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GOVERNANCE, TRANSPARENCY AND PRIVATE INVESTMENT IN AFRICA^{*}

James J. Emery

International Finance Corporation

Introduction

The quality of governance directly affects the level and nature of private investment in a country. Private investment in turn is a major determinant of economic growth, and the ability of a country to reduce or alleviate poverty and improve the lives of its citizens. The relationship of governance to private investment is complex and is subject to many influences; this paper will examine a relatively narrow aspect of that relationship – complex administrative regulation of business as an enabler of corruption and poor governance – to draw implications on the relation between governance in Africa and the inability of most African countries to create a positive investment climate, attract significant flows of investment, and maintain consistently high growth rates.

The impact of poor governance on the private sector is neither as severe nor as repressive for the general population as it is with respect to direct diversion of public funds, use of repressive force, and corruption of basic public services such as health and education. The amounts of money involved in securing bribes from the private sector are in most cases much less than can be gained from direct diversion of public funds, especially in resource-rich countries. The repression emanating from poor governance is one over economic activity, not personal freedoms, and so is not as severe in its impact on citizens. And the loss of business opportunities is probably not as directly important to most citizens,

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particularly the poor, as the failure of the state to deliver adequate basic services in security, health care and education.

Nevertheless, the impact of poor governance on private sector activity is crucially important in determining overall levels of private investment, and the nature of that investment. A number of studies have validated the importance of corruption as a disincentive to private investment. A global survey of private businesses, which focused on obstacles to doing business, indicated that corruption was the leading constraint on business activity in developing countries overall; further, the study indicated that the Africa as a region ranked as being among the more corrupt. (Batra et al, 2001)

Several major rankings of competitiveness or the business climate incorporate directly measures of corruption or governance, such as Transparency International's Corruptions Perceptions Index. (World Economic Forum, 2001; Transparency International, 2002) One service to businesses and countries focuses explicitly on a series of factors linked to the transparency of the legal/regulatory environment, and generates an "opacity index" which explicitly incorporates poor governance and corruption. (PriceWaterhouseCoopers, 2002) In general, the results of these surveys or empirical rankings based on surveys cites the effects of poor governance as increasing the uncertainty for business, raising costs – often far beyond the direct cost of bribery, and distorting the types of activity pursued by the private sector, all of which depress private economic activity, and hence incomes, employment, and growth.

The specific aspects of governance which affect private sector activity, and private investment in particular, cover a range of interactions between the public and private sector, and include the following:

- Maintenance of policy distortions which create exceptional opportunities for rent seeking, patronage and pilferage;
- Use of direct government ownership for political and patronage objectives, and the corresponding exclusion of private activity in these sectors;
- Corruption and dysfunction of the judiciary system;
- Corruption in the granting of licenses, permits, etc.
- Corruption or favoritism in the collection of tax revenues from business, including general taxation revenues normally collected by Revenue agencies and trade taxes collected by Customs Authorities;
- Corruption or arbitrary enforcement of business regulations, such as labor, environmental, and other standards.

All of these factors are important determinants of the business climate, and feature prominently in assessments of competitiveness, or the attractiveness of a country as an investment location. The first factor, policies which create substantial opportunities for corruption and diversion of funds, has been typical of the worst governance environments, often cryptically named "kleptocracies" or more politely as "state capture" by corrupt interests, of which Africa has claimed a number of examples.

There are examples of exceptionally bad governance where natural resource revenues controlled by the state have raised the stakes in terms of potential opportunities, and led governments to deliberately maintain otherwise dysfunctional policies, such as in Nigeria under Abacha and Zaire under Mobutu. Yet these types of policies have also been commonly found in countries with much better governance practices as well. In general, they have been the subject of reform programs supported by external aid institutions,

and except for extreme cases, have increasingly been addressed over the decade or more of economic reform programs in most African countries.

The use of state-owned companies as patronage vehicles has been widely documented, with the resulting inefficiencies and inadequacies in service provision and infrastructure which have resulted (World Bank, 1995). The successive privatization programs which many countries have adopted have steadily eroded the size of the parastatal sector in most African economies, but substantial pockets remain, particularly among those firms viewed as “strategic” during earlier rounds of privatization. The privatization process itself, often pursued via non-transparent means, also offered opportunities for patronage and rent-seeking. Although still an issue, the various issues around privatization are well acknowledged, even though the momentum for privatization in Africa may be slowing as the more difficult cases, strategic, and politically important firms, remain in state hands. At the same time, the appetite by international firms for new investments in emerging markets in infrastructure sectors in particular has dried up, contributing to the loss of momentum on further privatization in Africa.

