Overview

This year's *Africa Competitiveness Report* comes out amid the most significant financial crisis in generations. In this context, the state of Africa's financial markets figures among the main topics analyzed in the *Report*. The analysis finds that some African countries—namely South Africa, Algeria, Nigeria, and Egypt—are well poised to bounce back from the crisis. This is because these large economies enjoy competitive banking systems and have functional regulatory systems, the consequence of financial-sector reforms adopted since the early 1990s. However, as the *Report* points out, not all the reforms were the same; major differences exist in the pace and approach followed by these economies. South Africa represents a case of gradual restructuring, during which its banks have spread out throughout the rest of Africa. Nigeria, on the other hand, adopted a shock-treatment type of banking-sector reform. Egypt presents mixed signals in terms of effort and success, and perhaps needs to go one extra mile now; while Algeria, which has been a slow reformer, still demonstrates remarkable financial intermediation. Hence, in drawing lessons from these experiences, all African countries should be wary that, although financial-sector reforms are needed, they are not necessarily the same for all countries. Each country must determine the approach that is most appropriate given its particular circumstances.

Before the crisis, Africa had been experiencing a strong economic expansion in recent years. Between 2001 and 2008, growth in gross domestic product (GDP) on the continent averaged 5.9 percent annually. This growth was accompanied by significant flows of FDI into the region, leading to a near doubling of FDI stocks between 2003 and 2007 according to UNCTAD.[1] However, the recent global economic turmoil has raised questions as to how sustainable this growth will be over the medium to longer run. It is true that Africa's economies are less linked than many other parts of the world to global financial markets. Yet initial discussions of economic decoupling have not been borne out, and the region has not been spared the fallout of a crisis that originated in the sophisticated financial markets of the industrialized world: the International Monetary Fund (IMF) is projecting a decline in GDP growth for the region to 2.0 percent in 2009 and 3.9 percent in 2010.[2]

The projected slowdown in GDP growth is linked to a number of external forces that relate to the global downturn and that are out of the direct control of Africans. The region is facing falling global commodity prices (and deteriorating terms of trade for a number of countries) and a potentially significant reduction in aid and remittances, as well as the threat of rising protectionism in the rich world. Coupled with these external forces are potential internal dangers that are within the control of national policymakers. African governments must avoid drawing the wrong lessons from the present financial crisis; it would be incorrect to conclude that free and open markets caused the crisis and are therefore to be avoided. It would be catastrophic for them to back-peddle on policies that facilitated improved economic performance over the past decade.

More generally, the present economic downturn underscores the importance of developing an economic environment that is based on productivity enhancements to better enable national economies to weather shocks and to ensure solid future economic performance. This means keeping a clear focus on strengthening the institutional and physical prerequisites for strong and competitive private sector–led development. And it means focusing in particular on policies and interventions that open up opportunities for entrepreneurship and employment for all members of society. This will be critical to ensure that Africa continues to move in the positive direction that it has taken over the past decade. Moreover, high rates of growth over several decades, such as those observed in developing Asian countries, are desperately needed in Africa in order to significantly raise the living standards of its people. The present crisis should be seen as an opportunity to make many of the structural changes that will place Africa on a much stronger economic footing.

This year's *African Competitiveness Report* is the second in a series within a partnership between three institutions deeply committed to Africa's development. Following on our first joint report in 2007, the African Development Bank, the World Bank, and the World Economic Forum have come together once again to underscore the importance of discussing the challenges of competitiveness in Africa. Each institution approaches the topic in its own way, which, when combined in this volume, provides the reader with a rich set of complementary views about how to expand opportunities and increase productivity and growth in Africa. (Information on the key data sources used in this *Report* can be found in Boxes 1 and 2.)

Box 1: Data used in this *Report*

The Executive Opinion Survey

The Executive Opinion Survey (Survey) conducted annually by the World Economic Forum captures the perceptions of leading business executives on numerous dimensions of the economy from a cross-section of firms representing the main sectors of the economy. The Survey compiles data points in the following areas: government and public institutions, infrastructure, innovation and technology, education and human capital, financial environment, domestic competition, company operations and strategy, environment, social responsibility, travel and tourism, and health. Most of these areas feed into the 12 pillars of the Global Competitiveness Index.

The Survey serves as a gauge of the current condition of a given economy's business climate, and the data generated from it comprise the core qualitative ingredient of the Global Competitiveness Index as well as a number of other development-related studies and indexes carried out by the Forum and other institutions. The most recent Survey data cover 134 countries, with 12,297 responses worldwide including 2,610 senior management respondents in 31 African countries.

In the Survey, business leaders are asked to assess specific aspects of the business environment in the country in which they operate. For each question, respondents are asked to give their opinion about the situation in their country of residence, compared with a global norm. To conduct the Survey in each country, the World Economic Forum relies on a network of 150 Partner Institutes. Typically, the Partner Institutes are recognized economics departments of national universities, independent research institutes, or business organizations.

