INVESTMENT CLIMATE REFORMS

BEST PRACTICE LESSONS ON INVESTMENT CLIMATE REFORM STRUCTURES FROM GLOBAL TOP REFORMERS

Several competitiveness indicators rank South Africa as among the top places to do business in Sub-Saharan Africa, yet South Africa's performance has been declining over the past years, especially compared to the pace of reforms observed in the region. This note provides an overview of the importance of investment climate reforms and shares global best practice lessons in terms of designing and driving such reforms.

BACKGROUND

There is a wide consensus that the business environment in South Africa has become a major factor deterring private investment and capacity expansion, reducing the attractiveness of the country for FDI, and dampening job creation. Many indicators can be cited which capture different dimensions of this problem, for example, the drop in the business confidence which is at the lowest level in 3 decades, the decline in investment and productivity since the global economic downturn, or the downgrade of the country's credit ratings to junk status (see recent WB SAEU reports).

The World Bank Group's *Doing Business* report provides a measure of the 'ease of *Doing Business*' in 190 countries through a set of objective indicators that focus on the impact of laws and regulations (and their enforcement) on the ease of *Doing Business* for domestic firms in 10 areas from starting a business, operations to insolvencyi[i]. When viewed through the lens of the Doing Business (DB), South Africa shows continued slippage in the performance of key aspects of its business environment. Weak reform efforts compared to peers means that today the country is ranked 82 in DB 2018 down from 29 in DB 2007. This is in a context where Africa has become the most active region in terms of introduction of reforms measured by DB and seen some countries jump up to the top 25 countries, notably Rwanda and Mauritius.

FIGURE 1: TOTAL NUMBER AND SHARE OF REFORMS RECORDED PER REGION, FROM DOING BUSINESS 2004 TO DOING BUSINESS 2018

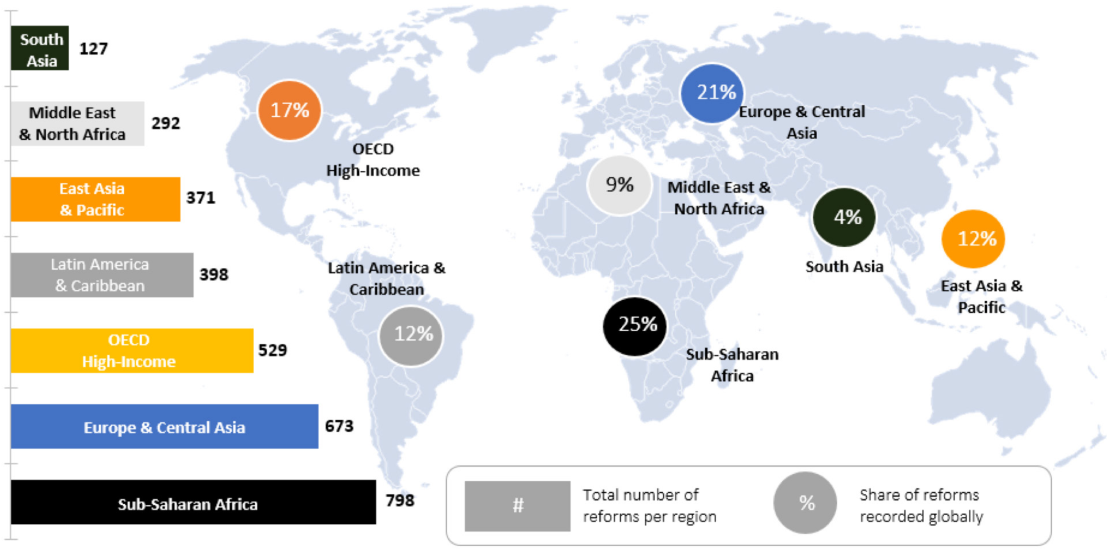
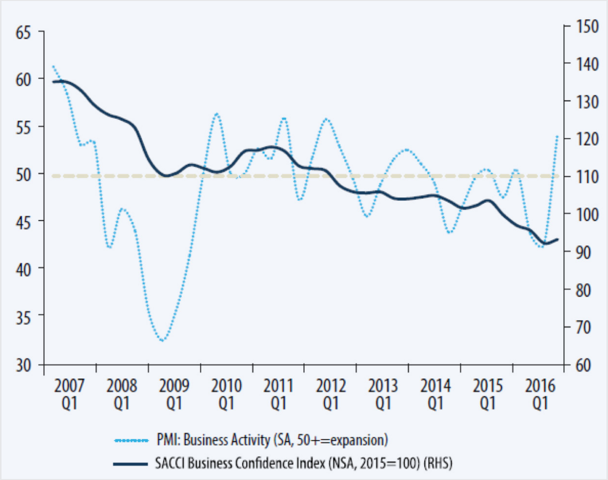