It is the remaining points concerning the judiciary, business licensing, tax administration, and the regulatory apparatus which have attracted somewhat less attention in the economic assessment of poor performance in Africa, and investment climate analysis. Indeed, addressing these issues has been classed as “second-generation” reforms, indicating both a lower level of priority as well as a later place in logical sequencing of reform programs. (IMF, 1999) The importance of these factors as determinants of the overall investment climate, has, however, become paramount as the agenda for first generation reforms has proceeded, and there has been little in terms of investment flows in response. Indeed, it has been this lack of a “supply response” to reforms in Africa in terms of increased investment, which has characterized much of the experience of African countries in the 1990’s.

This paper focuses on one particular aspect of this set of factors: the administrative requirements for establishing a new company in Africa. Thus, we are looking at the mechanics of private investment, in particular all the bureaucratic requirements connected with new investment. The resulting assessment is also valid for many operational aspects of doing business which apply to existing firms as well as ones being newly established. The focus on new investment captures an important stated objective of most development strategies – that of attracting increased private investment, and foreign investment in particular. The analysis of administrative requirements provides a specific look at the instruments of good or bad governance as it affects private investment, and so helps capture some of the essence of the resulting environment created by their structure and implementation. It allows more detailed and useful analysis of the impact of governance in practice than simply an analysis of the structure of policies and regulations, by focusing as well on their implementation.

Administrative Barriers to Investment

A significant volume of research and advisory assistance has been conducted for a number of African countries, following a comparable methodology, to identify the scope and nature of these second-tier administrative barriers to investment. This work has been undertaken by the Foreign Investment Advisory Service of the World Bank and International Finance Corporation, and the Services Group, acting as a contractor to the U.S. Agency for International Development. The analytical approach used in each case is quite simple conceptually. It consists of documenting, in precise detail, all the administrative requirements for establishing a firm and beginning operations. This includes all licenses, approvals, registrations, permits, or other formalities required to be in full compliance with existing laws and regulations. In addition, researchers also gathered data on the delays associated with each step, the costs, and the forms or information required.

This research was typically done in full collaboration with government agencies, whose active participation in the process was solicited from the beginning, and with the support of the private sector,

who provided confidential assessments of how various measures were actually implemented. (This work is presented in more detail in Emery and Spence, 2000. Much of the analysis presented in that report is summarized here, along with some updated information available since that publication. Morisset and Lumenageso, 2002 also provide a compilation and comparison of results of this work in West Africa). Later research has supplemented this analysis with more formal surveys of enterprises (FIAS, 2002 and 2003).

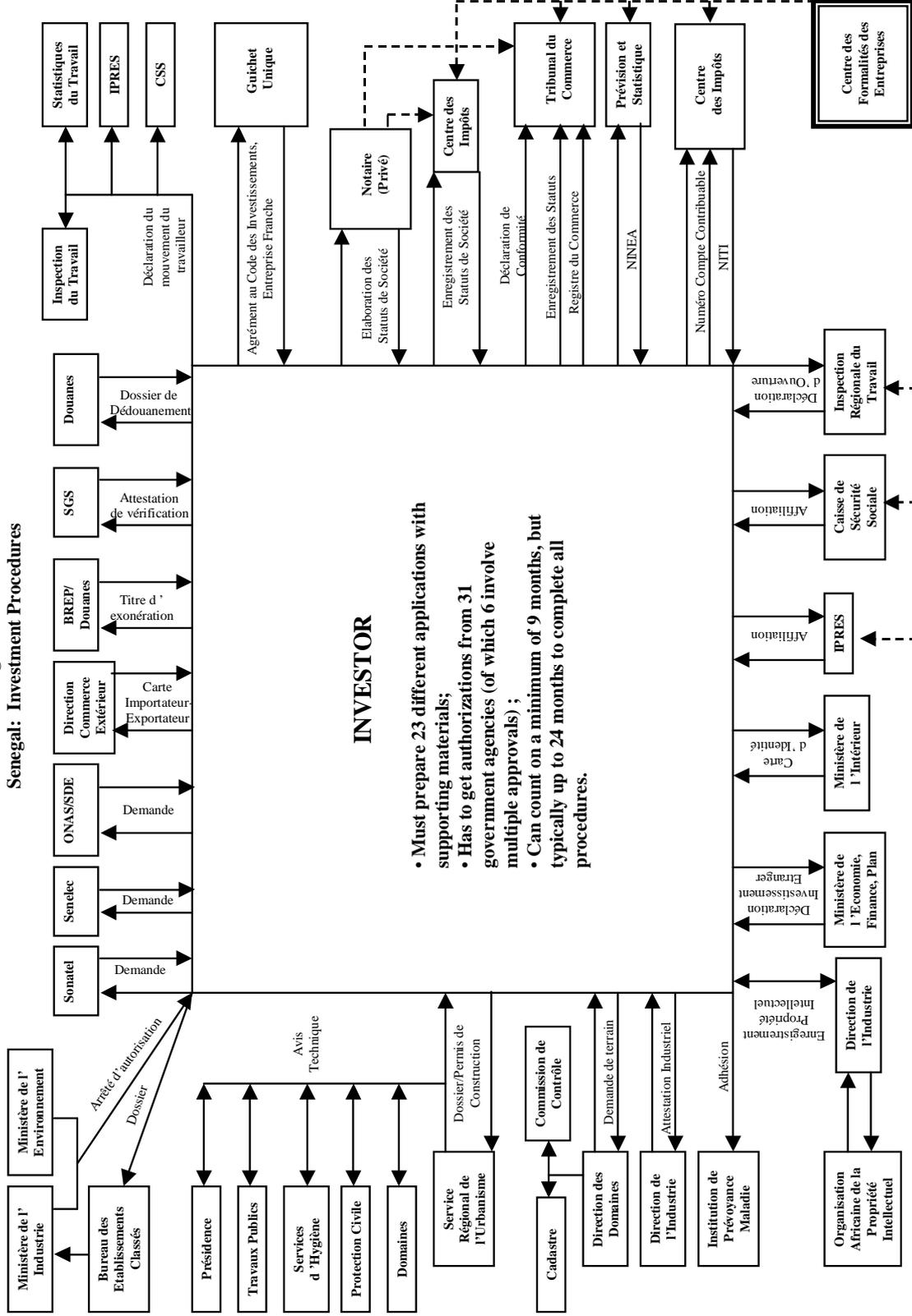
The resulting information is typically divided into four areas, roughly corresponding to the chronological process of making an investment:

- General licenses, approvals, and other requirements for all firms, including general investment approval, approvals for incentives, tax registration, company formation, expatriate work permits, business licenses, etc.
- Specialized approvals required for certain sectors or activities, such as are typically required for sectors involving resource utilization, tourism, financial services, transportation, etc.
- Site development constraints, encompassing securing land, improving it, getting utilities services, and constructing buildings.
- Operational requirements, which firms encounter once they begin operations. These are the result of regulations governing labor, foreign exchange, international trade, standards, etc. (The Services Group methodology uses a slightly different characterization of requirements for establishing, locating, employing, and importing/exporting. Services Group, 2002)

The result is a comprehensive mapping of all of the bureaucratic and other routine requirements related to realizing a private investment project in the country. To date, such assessments have been undertaken for the following countries: Ghana, Uganda, Mozambique, Tanzania, Kenya, Senegal, Guinea-Bissau, Zambia, Zimbabwe, Mali, Madagascar, Lesotho, South Africa (including differentiation by province), Namibia, Nigeria, and Mauritania. The resulting assessment is specific to that country, and provides the basis for dialogue and design of reform or institutional change programs to address the resulting constraints. Nevertheless, there are a number of broad consistencies across countries which emerged. And, while there were significant institutional differences in individual countries, and variances owing to their legal/administrative heritage which derived mostly from colonial administrations, there were also similarities.

Figure 1 shows a diagrammatic example of the process for a foreign manufacturing firm in Senegal. What is clear from this example is the complexity of the overall process, and the potential for delays and rent-seeking behavior by officials. In Senegal, there were a total of 23 different “dossiers” or applications with supporting material required, with the need to pass before 31 different agencies of national and local government, of which 6 required multiple visits, adding up to a process that takes from 9 months to 2-3 years to complete. This is by no means unique or uncharacteristic; indeed it is much better than in neighboring Guinea-Bissau or in Nigeria, for example, and probably on average rather typical for an African country. Some of the examples of this complexity are summarized for each type of administrative requirement as follows.

Figure 1
Senegal: Investment Procedures



General Approvals. There are a number of steps typically required of all firms in the process of establishing a new business. In some countries, such as Mozambique, simply registering a company can be a long and expensive process; in others such as Kenya, it is theoretically easy, but outmoded legislation and a Registrar General's office with no resources made it unnecessarily cumbersome. These business registration requirements are necessary services for private investors: establishing a company, registering a trade name or copyrighting a logo are important protections. The needed reforms are not to do away with these requirements but to provide the services effectively. The greatest obstacles and delays have occurred with countries that require special approval, and award fiscal incentives, for qualifying investments, typically those in sectors viewed as development priorities.

Here the need to prepare detailed feasibility studies and demonstrate project compliance with (often vague) eligibility criteria pose additional burden on firms, and delays long exceeding the legal time are common. Business licenses at a local level are another source of delays and duplicative submission of company and project data, but are usually an important revenue source for local authorities with limited taxation options. For foreign firms, special registration requirements for foreign investors are common, and significant delays are encountered in securing work permits for investors and expatriate managers. Duplicative tax registration procedures are common as well. As a result, these initial hurdles can often take many months, or even a year in some countries for complex projects.