More information on the Executive Opinion Survey can be found in Chapter 2.1 of *The Global Competitiveness Report 2008–2009*.

Enterprise Surveys

The World Bank's Enterprise Surveys provide another important source of data for this *Report,* collecting both perception and objective indicators of the business environment in each country. Although not carried out in every country in every year, the Enterprise Surveys are made up of larger sample sizes that allow for a nuanced analysis of the results—for example, by economic sector and gender of respondent. The data are collected through face-to-face interviews with hundreds of entrepreneurs; hence responses reflect the managers' actual experiences. The data collected span all major investment climate topics, ranging from infrastructure and access to finance to corruption and crime. Detailed productivity information includes firm finances, costs such as labor and materials, sales, and investment. The breadth and depth of data allow cross-country analysis by firm attributes (size, ownership, industry, etc.), and can probe the relationship between investment climate characteristics and firm productivity. Every year, 15–30 Enterprise Surveys are implemented, with updates planned for each country every three to five years. This reflects the intense nature of administering firm surveys and for the firms responding to the many, detailed questions. So far, over 110 countries have been surveyed, including over 20,000 entrepreneurs, senior managers, and CEOs in 38 African countries. In 10 countries in Africa, surveys have been conducted more than once; hence panel data are also available to researchers around the globe. For more information, visit http://www.enterprisesurveys.org.

Doing Business indicators

The World Bank's Doing Business indicators are carried out on an annual basis, providing a quantitative measure of a particular aspect relevant to competitiveness: business regulations relevant to the operation of domestic small- to medium-sized enterprises (SMEs) throughout their life cycle. Specifically, they cover the following topics: starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts, and closing a business. The indicators are built on the basis of standardized scenarios that permit consistency of approach and straightforward comparisons across countries. They also enable tracking of reform efforts over time. Ease of use makes this a useful tool for policy analysis. The Doing Business data are updated annually; the most recent report (published in September 2008) covers 181 economies, 50 of them in Africa. These indicators are one of the components of the Global Competitiveness Index. For more information, visit http://www.doingbusiness.org.

These three methodologies share similarities and also have differences. They are similar to the extent that they all focus on issues related to the business environment, and they are based on surveys of managers or experts. They differ in their objectives: the World Economic Forum Survey aims at capturing the differences in the business environment across countries, including the perspectives of CEOs and top managers, preferably with international experience. The World Bank Enterprise Surveys, on the other hand, aim at measuring many different aspects of the business environment and are more geared toward SMEs and domestically focused firms; the Doing Business indicators attempt to measure the regulatory environment across countries.

This joint publication looks at different factors that affect competitiveness in Africa. With *competitiveness* we mean *productivity*—in other words—the ability to create value. Hence in this *Report* we analyze both those factors related to the overall business environment (e.g., institutions, infrastructure, policies) as well as those internal to the individual firms (managerial ability, costs) that affect their level of productivity and, by extension, the productivity of the overall economy. The level of productivity of an economy, in turn, sets the sustainable level of prosperity that a country can achieve. In other words, more competitive economies tend to be able to produce higher levels of income for their citizens. The productivity level also determines the rates of return obtained by investments. Because the rates of return are the fundamental drivers of growth rates, a more competitive economy is one that is likely to grow more quickly over the medium to long term.

Accordingly, the different chapters in this *Report* highlight the large range of factors that are important for augmenting the productivity prospects of African economies. Given the present financial and economic crisis, a significant focus is placed on the state of Africa's financial infrastructure because it will be so critical not only for competitiveness but also for economic development.

Themes for sustaining development

This *Report* brings together the different approaches of each partner organization and highlights a number of common themes that emerge from the analysis of the competitiveness landscape in Africa. First, in the mist of the global crisis, two significant *short-term policy options* are of crucial importance: finance and trade.

Financial markets

This *Report* demonstrates the importance of finance for competitiveness in Africa. The present global financial crisis has highlighted the critical role of financial markets clearly. For better or worse, the future of Africa's financial systems is closely linked to the development of global finance, as are its real economies. However, it is up to the continent's financial-sector stakeholders—bankers, donors, and policymakers—to guide financial-sector reforms in a way that maximizes Africa's opportunities.

