate that key financial sector reforms should include microfinance programmes, flexible collateral systems and credit reporting agencies.

Learning from microfinance strategies to widen SMEs access to credit:

Microfinance institutions have evolved around the world to develop innovative products and mechanisms that overcome the constraints of rigid collateral systems and high lending costs, and broaden access to credit by SMEs and poor people, especially women (box 7.5).

Box 7.5

Microfinance can empower women and reduce poverty

Targeting women enhances the contribution of microfinance to employment creation and poverty reduction for a variety of reasons. First, many women have good business ideas and entrepreneurial skills that are not properly used due to lack of finance and laws that restrict their access to banks. Second, while men keep about 32–50 per cent of their salaries and contribute the rest to collective household funds, women contribute everything. Empowering women through microfinance improves family well-being, especially female health and education. Third, through microfinance women gain social respect, self-esteem, physical mobility and greater economic independence and security. In many countries reducing the gender bias contributes to faster economic growth, better governance and higher standards of living.

Attempts to empower women through microfinance often increase the pressure and work loads for women and lead husbands to withdraw some support to the household. But evidence from 62 microfinance institutions worldwide strongly demonstrates that the benefits of women empowerment far exceed costs.

Using microfinance programs to empower women and reduce poverty is conducive to the growth and sustainability of microfinance institutions because women tend to be better borrowers. On average, delinquency and default rates are far lower for female microfinance clients than male ones. Policymakers should thus pay special attention to legal and institutional reforms for promoting women's microenterprises and microcredit services.

Source: *Cheston and Kuhn 2002.*

"The benefits of empowering women far exceed the costs"

Experiences of microfinance in Africa and the policy lessons

Extensive evidence from Africa shows that these institutions complement the banking sector in extending financial services to poor people and draw from traditional community-based methods of financial services in the continent (Basu, Blavy and Yulek 2004; Hirschland 2003; Elhiraika 1999). The evidence highlights many features of microfinance institutions that can have important policy implications.

First, savings by poor people can exceed demand for credit. Microfinance institutions in Africa mobilize more savings in rural areas than banks: they do not require high opening and minimum account balances, they lower the cost of depositing and withdrawing funds by customers by locating closer to them and they simplify procedures to make operations easy for clients to understand. Poor people view safe and liquid savings facilities as a means to smooth consumption throughout the year as well as an insurance against income shocks.

Second, many microfinance institutions in Africa successfully rely on group-based saving and loan schemes that increase access to loans by group members because their combined savings serve as collateral against loans and reduce transaction costs and default

rates that enables them to develop into less constrained and more competitive intermediaries. Individual saving and lending programmes become more important as the industry matures because group-lending schemes might be restrictive and overly risk-averse with only the safest groups of borrowers and projects qualify for finance (Basu, Blavy and Yulek 2004).

Third, the formalization of traditional techniques of saving and lending and the use of innovative strategies enables microfinance institutions in some African countries (Benin and Swaziland) to be self-sustainable (Basu, Blavy and Yulek 2004; Elhiraika 1999). In Ghana and Guinea microfinance institutions' performance has also improved through greater commercial orientation, better loan management and improved financial reporting (Basu, Blavy and Yulek 2004).

Fourth, the evolution of microfinance in Africa appears to have accelerated financial and economic integration. Indeed, formal and informal microfinance institutions are becoming more linked with formal financial institutions in some African countries (Schoombee 1998). While banks serve government and customers in the formal private sector, microfinance institutions concentrate on rural households, poor small borrowers and SMEs. Thus, banks and microfinance institutions in these countries play complementary roles in the financial sector. Microfinance institutions benefit from links with banks in safekeeping for deposits, liquidity management and use of excess savings. They can even obtain loans from banks to cover short-term liquidity crunches, with their assets (loans) serving as collateral (Elhiraika 1999).