Sectoral Licensing. An additional layer of scrutiny and evaluation of projects by governments is applied for certain sectors. These include, importantly, natural resource exploitation rights, or allocation of other limited resources for business use. Here, concession procedures are particularly non-transparent, yet award of concessions is the primary policy tool for resource management. Licenses may be granted for political reasons, with little regard for performance or appropriate resource allocation. Governments have often been particularly weak in enforcement in these areas as well. As a result effective resource management policies are often undermined, and optimum levels of investment and exploitation are usually not achieved (with divergence in both directions). Governments also extend sectoral regulation into detailed aspects of business operations, for example prescribing management structures and qualifications requirements for tourism companies, and limiting foreign investment, often in contradiction with stated policy in other laws.

Site Development. It is in buying or leasing land, constructing facilities, and securing utilities services that the greatest delays are encountered. While most land in Africa is government or communally owned, poor policy formulation, cumbersome and non-transparent procedures for making land available for commercial use, and tenure rights of informal occupants often make for a long and uncertain process for investors. Undeveloped markets in private real estate mean that reliance on public sector land is virtually a necessity. To develop the land and construct commercial or industrial facilities requires a series of approvals and licenses. Here again, significant delays can be encountered, and the responsible authorities are often poorly equipped to evaluate proposed plans. Securing connections to utilities services – power, water and sewer, and telephone – is also fraught with delays and frustrations for investors. While telecommunications and power privatization have proceeded in a few countries, leading to improved service, securing utilities services still constitutes a major problem in many countries. New connections may be impossible in some areas, or the cost of extension must be borne entirely by the investor. A general lack of industrial estates or other comparable developed industrial facilities, means finding an existing building or even a fully serviced site in a desirable location can be quite difficult, so investors must typically be directly responsible for construction and all the related requirements.

Operational Requirements. Once operational, companies face a different series of interactions with government agencies. These are typically regulations and controls on foreign trade, foreign exchange, and labor and social security. While foreign exchange controls have in the past been one of the greatest sources of abuse and rent-seeking, due to the pricing distortions involved in managed exchange rates, these

administrative allocation systems have largely been abandoned in favor of market-determined systems. Nevertheless, much of the red tape associated with exchange controls persists, often with little policy justification and duplication over controls and reporting required for trade transactions. The persistence of partially liberalized foreign exchange markets still provides ample opportunities for arbitrage among different markets, and encourages otherwise illegal cross-trading, leading to periodic and sometimes arbitrary enforcement actions by Central Banks, as happened in early 2002 in Nigeria. Labour regulations are often very loosely enforced in Africa, even though there may be extensive legislation on the books. This reflects perhaps a pragmatic stance of many governments, where conditions in the informal sector pose much greater social issues than the enforcement of regulations on a much smaller formal sector labor force.

They are, however, often applied arbitrarily and can involve strong penalties for offending firms. It is the trade area, however, that corruption and poor governance are most widespread, with important implications for private firms' operations. Corruption in Customs Authorities is widespread in Africa, where a tacit acceptance of the nature of "porous" borders characterizes most regions. Firms who comply and pay duties are often saddled with delays and unfair competition from smuggled imports, and overall trade policy is undermined by the lack of enforcement. While tariff reform in many countries has reduced the potential gains from duty evasion, the results of the various studies point to the continuing corruption of most Customs Authorities.

The Impact on Private Investment

The overall picture of the investment climate in the African countries covered is thus, to varying degrees, hostile and bureaucratic. This is true even in those countries where serious reform programs have removed many of the major policies that acted both to foster poor governance on a grand scale and to deter private investment. Although clearly those countries are ahead of some of the reform laggards, such as Nigeria and Guinea Bissau, they still have not succeeded in creating an environment which is investor-friendly, but rather perpetuate one which fuels and enables poor governance and corruption. The relation between this administrative environment and governance is complex and has several dimensions.

First of all is the overall complexity of the process. Simply adding up the various requirements and the estimated time it all may take presents a dismal picture, as outlined above in Senegal. The overall complexity places a premium on means of circumventing, or speeding up the process, which creates a flourishing environment for corruption.

Second, there were many cases of overly complex or poorly designed procedures. These included a number of cases of "Catch-22" like vicious circles, where an investor could only qualify for the permit required if you already had another, which was in turn dependent on it. This type of situation was found in several countries, such as in Senegal for the requirement to disburse the capital to establish a company into a local bank account, where the bank required an investor's identity card to open the account, which was only issued after the company was duly formed. While some countries, such as Uganda, openly acknowledged these problems and consistently defined an appropriate sequence, others did not, leaving investors pursuing an impossible chain of events until they could convince one party or another to make an exception.