Africa's financial systems have seen deepening and broadening over the past years—the result not only of improvements in the macroeconomic and institutional framework but also of the worldwide liquidity glut, which directed more capital flows into Africa. The current global crisis threatens to reverse this trend and undermine this recent progress. In these adverse circumstances, it is even more important to upgrade the necessary frameworks for sound, efficient, and inclusive financial systems. The necessary policies include areas that governments have been working on in recent years, such as further institution building—including judicial reform and the establishment and reform of collateral and credit registries. But they also include cautious and context-specific government intervention to help financial market participants expand financial services to the frontier of commercially sustainable possibilities. Other policy areas have become even more important in the context of the global liquidity crunch. Efforts to deepen financial sovereign and corporate bond markets, for example, need to be intensified to improve the capacity for local debt financing, to provide instruments of suitable maturity and security for longer-term saving, and to facilitate the financing of African infrastructure. Finally, the global financial crisis poses new challenges for regulatory authorities across the region, as they have to be prepared for the failure of the parent bank of one of their large foreign-owned banks. By improving their crisis-preparedness, African countries can not only improve their ability to respond to possible immediate difficulties, but also address long-standing development needs supporting the preservation of asset values in situations where financial institutions need to undergo restructuring or be resolved.

These market-enabling policies discussed above require strong authorities that take an active role in redefining regulatory frameworks to include competition, inclusion, and efficiency as goals, while crowding in private initiative. In those situations where governments are called upon to intervene in financial markets, they have the opportunity to provide market-conforming interventions, such as partially guaranteeing credit to groups of borrowers—for example, small- and medium-sized enterprises (SMEs)—that are vulnerable to crowding out, while encouraging private banks to take on retail responsibility and develop expertise in credit risk assessment. Such developments imply a new role for development finance institutions on the wholesale and coordination level rather than retail lending. These policies also call for the embracing of technology to leapfrog in the attempt to broaden the outreach of the financial system. The fall-off in remittance flows intensifies pressure on governments to facilitate a reduction in the pricing of remittance transfers by opening competition among money transfer operators, lessening the costs of the domestic leg of transfers through interoperability between payments service providers, and leveling the playing field between providers of mobile-banking services and similar services provided by banks.

The current crisis also calls for a cautious approach to opening capital accounts. A premium should be put on regional integration to reap benefits from scale economies. While the time may not be right for opening capital accounts, the current crisis should not be used as a pretext for re-imposing capital controls in light of the negative repercussions they have for macroeconomic discipline and governance. The region stands to gain a great deal from the presence of both global and regional

financial institutions in terms of efficiency, competition, stability, and outreach. Foreign bank entry, however, cannot substitute for the necessary domestic reforms.[3]

Trade and free markets

As the world weathers the most significant global economic crisis since the Great Depression, it is understandable—indeed, it is essential—that efforts to restore confidence in the market have monopolized the attention of the world's policymakers. Yet, in these trying times, it would be dangerous for Africa's leaders to lose sight of those factors beyond financial markets, such as trade, that matter greatly for a country's economic success.

Empirical evidence suggests that international trade is positively associated with high economic growth. The benefits of trade are well known: it raises income through specialization, increased competition, and the exploitation of economies of scale. It increases the variety of products and services available in the market and promotes technological innovation.

Yet protectionist forces are emerging and will get stronger as the recession deepens and global trade falls. A number of countries—including some among the G20 who signed in November 2009 a pledge to avoid protectionist measures—have implemented measures to restrict trade at the expense of other countries; some African countries are also under pressure to protect their markets. Given the presence of international supply chains, protectionist measures will even further reduce global demand and restrict growth.

Pledges to avoid protectionism are common and welcome. However, domestic political pressures can easily revert such assurances. Proposals aimed at resisting the attempts to introduce protectionist barriers include encouraging transparency. Governments should commit to clearly disclose the measures taken and their rationale. These measures, which should indicate an expected duration, will encourage similar practices and avoid retaliatory measures.

The crisis has clearly shown the value of the World Trade Organization (WTO)–based multilateral trading system, although it has also highlighted the need to bind the levels of protection under WTO agreements more firmly. Hence leaders need to put back on track the Doha negotiations, since this is the only realistic way to further open world markets and lock in the trade liberalization achieved. Furthermore, although a number of measures have been taken to facilitate trade—for example, the regional development banks have substantially increased the average capacity under the relevant programs—there is a need for better coordination and information sharing, such as circulating a list of new programs among the relevant credit agencies.[4]

Enhancing trade in Africa will help the continent weather the global slowdown. Trade flows in Africa are constrained by falling prices for commodities, declining overall trade volumes, and shortages in trade finance. These conditions will increase competition in the global markets. Within this context, improvements to the trade facilitation framework to reduce the cost of exporting become even more necessary. In order to facilitate the transport of goods over borders and strengthen revenue collection, governments should accelerate reforms aimed at cutting red tape and lowering transaction costs. Customs reform comes at a relatively low cost, quickly shows results, and is usually not subject to political-economic considerations because of its technical nature. At the same time, it accrues high benefits to the country through enhanced trade and increased security as well as providing additional fiscal revenues through reduced illicit trade. Trade facilitation measures, in addition to directly affecting trade, will also have beneficial effects in the context of the current crisis: investment in infrastructure will provide a stimulus to the country's economy, and streamlining customs will improve the efficiency of fiscal revenue collection, thereby improving the ability of the government to respond to crises.