Governments should build institutional capacity to get the financial sector ready to serve small borrowers and SMEs (Hallberg 2000). To do so, the authorities should:

- Develop a comprehensive policy framework that provides a legal and regulatory environment as well as capacity building for microfinance institutions to register, achieve self-sustainability and upgrade their services to compete in the modern financial sector. The framework for promoting microfinance institutions should be based on deposit mobilization, adequate capitalization, incentive-compatible governance and independence from government ministries and political pressure that induce rent-seeking and restrict interest rates.

- Discourage providing direct financial support from government, nongovernmental organizations and donors that can impair the ability of microfinance institutions to achieve both outreach and self-sustainability. If necessary, direct government or donor assistance should be well targeted and given through a central agency or apex institution in a way that helps microfinance institutions meet short-term financing needs without impairing innovation and efforts to attain self-sustainability in the long run.

- Ensure that the microfinance institutions' regulatory framework is flexible enough to accommodate the needs of different microfinance institutions and avoid over regulation, which can stifle competition and make it costly for them to deliver low-cost services to clients.[3]

- Ensure that supervisory institutions and personnel are adequately trained and have the competence to supervise and monitor microfinance institutions effectively.

- Define the activities that microfinance institutions can do initially and the capacity needed for them to expand the range of these activities before they become full-fledged financial intermediaries.

- Support capacity building through training microfinance institutions' employees on bookkeeping and reporting standards, strengthening internal controls and lending mechanisms and increasing the use of technology.

Reforming collateral requirements

Collateral-based lending excludes many potential entrepreneurs from obtaining loans, especially start-ups because only a few fixed assets are considered as credible forms of collateral. To prepare the financial sector in developing countries for increased lending to SMEs, it is necessary to reform the collateral system to allow a larger range of collateral, such as movable items and even non-collateral-based lending (World Bank 2002). This requires a reform of banking regulations, a more prudent credit appraisal procedure, and reform of enforcement mechanisms and property rights besides building institutions to create mutual trust.

A recent survey suggests that to instigate a pro-poor reform of the collateral system, the authorities must take three steps (World Bank 2002). First, determine the assets owned by poor people that can serve as collateral, and develop the necessary legal framework to support their application. Second, establish priority of claims over pledged assets through public or private registries that are easily accessible without prohibitive charges. Third, educate judges on collateral law and priority of claims to make ruling easy and more predictable. The law should make it easy for lenders to seize and sell collateral in the case of default without court ruling if there is no dispute between lenders and borrowers.

> *“Collateral-based lending limits private sector development”*

Credit registries for creating mutual trust

Out of a sample of 27 African countries, only 10 countries had public credit registries, and only 3 (Botswana, Namibia and South Africa) had private credit registries (World Bank 2004a). So the potential influence of credit registries in expanding access to credit by poor people and SMEs has yet to be properly explored in Africa. In addition to collecting information on the cash flows of a borrower's bank account or business over a certain period of time, banks rely on collateral to secure loan repayment. They also design incentives and monitoring procedures to reduce default. The creation of credit registries[4] or credit reporting agencies can reduce the information cost as well as the need for collateral.

Policymakers and other stakeholders in Africa should seriously consider the establishment of credit registries as a means of expanding SMEs' access to finance. The demand for credit registries increases with the size of the market for credit and the heterogeneity of customers. In brief, for those lenders who are willing to pay subscription fees, credit registries

can equalize access to information, raise competition and lower credit cost. Borrowers are also made more mobile and can obtain loans from more sources than before. This signifies that credit registries and information sharing can be helpful for both lenders and borrowers. Indeed, 43 Latin American banks consider information provided by credit registries as more important than collateral or the financial standing of the borrower or his history with the bank (Miller 2000).

Preparing labour markets for the job boost

Labour markets in Africa suffer from market failures. First, institutions to coordinate labour demand and supply are limited. Many job-seekers are not informed about vacancies in the private sector and therefore do not search for them. Second, the state often feels the need to intervene in the labour market to protect workers. Although labour protection is important, it may not fulfil its purpose if overprotection of labour discourages employment in the private sector, which is the case for several African countries.