Third, there were many cases where duplicative information was required at successive steps, and a large volume of supporting information is also demanded. There was little exchange of information among different agencies, nor was there much trust among them. Thus, for example, to secure a building permit one often would have to submit copies of the company statutes, not simply the record that the company was duly registered and the statutes submitted to the authorities who were actually concerned with them. A few countries had attempted to overcome this problem of simple registration with "one-stop-shops" for

investor registrations, but essentially none were that effective. In many francophone countries another model of the Centre des Formalités des Entreprises was being implemented, whereby a computerized system of submitting standard information for various registrations was handled centrally and then distributed to the various agencies requesting it. This had been done with some success in Mali and Senegal, for example where the program was administered by the Chambers of Commerce.

Third, in many specific areas the enabling legislation or the nature of the administrative requirement may not be unsound or overly complex, but the institution administering it is either lacking resources, poorly managed, or overly subject to political pressures. Many of the institutions concerned with business licensing and regulation are obscure agencies with limited visibility and perceived importance. They may operate outside of major ministries, with indirect reporting lines and little in the way of strong oversight. Corporate registries, municipal business licensing agencies, immigration authorities, factories inspectorates, sectoral licensing agencies, are often examples of these. They are typically lacking in resources and capacity, and so are unable to do a proper job, even where their staff may be otherwise motivated to do so. Corporate records, whether kept by a registrar's office or a commercial court, often consisted of handwritten index cards filed in shoeboxes scattered around dimly lit storerooms. Searching for such records could take days or weeks. Factory inspectors typically could visit only a small portion of the industrial sites they are responsible for monitoring, and lacked money for fuel even if they had vehicles. In these cases the nature of the problem was often inadequate services being provided, so that firms were subjected to delays, and even bribes wouldn't necessarily bring better results.

Fourth, one finds an astonishing prevalence of petty obstructionist behavior by officials. They may be in a position to impose a requirement on a firm, and then act in classic rent-seeking fashion to leverage their position. Many of these offences may be petty; for example the official who insists on a form, but the office has none available except for his own "private" copy. However, when presented with this behavior at every turn the result can be frustrating for investors.

Fifth, there are substantial areas of business regulation and taxation in African countries where corruption is the norm, or is not exceptional. This is certainly true of Customs authorities the countries reviewed in these studies, where the ability to bribe a few officers to avoid paying duties, or reclassify goods into more favorable categories, is widespread. Officers also use their ability to stop commerce by obstructing export or exempt import shipments to extract bribes, where the urgency of the shipment gives them leverage even though no duties may be charged. With many countries, tax administration is also arbitrary and subject to extensive negotiations. A typical procedure may involve a company submitting a return, the tax authorities responding with their own higher estimate of the taxes due, and then a negotiation. Most countries have non-existent or non-functional appeals mechanisms for tax disputes with the authorities. When revenue demands are high, tax inspectors may often proactively visit companies looking for various areas of non-compliance. These corrupt practices typically have a pervasive negative influence on business operations. Unlike predatory behavior directed at extracting rents from specific activities, this form of corruption is not tied to specific value being created, is spread throughout the economy and raises factor costs in general. Thus is much more likely to kill off economic activity than if it were directed at simply extracting rents. (Shliefer and Vishny, 1993)

As a result of these factors, in all the countries assessed, which includes a broad spectrum of African countries, the environment for private investment remains negative or outright hostile. And this was true in many countries which had placed a priority on economic reforms and attracting private investment, particularly foreign investment. Thus, one can say that virtually no African country, with the exception of several not assessed in this manner, such as Botswana, Mauritius, and South Africa, has an investment climate which is reasonably attractive, transparent, and mediated by strong public institutions. While most have some form of fiscal incentives for new investment, and devote resources to some kind of investment promotion organization, and send officials overseas on missions to promote the country to investors, the

reality on the ground is shockingly divergent with the image that the countries may be portraying. While this is clearly a generalization, the inability of most African countries (again with the exceptions of those noted above plus some small countries with high rates of growth driven by natural resource exports) to generate and sustain high rates of private investment and economic growth is currently one of the continent's great economic problems.

One of the major factors underlining this poor economic performance is the low rates of investment in Africa. Sub-Saharan Africa accounts for about 5 percent of GDP of all developing countries, yet for only 4 percent of FDI of all developing countries. Furthermore, this foreign investment is overwhelmingly in resource extraction sectors, primarily petroleum and mining. The picture for total private investment is even worse, with Africa generating only 3 percent of total private investment in all developing countries.