While dealing with the current crisis, African leaders should not forget those factors and policies that will remain critical for competitiveness and development once the crisis subsides. Hence, equally important *long-term policy options* to foster competitiveness in Africa remain. These notably include infrastructure; education and health; and institutions, governance, and transparency, each of which will be discussed below.

Infrastructure

Extensive and efficient infrastructure is an essential driver of competitiveness. Well-developed infrastructure reduces the effect of distance between regions, with the result of truly integrating national markets. A well-developed and efficient transport network is a prerequisite for entrepreneurs to get their goods to market in a secure and timely manner, and to facilitate the movement of workers. Economies also depend on electricity supplies that are free of interruptions and shortages so that businesses and factories can work unimpeded. Finally, a solid and extensive telecommunications network allows for a rapid and free flow of information, which increases overall economic efficiency.

This year's *Report* confirms once more that infrastructure, and more specifically energy and transport, remains a major obstacle to competitiveness in Africa. Compared with major competitors in Asia, African entrepreneurs suffer a severe disadvantage with respect to these services.

This circumstance calls for a renewed attempt by African leaders to continue in their effort to foster investments in infrastructure, technology, and products. In the mist of the current crisis, expenditures on infrastructure would serve as a fiscal stimulus for many

Box 2: The African Development Bank: Knowledge to improve investment climate and competitiveness

The African Development Bank Private Sector Country Profiles

The African Development Bank (AfDB) prepares Private Sector Country Profiles for regional member countries as part of its efforts to support an enabling environment for private-sector development on the continent. The profiles provide an in-depth analysis of the private sector: the political, economic, and legal environments; opportunities and constraints; and a strategy for the future.

The African Development Bank Country Governance Profiles

The African Development Bank Group's governance policy and its implementation guidelines provide the basis for addressing governance issues facing Regional Member Countries. Also, good governance remains a key criterion in the performance-based allocation of African Development Fund resources, with more resources going to countries with high governance ratings. The AfDB prepares Country Governance Profiles for a number of countries annually. These profiles provide detailed assessments of major governance issues in the concerned countries. They analyze the governance situation in the political, social, economic, and corporate governance areas. They also review existing policies, institutional frameworks, and related capacity issues. Finally, the profiles highlight governance challenges and propose measures and recommendations to move the governance agenda forward. The AfDB's support for good governance and anti-corruption programs is carried out through projects in public sector management, industrial import facilitation, export promotion, and institutional support.

African Economic Outlook

African Economic Outlook (AEO) is an annual publication jointly produced by the AfDB and the OECD Development Centre since 2001–02, which were joined by the UN Economic Commission for Africa in 2007. It reviews recent economic developments in Africa by adopting a comparative approach and a common analytical framework. It provides forecasts for key macroeconomic variables. The AEO surveys and analyzes the current socioeconomic performance of African economies and provides information on a country-by-country basis on their socioeconomic progress as well as on the short- to medium-term prospects of these countries. Each year, the AEO addresses a specific theme that focuses on a critical but under-researched area of Africa's socioeconomic development. The 2009 theme is *ICT and Africa's Development*. The AEO provides an overview of specific international developments that may impact African economies, country notes on selected countries, and a statistical appendix on African countries. The current edition of the AEO is the eighth, covering 47 African countries—11 more countries than in the previous edition. The key objectives of the AEO are to broaden the knowledge base on African economies and to offer valuable support for policymaking, investment decisions, and donors' interventions. Another important objective is to assist in capacity building. Through the involvement of African experts and institutions in its preparation, the AEO increases research capacity and reinforces its ownership by African local experts.

African countries. However, this must be done not at the expense of macroeconomic stability.

With respect to energy, Africa suffers from a complex set of challenges: (1) geography—the existence of plenty of resources amid poor access (a situation called energy poverty); (2) affordability—the very limited possibility to cross-subsidize energy costs; and (3) capacity—the limited ability to bring in investments and technology. These challenges need to be addressed especially through the harmonization of donors and country interventions, and by not only bringing in investments and managerial capability but also by creating the right environment.

Although a number of countries have taken concrete steps, Africa needs to do more to improve its energy generation and distribution systems. The opening of energy generation and transmission, as well as the distribution sector, must be accompanied by proper institutional and legal frameworks. Further, governments should encourage large investors and SMEs to invest privately or through public-private partnerships (PPPs) in electrification through co-generation projects, mergers of small projects to bring economies of scale, and cooperative arrangements. Governments should be wary that the sequencing of reforms is important to ensure that energy is available to all. In particular, the establishment of structures and mechanisms for increased electrification in rural areas ought to be in place before large-scale reforms such as privatization are initiated. Finally, the enormous potential of renewable energy sources (especially hydroelectric and solar) should be exploited and has the promise of making Africa not only a major producer but a net exporter of energy.