Creating effective job centres with links to training institutions

Informal mechanisms, such as family or friends, are the most common ways for coordinating labour demand and supply in Africa. Consequently, the private sector is not always able to attract the most qualified and most suitable staff, while qualified people do not find an adequate job if they lack the necessary network contacts. This underlines the need for state intervention to establish job centres where jobs can be advertised and job-seekers can find information on vacancies.

In many countries the public sector is the preferred field for university graduates. Evidence from Ethiopia and Tunisia, for example, has shown that university graduates are prepared to wait a long time in the job queue to obtain a public sector job, rather than seek a job in the private sector (Adenikinju and Oyeranti 2000). Governments often indirectly encourage this attitude by taking over the role of the employer of the last resort. The Moroccan government created additional civil service posts in the last few years to tackle high unemployment, despite its commitment to reduce public spending.

To coordinate labour demand and supply, detailed information is needed on vacancies in the private sector, the nature of skills required, gender, age and qualification profiles. It is also important to improve labour statistics to allow governments to refine their labour market policy, target vulnerable groups and offer training courses to provide the skills needed by the private sector (Kausch and Trommershäuser 2002).

Job centres should take the role not of an administrator but of a job consultant or employment advisor. Staff at job centres have to identify the qualification profiles demanded by the private sector and assist or advise job seekers accordingly. These centres should cooperate closely with training centres to ensure that training provides the right skills. They should also visit firms to actively promote the job-seeker's profile.

Box 7.6

Faith-based organizations acting as a job-placement agency and training centre: the example of South Africa

The South African National Zakah Fund (SANZAF), a Muslim faith-based organization in Durban, originally founded to collect the religious tax and to spend it on pure charity projects, has taken over a more sustainable role. The aim is to get people away from charity in the long-run and to enable them to be self-sufficient. To this end, SANZAF has become a job-placement agency and training centre.

SANZAF cooperates closely with a network of Muslim enterprises in Durban to find jobs, at least on a temporary basis, for unemployed job seekers. Businesses now contact the SANZAF to find workers in a short time almost without transaction costs. The pay is often below average, but it is a chance for long-term unemployed workers to go back to work and move away from charity.

The organization also has a small craft shop where men and women can learn the profession of a carpenter or a tailor. With these skills they might be able to open a small business on their own.

The organization also provides training on how to apply for a job, perform in job interviews and go to work on time.

Source: *Steinmayer 2004.*

"Credit registries can reduce information costs"

Since experience with governmental placement agencies has not always been successful, the job-matching task could be taken over by the private sector, with the state assuming a regulatory role. Since private firms in Africa might not be able or willing to pay a fee, public-private partnerships could be a good model, with the government paying a fee to the private agency for each successful placement. Even nongovernmental organizations can be a placement agency in partnership with a private sector company (box 7.6).

Labour protection or labour market flexibility?

State intervention in the labour market is often considered necessary to protect workers from unfair treatment. But if protection reaches a level that discourages labour demand by prohibitively increasing costs in the private sector, it may reduce opportunities for regular employment in the formal sector. Moreover, groups that might be disproportionately more affected by the cost of job regulation are the most vulnerable groups—including women, young people, the unskilled and the poorly educated. It is thus necessary to balance labour market flexibility and employment security acceptable to both parties. This balance is achieved when labour input can be easily and quickly adjusted to meet labour demand, while assuring a reasonable level of protection for workers.