The low rates of aggregate private investment in Africa mask a particularly difficult challenge, that of the high rates of capital flight. Attracting foreign investment requires overcoming negative images, information barriers, language and cultural differences, etc. in addition to demonstrating the fundamental returns from business activity. Domestic investors don't face these hurdles, and should be better equipped to cope with the nature of most uncertainties. However, in the most telling condemnation of the insecurity of African investment climates is the extent of capital flight. Some estimates have placed capital flight from Africa as the highest in the world, on a par with the Middle East, in terms of the percentage of private assets held abroad. (Collier and Patillo, 1999). Other recent estimates place the volume of capital flight exceeding that of inward foreign investment and foreign aid, making Africa a net capital exporter (Boyce and Ndikumana, 2001). This is to a great degree a function of political instability and the historical weakness of most African currencies, but is also in part a reflection of the lack of security of property rights in Africa and the insecurity of the business climate due to cumbersome red tape and arbitrary enforcement. (Ibi Ajayi and Khan, 2000) For successful African businessmen, the first and most important hedge against an uncertain future at home has been to move money into safe investments in hard currencies overseas. This has occurred despite the extensive capital controls in virtually all African countries which have limited outright transfers and investments.

The degree of regulatory and bureaucratic complexity these systems have generated are a clear deterrent to investors, which result from the delays, added costs, and uncertainty of trying to establish a business. Some surveys of the private sector have shown that regulatory compliance and other aspects of dealing with the government assume as much as 20 percent of managerial time and effort, and bribes are the primary means of reducing this burden, affecting over 80 percent of firms in Uganda, for example. (Svensson, 2000) While these factors are an important deterrent to investment arising from poor governance, the impact also goes further than these relatively predictable impacts, to affect the basic property rights of private investors.

Due to the complex nature of most business regulation in Africa, virtually all firms are operating illegally in some respect. Thus, they are vulnerable at any time to reprisals for what may be otherwise minor and indeed routine noncompliance. This vulnerability, combined with the arbitrary nature of enforcement arising from poor governance means that firms can be closed down or worse for operating in exactly the same way as their neighbors, their competitors, or their clients and suppliers. This, indeed, is the quintessential nature of the business climate in most African countries – the fact that you can and most likely will be at some time singled out for what is on the surface simple enforcement of arcane or otherwise unclear and obscure regulations. (Box 1)

The severity of this threat places a premium on political influence in the survival of a business, and makes such influence virtually essential for a business to thrive. A personal relation with a Minister or other high government official is a key element to business success in Africa. If not a personal relation, then via access to key officials firms can insulate themselves by furthering either the personal or political

agenda of those officials by payments, or other means of accommodation. The nature of these relations is difficult to document or assess empirically. Some experts have simply noted that they play a strong role in business success in the broader context of anticipating and positioning a firm to respond to policy changes emanating in an unpredictable manner from government (Utomi, 1998).

The importance of political influence on business success and the ability of private business to influence political leaders in their policy determinations is perhaps universal; in the U.S. lobbying is elevated to a high degree of respectability and political contributions by business groups to campaign funds are the currency of influence. However, what is unique in Africa is the need for such influence to insulate the firm from the ever-present threat of politically motivated actions, based entirely on enforcement of existing laws and regulations. The key role of political influence is not necessarily on policy formulation, although this is also a concern, but on securing fundamental property rights which are otherwise at risk. The judiciary offers little in terms of protection in most African countries, and in any case the problem is that firms are actually in non-compliance and thus even in a responsive and independent judiciary wouldn't necessarily benefit from protection of rights by the courts.

These administrative barriers to investment have proven remarkably resistant to reform efforts. In each case where an assessment was done, there were a number of actions which governments took to either remove obsolete regulations, eliminate the sort of double-jeopardy situations and anomalies that some regulations created, or otherwise use administrative changes to streamline or eliminate some of the procedures found to be without substantive merit. However, the kind of systematic action to address these constraints as part of an overall reform effort to improve the investment climate has not been implemented.

In some cases, attempts to improve enforcement of business regulation and eliminate corrupt practices have backfired. In Nigeria, for example, where corruption in Customs and the Port of Lagos makes it one of the most expensive and least efficient ports in the world, Customs attempted to attack corruption increasing resources for Customs inspectors, and imposing mandatory pre-shipment inspection as well as on site inspection of all goods. In effect, this action merely added a layer of red tape to an otherwise unchanged and unreformed process, and hence made it worse. The business community complains bitterly that import clearance procedures are more complex, and clearance times longer, without any improvement in enforcement (Marchat et al, 2001).

BOX 1: ENFORCEMENT OF ENVIRONMENTAL REGULATIONS IN GHANA

In late 1998 a new hotel was being constructed in Accra, Ghana. This was a routine project, not unlike many other new facilities being constructed in the country. As it was nearing completion, an inspection for compliance with recently established environmental review procedures turned up a number of violations and instances of non-compliance. As a result, the government had the structure razed to the ground.