Addressing the transport problem in Africa requires action on two fronts: infrastructure and regulations. Creating a major road network in Africa has been advocated for years, but thus far has not happened. Yet such a network would generate an estimated expansion of overland trade by about US$250 billion in 15 years, with benefits for Africa's rural poor. Furthermore, road construction is labor intensive and would also help improve road safety. On the other hand, high transport

costs in Africa are mainly due to lack of competition in the trucking industry. Consequently, without a proper deregulation of trucking services, prices will remain high and firms will not benefit from the investment in road rehabilitation. In West and Central Africa, this strategy is most warranted. There cartels should be abolished and the tax structure should reward those who operate more modern vehicles and utilize them more intensively. Deregulation should also facilitate new entrants' access to freight. In East Africa and in the South African road network, lower transport costs could be achieved through improvements in some critical road sections. Similarly, the establishment of one-stop border posts would reduce delays and would help achieve lower transport prices. Finally, in East Africa it might be appropriate to lower fuel taxes in landlocked countries so that the domestic trucking operators are not disadvantaged compared with coastal countries' operators.

Education and health

A healthy workforce is vital to a country's competitiveness and productivity. Furthermore, education is increasingly important for moving up in the value chain. Lack of basic education can therefore become a constraint on business development, with firms finding it difficult to become more productive. Today's globalizing economy requires economies to nurture pools of well-educated workers who are able to adapt rapidly to their changing environment.

Despite some progress achieved in recent years, Africa continues to lag behind other regions with regard to health and education. In order to expand and improve educational attainment, African governments should: (1) enhance public information campaigns to educate communities on the right of children to attend primary school irrespective of their economic circumstances, the benefits of schooling, and the need to start school at the appropriate age (especially in rural areas and for girls); (2) increase resources that are channeled directly to the schools to ease the burden on households, especially when it comes to purchasing pupils' school materials, and tie resources to pupil retention and overall school performance; (3) deploy teachers better to ensure that qualified ones are distributed more equitably, especially in rural areas where the supply of qualified and female teachers is limited; (4) build schools closer to communities to reduce the travel time to school, and to consolidate lower and upper primary schools into one place to increase the likelihood of continuing from one level to the next; and (5) encourage private sector participation in education at all levels. Student organizations, parents' associations, and so on should monitor the system. Information-sharing mechanisms are crucial to reduce corruption and improve the use of education funds.[5]

Information, monitoring, and enforcement are crucial elements to improve any health system, regardless of the resources available for health services. Finding a balance in the public-private mix to minimize the consequences of market and government failures in financing and providing health services is a key component of providing health care.[6] Service delivery should be improved through standardization and empowerment, and policymakers must be accountable for health outcomes through (1) investing in monitoring and evaluation and (2) empowering the voice of citizens and improving mechanisms for citizen oversight. Finally, better infrastructure (roads, water, electricity, etc.) is needed to improve working conditions of health and education workers, especially in rural areas, and to increase citizens' access.[7]

Institutions, governance, and transparency

The institutional environment forms the framework within which individuals, firms, and governments interact to generate income and wealth in the economy. The institutional framework has a strong bearing on competitiveness and growth. It plays a central role in the ways in which African societies distribute the benefits and bear the costs of development strategies and policies, and it influences investment decisions and the organization of production. Owners of land, corporate shares, and even intellectual property are unwilling to invest in the improvement and upkeep of their property if their rights as owners are insecure. Of equal importance, if property cannot be bought and sold with the confidence that the authorities will endorse the transaction, the market itself will fail to generate dynamic growth. The importance of institutions is not restricted to the legal framework. Government attitudes toward markets and freedoms and the efficiency of their operation are also very important: excessive bureaucracy and red tape, overregulation, corruption, dishonesty in dealing with public contracts, lack of transparency and trustworthiness, or the political dependence of the judicial system impose significant economic costs to businesses and slow down the process of economic development.

Good governance and strong and visionary leadership through formal institutions and informal rules have greatly contributed to the success of Botswana, Mauritius, Namibia, and Tunisia. In Botswana, institutions protected the property rights of actual and potential investors and provided political stability. Mauritius and Namibia share strong and transparent public institutions as well as an independent judiciary. And Tunisia's institutions rest on fairly transparent and trustworthy relations between the government and civil society. Public governance has also played an important role in the four countries as, compared with most other African countries, they benefited from an efficient state combining responsible governments and good governance.

Indeed, recent empirical evidence has shown that growth volatility has a substantial impact on governance and conflict indicators in Africa.[8] Consequently, the cur-

rent global crisis could have unprecedented consequences for governance on the continent and could even fuel governance reform reversals. For this reason, and because of the evidence presented in this *Report,* reforms aimed at improving governance on the continent must continue. And while there have been measurable developments in the institutional environment of many African countries, much has yet to be achieved to improve governance.