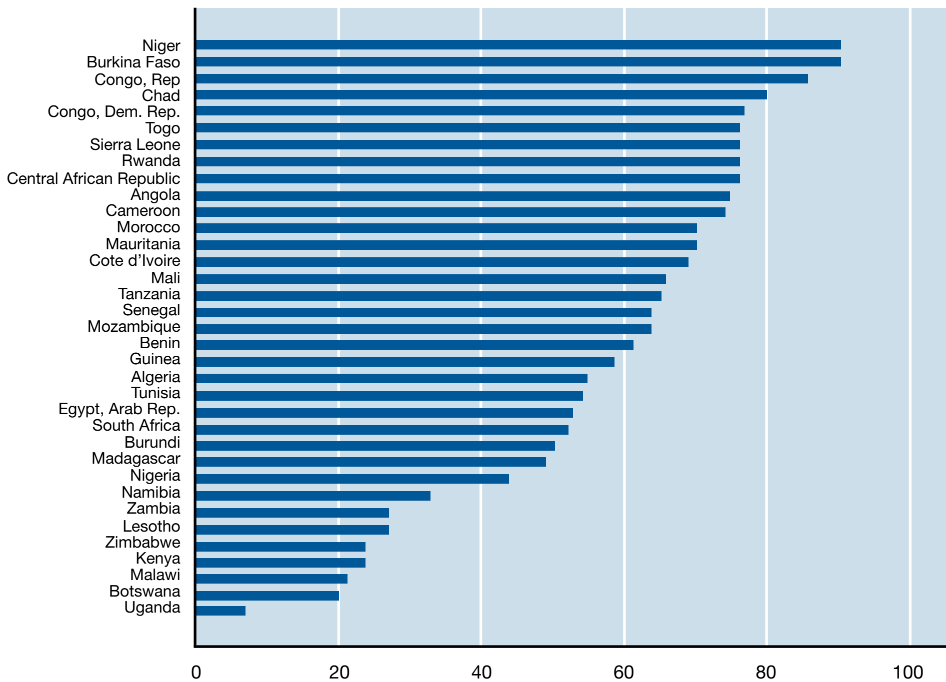
High firing cost and restrictions on temporary contracts tend to create inflexible formal labour markets. If temporary contracts are not allowed and firing costs are high,

employers would prefer to hire less risky workers. Inflexible labour markets especially discourage the employment of vulnerable groups, such as women and young people. Formal employment in Africa is the most rigid in the world (World Bank 2004a). But it has to be taken into account that the largest share of Africans are self-employed, either in agriculture or in the informal sector, and are thus not covered by labour regulations. Rigid labour regulations can encourage businesses to remain in the informal sector and discourage new labour-intensive investment, especially foreign direct investment.

The five African countries with the least rigidities on employment are Uganda, Botswana, Malawi, Kenya and Zimbabwe—the five with the most are Niger, Burkina Faso, Congo, Chad and the Democratic Republic of Congo (figure 7.6).

Although minimum wages are desirable to ensure a minimum level of living, they may discourage employment in the SME sector if they are excessive or if the threshold for pay-

Figure 7.6
Rigidity of employment in Africa



Labour market flexibility and employment security must be balanced

***Note:** Rigidity of employment here is measured as an index on a scale between 0 and 100, with 0 meaning a fully flexible labour market and 100 the most rigid labour market. The index consists of measures of the difficulty of hiring, which includes the possibility of fixed-term contracts and the ratio of the minimum wage to the average value-added per worker, the rigidity of working hours (including the possibility of night and weekend work) and the difficulty of firing.*

***Source:** Doing Business 2005 database, World Bank.*

ing minimum wages is too low. In Burkina Faso the minimum wage is 82 per cent of the value added per worker (Rama 1998). In South Africa many small enterprises in Cape Town's apparel sector do not desire to grow above the number of eight workers because they would be forced to pay minimum wages (Steinmayer 2004).

Firing costs, measured by the severance pay in weekly wages, are extremely high in some African countries. In 15 African countries severance pay is equivalent to the pay of one year or more (World Bank 2004a). The severance pay is equal to the pay for 47 months in Morocco and 40.5 months in Burkina Faso.