Was this strict enforcement of environmental laws impartial and in concert with the violations? Other projects had not been similarly treated, and Ghana's relatively recent environmental review procedures were still being established and were not well understood in the business community. The real reason, picked up and noted by the local press, was that the hotel's owner was a member of the political opposition. As this news was then getting widespread attention, the government responded by proceeding to raze indiscriminately a number of other structures under construction, all of which were also found to have some aspect of environmental non-compliance, in an attempt to counter the charges the actions were politically motivated.

These instances are not unique to Ghana, and are not restricted to environmental regulations – there are many other options which can serve just as well for the political aims. The case does illustrate well where the potential severity of arbitrary enforcement within a system of poor governance and its threat to fundamental property rights. The hotel owner, now that a new government is in power following the 2001 elections, is pursuing his claim in the courts, an action that would have been futile under the same government which had taken the action against his property.

The result has been that while there have been some improvements, and the methodology and approach has proven a useful tool in the dialogue between government, the private sector and donor institutions, fundamental change has been lacking. This has been explicitly confirmed in Mozambique, Senegal, and Ghana where the original analysis was updated several years later, specifically to identify where changes had been made (FIAS, 2001, 2002 and 2003). The difficulty in reforming these administrative barriers has been witnessed in a number of countries which otherwise were engaged in serious efforts to improve their investment climate and attract new foreign investment flows in particular.

The Political Economy of Investment Barriers: from Roadblocks to Red Tape

To understand the perpetuation of these types of administrative barriers to investment in Africa, one needs to look beyond their economic impact. While this is significant, it is probably less so for the government leaders than political imperatives. These systems, stifling as they are for private investment, serve the important purpose of extending control over private business by political entities. This control is important for what is perceived to be the effective exercise of political power in most African states. These systems are not perpetuated just to enable corruption and bribes, and hence the personal gain of government officials, although that is certainly a common by product. Only in that small group of resolutely "kleptocratic" states is the motivation of extracting as much financial gain as possible from private firms the basis for maintenance of a complex and unproductive business regulation system.

African countries did not invent the complex systems of business regulation they now operate. In most cases these represent the legacy from earlier, more fundamentally flawed economic policy orientations. The starting point is the colonial administration systems operating in the British, French, and Portuguese colonies. Here economic activity was strictly controlled and regulated, with all attractive opportunities reserved for settlers and trading companies from the colonial parent, trade restricted in various ways to maximize the interest of those parties, property ownership and business operation reserved for colonial nationals, and in some cases job classes or professions also allocated on ethnic grounds.

Upon independence, the priority of the new governments was to seize control of this apparatus, and if not dismantle it, turn it around so that it no longer acted to constrain the interests of Africans. Nationalization was a key element of most economic strategies, to directly control the companies which previously functioned as the agents of the colonial system. Where this was not done, a myriad of controls over private business operations substituted for direct ownership and allowed the new nation states to assert their control over economic activity. The extension of political control over the economy was supplemented by new investments, often in industry, by governments in many cases temporarily enriched by the increase in commodity prices which prevailed in the 1970's.

As African governments have subsequently liberalized, privatized, and sought to attract private investment, they have done so without the benefit of experience in managing open market economies. They have also done so without much confidence in the business community to produce positive economic results on its own, mediated mostly by competition rather than regulation and administrative control. And while they may be well guided by the institutions assisting them in these processes, and have proceeded slowly and incrementally to do so, most African leaders are attempting to establish something which has never existed in their countries, at least in large scale formal economic activity. (In subsistence activities and in the small scale informal sector one does find atomistic competition and an essentially unregulated environment.) As they now grapple with the "second generation" reforms, reforming and/or creating the institutions which are required for a modern economy to function well, they themselves as well as their development partners are recognizing the difficulties and complexities of these complex institutional and behavioral, and microeconomic issues (World Bank 2002).

The maintenance of these complex administrative and regulatory systems and institutions which by objective standards perform poorly can create its own political constituency. The interests of those who benefit directly can be a strong barrier to reforming these institutions and the regulations they administer. Thus, for example, it has been exceptionally difficult to reform Customs administrations and privatize Port operations in most African countries. The direct beneficiaries, as well as the businesses that have learned to benefit from their ability to pay bribes rather than tariffs, have proven to be too important a political force to challenge.