In particular, institutions in Africa need to be more business friendly to foster competitiveness. More specifically, the related existence of informal payments remains a major problem. Tackling corruption is not an easy or a short process. It requires political will, popular support, and the necessary resources. Hence governments around the continent need to clearly and unequivocally declare the political will to fight corruption from the very top. Second, they will have to allocate the necessary resources to the fight—more specifically, they need to assign at least 0.5 percent of their national budgets permanently to this battle. Third, they need to establish an independent anti-corruption agency; recruit investigators and staff; define a clear mandate; and promote further reforms in civic service, public finance, procurement, and the judiciary (e.g., implement effective conflict-of-interest laws, and extractive industries transparency initiative, e-procurement, and financial transparency). Finally, they need to develop and support an anti-corruption campaign to build popular support.

Linked to the issue of governance and corruption is the issue of transparency in the regulatory environment. Significant progress has been achieved in the last few years, as demonstrated by the improved ranking of many African countries in the *Doing Business* report, for example. This notwithstanding, Africa remains the region with the lowest comparative ranking on the quality of its regulatory environment. Hence more needs to be done. Entrepreneurs in Africa still face a burdensome regulatory environment, particularly in regard to trading across borders, starting a business, and registering property. With respect to these steps, Africa stands out as a difficult location in terms of time and/or cost of doing business.

The government plays a crucial role in fostering competitiveness within the African continent. This role is not limited to facilitating a business-friendly institutional environment and an adequate supply of human and physical infrastructure. The state should also adopt active and inclusive interventions in the factors of production. For example, in the labor market the government should not only establish unemployment benefits and reduce the regulatory burden to hiring or dismissing workers, but should also adopt programs that enhance labor market integration through demand- and supply-side measures, such as labor market training, job creation in the form of public and community work programs, and enterprise creation programs. In finance, the government should promote inclusiveness by reducing the transaction costs through the creation of credit registries with repayment records, give every individual a national identification number, reduce costs of registering collateral, and support the establishment of guarantee funds. In trade, simply lowering tariffs is not sufficient to prompt export dynamism. Rather it is important to have efficient export promotion agencies (or even economic officers in foreign embassies), investment promotion agencies, standards bodies, agencies to support innovation and clustering, and duty refund schemes.

Most importantly, African governments need to be committed to fostering their economies' competitiveness by incorporating competitiveness more broadly and effectively into their national development strategies. It is therefore important that any intervention be brought together within a comprehensive strategy on competitiveness rather than being a series of ad hoc interventions.

Analyzing African competitiveness

This joint publication is organized in six chapters, each addressing different aspects of competitiveness in Africa. The first chapter of the *Report* analyzes competitiveness across the region by looking at a wide range of factors in the business environment that have an impact on productivity, from infrastructure and institutions to technology. The subsequent two chapters focus on particular aspects of Africa's financial infrastructure. The first of these looks globally at trends in Africa's financial markets, and the next is a case study of financial market development in the continent's four biggest economies. The fourth and fifth chapters analyze production costs and trade in Africa and the final chapter presents a case study of successful African countries in order to highlight the lessons learned in some of the areas described above. A number of chapters suggest concrete policy recommendations.

In Chapter 1.1, Jennifer Blanke of the World Economic Forum and Xavier Sala-i-Martin of Columbia University analyze the results for 31 African countries compared with the performance of all 134 economies included in the Global Competitiveness Index (GCI). The GCI assesses the set of institutions, policies, and factors that drive productivity and therefore set the sustainable current and medium-term levels of economic prosperity. The GCI, with its 12 distinct pillars, captures the idea that many different elements matter for competitiveness, thus setting the stage nicely for the more in-depth analysis in the chapters that follow. These pillars are identified as institutions (public and private), infrastructure, macroeconomic stability, health and primary education, higher education and training, goods market efficiency, labor market efficiency, financial market sophistication, market size, technological readi-

ness, business sophistication, and innovation. The exact methodology underlying the construction of the GCI is described in the chapter.

Specific comparisons are made with relevant developing countries and regions, including Latin America, economies of developing Asia, and the four emerging BRIC countries—Brazil, Russia, India, and China. By placing individual country performances into an international context, the authors highlight those areas requiring urgent attention within African countries to increase competitiveness and to better ensure sustained strong economic performance going into the future.

The results show that there is a significant variety of performances across the continent. Some countries have been quite successful in putting into place many of the factors for economic success, such as improved public institutions, macroeconomic stability, and well-functioning markets. Yet, as is well known, many obstacles to competitiveness remain across the majority of African countries; among such constraints are underdeveloped infrastructure, deficiencies in education and health-care provision, and market inefficiencies, including those related to finance and trade.