FIGURE 2: DECLINING BUSINESS CONFIDENCE[ii].



SUB-NATIONAL DOING BUSINESS (SNDB)

In order to create a baseline for the regulatory constraints facing SMEs at the subnational level, the Government of South Africa (GoSA) commissioned the *Subnational Doing Business (SNDB) Report in South Africa* in 2014. The report, delivered by the WBG in 2015, measured business regulations and their enforcement in nine urban areas and four major ports[iii].

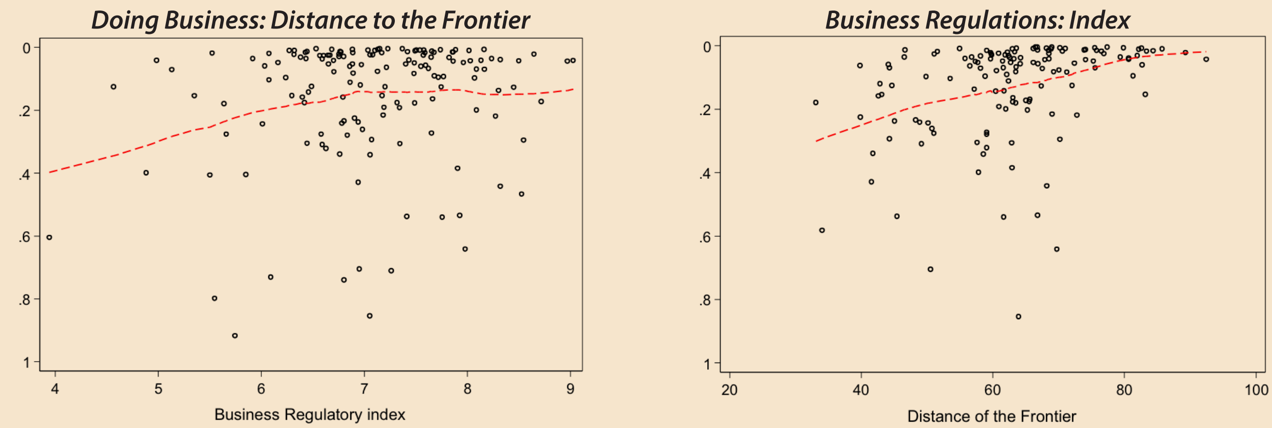
The 2015 report highlighted that entrepreneurs face different regulatory hurdles depending on where they establish their businesses in South Africa. While the same legal and regulatory framework applies across locations, its implementation varies and local regulations may be different.

Another key finding of the report is that in South Africa there are good practices to be found on various indicators across locations. For example, according the SNDB 2015, combining the subnational good practices in dealing with construction permits, getting electricity and enforcing contracts would improve South Africa's score above the OECD high-income economy average on all 3 indicators. The SNDB unpacked this opportunity whereby tangible improvements can be achieved by introducing measures already successfully implemented elsewhere in South Africa. GoSA has launched a number of initiatives to address the business environment challenges at both national and subnational levels.

WHY IS INVESTMENT CLIMATE REFORM IMPORTANT?

The DB report has spurred a stream of academic papers that investigate how improvements in various DB indicators can lead to improved economic outcomes. For example, studies investigated how firms' ability to diversify is determined by regulations that govern their day-to-day business operations and investment decisions. These include tax regulations, credit market and labor market regulations[iv]. Business regulations governing trade logistics, quality standards, and trade facilitation are also critical for firms entering new export markets[v]. The extent to which these regulations are evenly applied matters for allocative efficiency.