More fundamentally, however, the needs of a modern market economy, and the institutions to support it, appear to be at odds with the political structure of most African economies. Insights from African political studies give us much better understanding of why, in spite of reform programs and governments seemingly interested in attracting private investment, they have yet to create a truly supportive environment. In fact, a dynamic private sector which thrives independent of government, other than some modest regulation and payment of taxes, is anathema for most African political leaders. The political systems they have inherited, created, and shaped from traditional and colonial political structures are founded on patronage, and require maintaining alliances with disparate groups in a hierarchical system. They are expected to deliver economic benefits directly, not through the independent operation of the private sector, and ensure these are used to cultivate bases of support (Lewis, 1996). These "neopatrimonial" states need not be kleptocratic or driven by predatory bureaucracies, although this result has not been uncommon in Africa. Indeed, many function reasonably well delivering stability and enough of opportunity and inclusion to keep themselves intact without recurrent crises. This fundamental priority – of maintaining themselves in power – has meant that control of the state apparatus and its use as a patronage mechanism to appease political allies and potential challengers is the most important exercise of power.

In recent decades, most African states have become more open than earlier in the post-independence period, when they were actively consolidating statehood and expanding the instruments of power. During this period roadblocks by government troops were a common projection of power as well as poor governance, as troops used their monopoly of force to interrupt the daily commerce and travel of ordinary

citizens, both as an expression of political control and for immediate personal enrichment. In stable states roadblocks are no longer a staple of African life, and now appear mostly in conflict-affected states or those with persistent poor governance, where their political role is secondary.

However, the more complex and subtle form of roadblocks still exists for the private sector in the form of the red tape and administrative barriers discussed above. Businessmen are still subjected to a seemingly meaningless maze of requirements, many of which are duplicative or dysfunctional. Yet these have been difficult to dismantle, even by governments otherwise committed to opening the economy and encouraging private investment. This degree of administrative control serves an important political function, albeit indirectly. This function is to subject any business to arbitrary and punitive enforcement through entirely legal means at virtually any time, so that even a successful business in an unregulated sector is always exposed to political action, by subtle and indirect means, for which the courts or other forms of redress offer little counterweight. While no administration would set out to design such a system of business regulation for this purpose, having inherited it, governments have been slow to reform and improve those systems, at least in part because they have proven politically useful or expedient.

A successful businessman who is not somehow beholden to the political establishment for his success is a potential political threat. If he's an active member of the opposition or developing his own power base by virtue of his economic clout, then he is perhaps a real political threat. The patrimonial nature of much African politics makes this type of situation undesirable or intolerable. In weak states, the perceived threat from an emergent business sector is relatively greater, and hence the political utility of keeping private activity in check is even greater.

Such a threat is not posed by foreign investors. Their economic clout, often cited as overwhelming that of the state in which they may be operating, can be substantial without posing a political threat. Indeed, foreign investors can be a willing or unwitting source of patronage benefits, with an explicit political sanction required for their continuing operation.

Attempts by African governments to reform these systems, often with the encouragement of their development partners, have so far failed to overcome the problem. Certainly, tremendous improvements have been made, and many of the explicit barriers to business, such as restrictive investment codes, import and foreign exchange licensing, etc. have been eliminated. Yet few have made much headway on the second tier reforms, particularly those highlighted here as administrative barriers. As a result, African investment climates, in general terms, still are unattractive to investors, and as a result these countries have failed to attract significant foreign investment and to stem capital flight.

To move forward to achieve this will require addressing the issue on a political level, for those governments who may be more willing to relinquish these types of control over private business with the promise of generating some form of political payoff in the not so distant future. Yet almost no African government has yet achieved political success and longevity by delivering economic growth and rising standards of living. The political sense of doing so, when it involves giving up traditional instruments of patronage and controls which have been so central to the maintenance and expression of political power, is not in any way clear. The African countries which have demonstrated economic success, such as Botswana and Mauritius, are viewed as exceptions and the subject of special circumstances.

Until this political equation is changed, there is unlikely to be truly positive change in African countries' investment climates. Even though governments may pursue reforms, and these will create improvements, the experience to date suggests they will not go far enough to relinquishing the structure and subtle mechanisms of control over business activity to assure a true measure of independence and establish true private property rights. Even more important, beyond reducing administrative controls and

other regulatory barriers to investment, the task of assuring effective enforcement of appropriate business regulation and taxation also requires a fundamental shift in governance.

In this sense, better governance needs to translate into administering business regulation and taxation to assure that level playing field, not the preferential and discretionary systems which have so far evolved. As more African political leaders are drawn from the private sector, they increasingly have the understanding of the impact of poor governance on business, and confidence to relax many types of restrictive regulation in order to attract additional investment. Also, as the political experience of most leaders is based increasingly in the recent decades of declining governance, poor economic performance, and deteriorating social conditions these imperatives become more important than those of Africa's first generation of political leaders in independence, whose goals were asserting the rights of statehood, securing political control, and maintaining fragile political structures. There is some promise of improvement in this critical area of creating a positive investment climate in Africa, but it will depend on changes in political structures needed to accept and facilitate the economic reforms needed.

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