In Chapter 1.2, Thorsten Beck, Michael Fuchs, and Marilou Uy from the World Bank show that, in spite of shallow financial markets, sub-Saharan Africa will not escape the repercussions of the global financial crisis. To the contrary, the global turmoil threatens the progress sub-Saharan Africa has made in deepening and broadening the financial sector over recent years and underlines the importance of continuing and intensifying the necessary institutional reforms. In this context, the authors show that it is important to define the role of government in expanding financial sectors in a sustainable and market-friendly manner. Foreign banks have brought more benefits than risks for their host economies in sub-Saharan Africa, but they are certainly not a substitute for institutional and policy reform. The profile of foreign banks, however, has changed, with more and more regional banks emerging. This trend toward regional integration is promising because it might allow the small African financial system to reap benefits from scale economies, but it also requires regulatory and supervisory improvements and coordination across the region.

Chapter 1.3 by Louis Kasekende and Kupukile Mlambo from the African Development Bank, Victor Murinde from the University of Birmingham, and Tianshu Zhao from the University of Stirling analyze Africa's financial markets through case studies. The authors review the broad financial-sector reforms in each of the four largest economies in Africa—South Africa, Algeria, Nigeria, and Egypt (SANE)—in the face of globalization and internal factors that may have influenced the form and impact of the reforms. The role of competitive financial sectors in Africa is crucial for economic growth—there is a large body of evidence on the positive relationship between finance and growth. The idea is that competition stimulates productivity growth either by general technical progress or by efficiency improvements, or both. An important challenge facing policymakers in Africa, while the financial sector reforms are *in situ,* is to reliably measure and monitor the competitive conditions in the financial services sector. This is especially important at this point of financial globalization and in the context of the looming threat from the global financial crisis that started in late 2007 with the sub-prime mortgage crisis in the United States. The chapter applies some plausible empirical measures of bank competitive conditions in the SANE economies, namely the *H* measure of the environment of competitive conditions among banks and the theta measure of each bank's competitiveness relative to the industry average. These metrics are recommended for use by policymakers, such as central banks, bank shareholders, and bank managers, to monitor the evolution of bank competitive conditions over time. The chapter notes three important lessons for Africa. First, financial reforms are not one-size-fits-all: there are major differences in the pace and approach among the SANE economies. South Africa represents a case of gradual restructuring, while Nigeria adopted a shock-treatment type of banking sector reform, which amounts to a "big bang," and has emerged with stronger banks; Egypt presents mixed signals in terms of effort and success, and perhaps needs to go one extra mile now; while Algeria, which has been a slow reformer, demonstrates remarkable financial intermediation. Second, the reforms in South Africa have had positive spillover effects on Botswana, Lesotho, Namibia, and Swaziland, providing lessons for East African or West African states to share access to banking, securities, insurance services, and currencies. Third, financial reforms and competitive banks should enable banks and capital markets in Africa to recover quickly when the global financial crisis is over.

In Chapter 1.4, Giuseppe Iarossi from the World Bank looks at competitiveness from the perspective of the individual firm. The author shows that, at the micro level, one way to assess productivity is by looking at how efficiently firms are able to convert inputs, and henceforth costs, into output—that is, sales. Hence this chapter looks at how costly it is to run a business in Africa compared with other regions in the world. The analysis first considers a number of costs associated with doing business (such as labor, finance, infrastructure, and the business environment) and then estimates their impact on firm productivity. The chapter classifies costs into three broad categories—direct, indirect, and invisible—and presents evidence on all of them across selected regions. The evidence demonstrates that African firms experience the highest cost—as shares of sales—in all three categories among all developing regions considered. These results illustrate the low level of competitiveness of African firms. More specifically, the author estimates that African firms are almost 20 percent more

expensive to run than firms in East Asia. After looking at each category of cost individually, the author shows that most of the competitive disadvantage of African firms is due to invisible costs—that is, losses experienced by African firms because of the poor infrastructure, demanding credit market, and burdensome regulatory environment (including corruption and lack of security). The chapter concludes by offering ideas on policy options to address these constraints.

In Chapter 1.5, Margareta Drzeniek Hanouz of the World Economic Forum and Robert Z. Lawrence of Harvard University analyze the results of 25 African countries on the Enabling Trade Index (ETI), benchmarking them against the total sample of 118 economies. The ETI measures the *factors, policies, and services facilitating the free flow of goods over borders and to destination.* The Index captures a wide range of enablers, broken down into four overall issue areas: market access, border administration, transport and communication infrastructure, and business environment. Each of these categories is composed of pillars of enabling trade, of which there are 10 in total. These are tariff and non-tariff barriers, proclivity to trade, efficiency of customs administration, efficiency of import-export procedures, transparency of border administration, availability and quality of transport infrastructure, availability of quality of transport services, availability and use of information and communication technologies (ICTs), regulatory environment, and physical security. The exact methodology is described in the chapter.