Studies of Morocco show that difficult firing regulations hamper job creation (Agénor and El Aynaoui 2003). Dismissing an employee implies a long legal process that usually results in a high severance pay determined by the court. Because it is so complicated to fire an employee, employers enter into costly direct agreements with the employee himself, reducing the employment chances for those with less influential networks.

"High firing costs deter formal hiring"

Employers are reluctant to hire workers, and dismissed employees have no incentive to look for new jobs quickly because they can live for several months on the severance pay. But without any severance pay, dismissed workers could fall into extreme poverty immediately. To enhance employment in SMEs it will be important to deregulate excessive severance pay requirements.

Conclusion

Creating an enabling environment for the private sector to grow and create jobs is an important government responsibility. Although the macroeconomic environment has improved in many African countries since the 1990s, stabilization programmes appear to have no significant impact on private investment in Africa as a whole, while the increase in growth is insufficient to reduce poverty considerably. So, further and deeper second-generation reforms are necessary to improve the business environment, prepare the financial market for small-scale lending, and ensure adequately flexible and efficient labour market institutions.

To create an enabling environment for SMEs and private sector growth, African governments must improve physical infrastructure, encourage informal businesses to register, simplify the registration procedures, secure property rights, improve contract enforcement, promote an entrepreneurship culture and encourage networking among SMEs. Promoting microfinance institutions is an essential part of efforts to prepare the financial sector to provide wider and sustainable services to poor people and to SMEs. Fostering microfinance institutions requires dynamic and adaptive regulation and supervision, reform of the collateral law, the creation of credit reporting agencies and closer links between microfinance institutions and banks. And microfinance programmes should be gender-sensitive and involve financial products that take into account women's needs and constraints.

Labour markets must be flexible enough to stimulate employment, especially for vulnerable groups. Worker protection laws—minimum wages or hire-and-fire regulations—have to be carefully designed and regularly revised to minimize any adverse effects on business growth and labour demand. To hold down search costs and facilitate employment, governments should create and support job centres that not only match employers and potential employees but also provide reliable labour market statistics, training and skills development opportunities as well as advisory services.

Endnotes

1 This section is largely drawn from UNECA (2004b).

2 The OECD average is 34 days, whereas it takes 20 days in South Africa, 28 days in Namibia and 32 days in Mozambique.

3 The regulatory framework may vary across countries and over time (see Basu, Blavy and Yulek 2004). For example, in Benin and some other West African countries there is a dedicated microfinance law that covers saving and loan cooperatives, whereas in Ghana the activities of rural banks are regulated under the commercial bank act.

4 Credit registries are private or state-run reporting agencies that collect and disseminate information on the repayment performance as well as other aspects relating to the creditworthiness of a customer.

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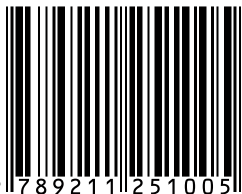
Economic Commission for Africa

Poverty in Africa is substantially higher than in other developing regions. More enigmatic is that poverty on the continent is chronic and rising. At 46 per cent, the share of the total population living on less than $1 a day threshold is higher than in the 1980s and 1990s- this despite significant improvements in the growth of African GDP in recent years. The implication: poverty has been unresponsive to economic growth. Underlying this trend is the fact that most people have no jobs or secure sources of income.

Various reasons have been given for Africa's lack of response of poverty to economic growth. First is the inadequacy of the growth rate. African countries need to grow by an estimated 7 per cent a year to reduce poverty enough to achieve the first Millennium Development Goal of halving the number of poor people by 2015. This growth is far higher than the average of nearly 4 per cent witnessed in the last decade.

Prerequisites for creating decent employment include the transformation of African economies from low productivity traditional agriculture to high value agriculture and agroprocessing- and to the growing industrial and services sectors, taking advantage of the opportunities presented by globalization. Political leadership is required in order to prioritize broad-based employment creation in national development programmes, including poverty reduction strategies.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