FIGURE 3: QUALITY OF THE BUSINESSES REGULATIONS AND EXPORT DIVERSIFICATION (AVERAGE 2012-2013)



Source: " Economic Diversification Guidance Note, WBG 2017. Export diversification is proxied as the diversification of countries' export basket. Quality of the business environment is proxied by (i) the distance to the frontier of the Doing Business indicator measures the efficiency and strength of laws, regulations, and institutions relevant to domestic small and medium-size companies throughout their life cycle, and (ii) by the business regulation index from the Fraser institute, measures the extent to which business regulations restrain entry and reduce competition

SUCCESS FACTORS FROM GLOBAL TOP REFORMERS

Governments that made significant and sustained progress in business environment reforms tend to have certain common features. The objective of this section is to lay down some of the common features adopted by these countries when driving their reforms.

a) Set up clear goals, mandate and roadmap

Effective reform programs define clear objectives that are related to the long-term strategic vision of the country. Many top reformers set specific goals that help them stay focused on achieving their target and bring the different stakeholders around the reform agenda. Successful cities and governments see and approach the business environment reform agenda in the larger context of the competitiveness of their economy. This requires a longer-term agenda that goes hand in hand with the overall competitiveness of the economy, and is not limited to conducting sporadic and small-scale reform efforts to offer temporary fixes.

Adopting such an approach increases the chances of success and impact, given that reforms in different areas tend to be complimentary. These countries used not only global indices such as the Ease of Doing Business and the World Competitiveness indicators, but they also used firm statistics and private sector surveys to identify opportunities for improvement in various areas of their economy. Additionally, the reform program identified priority areas and set specific measurable goals, along with clearly assigned deadlines and responsibilities. Afterwards, monitoring the implementation and impact of reforms highlights areas of success as well as areas where further effort is needed.

b) Set up a strong institutional mechanism

Successful reformers involve all relevant public agencies and private sector representatives. To ensure coordination among all the relevant stakeholders, agencies and departments involved in the process, successful reformers assign clear accountability to relevant actors. Many establish level oversight committees that set the strategic vision for reform, work to prioritize the reform agenda, maintain reform momentum, and provide the political weight for reform implementation. Technical working groups then lead implementation at the agency level. The most successful technical/steering committees have representatives from all key agencies involved in an area, as well as knowledgeable members of the private sector.

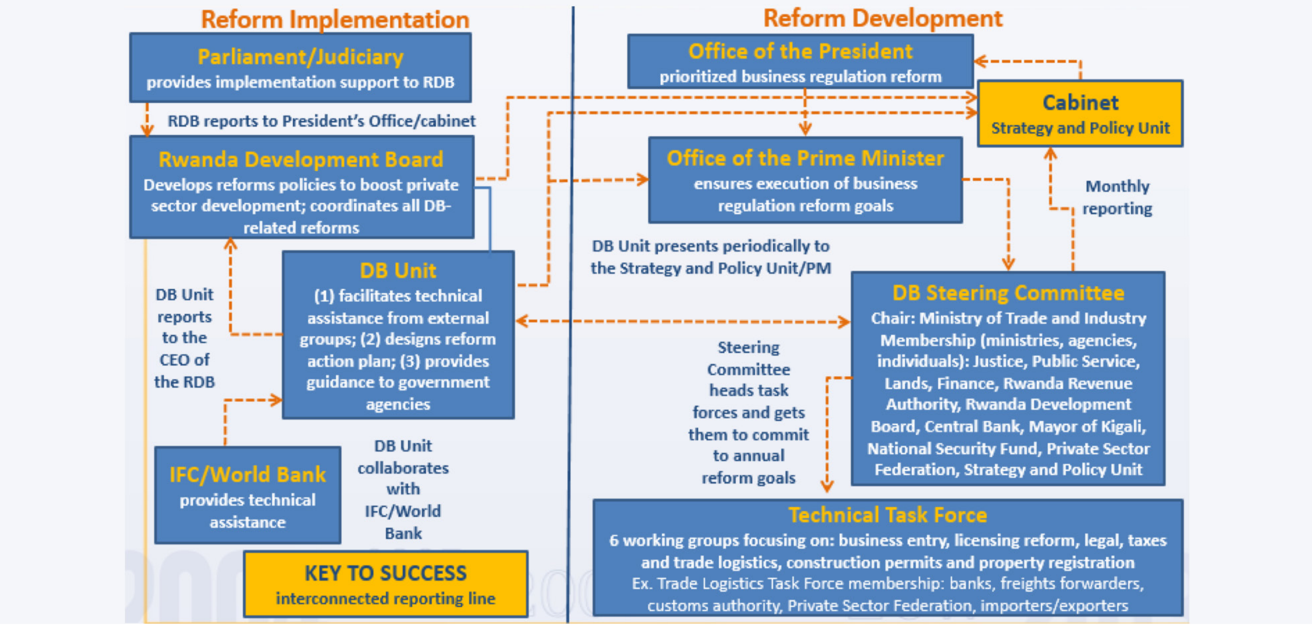
c) Ensure high-level leadership and ownership of the reform agenda