By analyzing the performance of African countries in an international and regional context, the authors identify strengths and weaknesses of the countries covered, indicate areas for improvement, and derive a set of policy recommendations for the region. Overall, the ETI results point to a high degree of heterogeneity among African countries when it comes to enabling trade, in particular when it comes to the use of tariff and non-tariff barriers but also in the efficiency of border administration and the availability of infrastructure. The results also identify the low use of ICTs as an impediment to trade.

The authors conclude that, in the short term, keeping trade levels high will contribute to mitigating the effects of the current crisis. Therefore African leaders need to withstand the pressures to revert to protectionist policies that would severely exacerbate the crisis and instead must maintain their commitment to continuing trade-enhancing reforms. In this context, reforms of border administration that have been successfully undertaken in many African economies are particularly important, as is continued investment in infrastructure.

In Chapter 1.6, Léonce Ndikumana, Peter Ondiege, and Désiré Vencatachellum from the African Development Bank and Patrick Plane from the University of Auvergne analyze the recent competitiveness performance of Botswana, Mauritius, Namibia, and Tunisia, as well as the main factors that are affecting their competitiveness. The analysis shows that economic policy has been a key explanatory factor for their competitiveness. The use of an active exchange rate policy and sound, credible, and predictable state institutions are identified as the main pillars of those countries' competitiveness. An active exchange rate policy has helped Mauritius and Tunisia, in particular, to maintain their external competitiveness. Sound institutions have been a decisive factor for reducing transaction costs and promoting innovation in those countries. Credible and predictable state institutions have encouraged entrepreneurship and supported the development process.

An important lesson from those four countries is their long-run holistic vision of development. This orientation of economic policy was supported by strong and visionary political leaders where the state played an important role. They constitute a counter example to the commonly held view that African states are typically weak. The successes of Botswana and Namibia indicate that the Dutch disease (or "resource curse") can be avoided. Mauritius and Botswana illustrate that the state can promote manufacturing diversification and seize opportunities, as they have with their partnership with the European Union. The relative success of these four economies suggests that the functioning of the market is underpinned by sound state institutions.

Beyond a sound macroeconomic framework, institutions have been a determinant factor for social cohesion in all four countries. Sometimes, as is the case in Botswana, formal and informal rules have been combined. Governance is part of this institutional environment and has proved to be efficient. States have proved to be efficient in promoting a long-run holistic vision of development, taking into account the constraint that their size imposes on small economies and the need to maintain social cohesion. The governments of Mauritius and Tunisia were concerned about the political feasibility of reforms and chose gradualism over shock therapy. This choice was made within a framework of credible public actions and the ability of these governments to commit for the long run. As in some Asian countries, PPPs were favored over large public sectors in the management of economic affairs. Some of these positive elements will prove to be significant assets for these countries in managing the implications of the global economic crisis and in diversifying their economies to enhance their competitiveness.

These four countries now face the challenge of the current global economic crisis in the short and medium term in managing their economies and competitiveness —the crisis is now having an impact on the real sector of those economies. Their growth outlooks have deteriorated and their macroeconomic balances worsened. The crisis has underscored the relative vulnerability of these four small open economies, which are highly reliant on a few key products that either face acute

competition on world markets (e.g., textiles) or whose prices are highly correlated with the global economic situation (diamonds). There is a critical role for export diversification in reinforcing the resilience of economies to external shocks so that they can enhance their competitiveness in the long run. To achieve this goal, the stiffer international competition calls for these countries to improve their business environment and deepen policy reforms.

There is a need for these countries to increase the quality of their human resources to further their competitiveness. Given their current stage of development and the global economic environment, high-quality human capital will be a key condition for these countries to enhance firm productivity, upgrade technologies, and develop high-value-added services. For this reason, higher education and training need to address labor market needs. All four countries would gain by having greater flexibility in the labor market. However, such flexibility needs to preserve the social consensus that prevented them from experiencing violence, crime, and corruption. The economies also need to facilitate increased access to bank financing. Channeling adequate and long-term financial resources to producers, which is a driving force for diversifying the economy and for the restructuring of the manufacturing sectors, still remains a challenge for them.

The final section of the *Report* provides detailed country profiles for the African countries included in the World Economic Forum's Executive Opinion Survey and the World Bank Enterprise Surveys. The first set of profiles presents the detailed rankings that go into the broader GCI ranking. The second set provides mostly objective measures of indicators of the business climate. They are drawn from the Enterprise Surveys and—thanks to the large sample size—are also presented across size of firms, export orientation, and ownership.

Notes

1. According to UNCTAD's *FDIStat* database, between 2003 and 2007, the stock of FDI increased from US$202 billion to US$393 billion. Data are available online at http://www.unctad.org/Templates/Page.asp?intItemID=3199&lang=1.
2. IMF 2009.
3. See United Nations 2006; Stephanou and Rodriguez 2008; Beck 2008.
4. Baldwin and Evenett 2009.
5. Gottret et al. 2008.
6. Akyianu 2008.
7. Coudouel et al. 2007.
8. Arbache et al. 2007.

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