Governments that undertook substantial reforms and succeeded in achieving results are often those that commit to the reform agenda at the highest political level. Endorsement, ownership and determination was what drove successful business environment reforms in most top reformers. Without such political ownership and endorsements, reforms often lose momentum and are not successfully implemented.

d) Ensure private sector participation

Consultation and collaboration with the private sector is another key aspect in the reform process. Without understanding private

FIGURE 4: RWANDA INSTITUTIONAL ARRANGEMENTS



sector's concerns and the barriers that prevent them from starting, operating and growing their businesses, no city or government can claim to set up a comprehensive reform agenda that will bring a real difference to the business environment and the economy. Successful reform initiatives have established an effective platform that allowed for regular consultations between the public and private sectors, making the latter an important part of the reform process ensuring advocacy, implementation and sustainability of the reforms.

e) Monitoring and evaluation and communication

Progress is difficult to track and report if it is not measured. All successful reformers made sure to incorporate solid monitoring and evaluation mechanisms into their reform structures. Many of the cities and governments have set up executive committees that deal directly with daily follow up of technical working groups' activities including aspects such as implementation, coordination and measurement of their achievements. Such committees reported back to the political leadership on progress against objectives. Finally, strong reformers constantly communicate their reforms effectively to implementing agencies, the business and legal communities, and the general public, to ensure that changes are accepted and put in practice consistently

CONCLUSION

Governments that made significant and sustained progress in business environment reforms tend to have certain common features. They have the vision and support from very high levels of the government and they follow a comprehensive approach towards the reform agenda. Many establish high-level oversight committees that are crucial as a convening power which is key when a reform involves multiple stakeholders that need to coordinate and work together. Dedicated technical working groups lead implementation at the agency level under the guidance of designated point people and target timelines. The most successful reforms had representatives from all key agencies involved, as well as strong private sector participation. South Africa's private sector can play a key role in addressing some of the country's most pressing issues especially the unemployment challenge. A sound business environment is key to enable the private sector to play a role in job creation and poverty alleviation. With this agenda being a high priority for the new political leadership of the country, it is expected that the country is on its path to address the core challenges hindering private sector growth and investment. The Subnational Doing Business report unpacked an opportunity whereby local solutions and best practice are already adopted by the different metros. Peer to peer learnings, partnerships and political commitment are key success factors in moving forward with the much-needed business environment reforms in the country.

i. *www.doingbusiness.org*
ii. *Haver Analytics*
iii. *The 2015 study was implemented by the Global Indicators Group (Development Economics) of the World Bank Ground in collaboration with National Treasury, the Department of Trade and Industry and the Cities Network. The study was co-funded by National Treasury and the Switzerland State Secretariat for Economic Affairs (SECO).*
iv. *Soledad et al, 2014; Djankov et al, 2011*
v. *Wilson and Portugal-Perez, 2012*

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For further information, contact: **Roland Hunter,** Cities Support Programme: National Treasury
E | Roland.Hunter@Treasury.co.za • **T** | 012 -315 5613 • **W** | www.csp.treasury.gov.za

National Treasury
Private Bag X115, Pretoria, 0001 | 40 Church Square, Pretoria 0002 | South Africa
T | +27 12 315 5526 • **F** | +27 12 406 9055

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Confédération suisse
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