Discussion FORUM

IRG

September 2005 Number 24

Removing Obstacles to Economic Growth

Washington-area professionals gathered on September 15th for the twenty-fourth IRG Discussion Forum, "Removing Obstacles to Economic Growth." Featured speakers included Amy Cogan, Senior Competitiveness Advisor at the U.S. Agency for International Development (USAID), who works with the Agency's field missions on best practices for enterprise development, and Vicki Tsiliopoulos, Chief Operating Officer of EnterpriseWorks/VITA, a non-profit organization that provides business development programs for small agricultural producers and micro entrepreneurs in 12 developing countries. Ms. Cogan and Ms. Tsiliopoulos provided an overview of the ways microeconomic policy reform can improve the business environment and foster economic growth in developing countries.

The business environment in a developing country can be a substantial obstacle to economic growth, particularly for micro and small enterprises (MSEs). Businesses in developing countries may face three times the administrative costs, spend twice the time dealing with bureaucratic procedures, and enjoy half the protection of property rights compared to businesses in advanced countries. Moreover, the gap is widening. In 2006, entrepreneurs in the 30 member countries of the Organization for Economic Cooperation and Development will spend, on average, 19 days to start up a new business and 6 percent of per capita income, while their counterparts in developing countries will spend 55 days and 111 percent of per capita income.

Pictured, left to right: Timothy R. Knight, Corporate Vice President and Director, Relief and Reconstruction, IRG; Vicki Tsiliopoulos, Chief Operating Officer of EnterpriseWorks/VITA; Amy Cogan, Senior Competitiveness Advisor, USAID.

Why the Microeconomic Environment Matters

Regulations and policies that directly influence firms' daily operations are among the most critical determinants of a country's business success. Even with sound macroeconomic monetary and fiscal policies, a nation's expected economic growth may not be forthcoming because problems remain with its microeconomic policies.

Microeconomic business policies are often a legacy of colonial times and the continuation of time-consuming and outmoded local regulations. According to Amy Cogan, "While the fees associated with these procedures may be a source of revenue for the government, and local labor regulations may have noble intentions, the actual results of these policies can be less than favorable for small businesses." Because of such regulations, risk-averse small businesses may prefer to stay in the informal sector, even with limited opportunity for growth, less protection for workers, greater uncertainty, little access to credit, and no ability to enforce contracts.

The benefits of microeconomic reform include as much as 2.2 percent faster economic growth and a reduced burden on government budgets of as much

For More Information

World Bank, Doing Business
http://www.doingbusiness.org/

EnterpriseWorks/VITA
http://www.enterpriseworks.org/about.asp

USAID Investor Road Map
http://www.ild.org.pe/pdf/annex/Annex_13.pdf

as 1.8 percent, and resultant savings may be applied to improved services for health and education. Reform encourages microenterprises to enter the formal sector, thereby reducing their risks, increasing their ability to grow, fostering greater economic and social inclusion, and increasing employment and tax revenues. Other benefits of reform include reduced corruption and improved prospects for Millennium Challenge Account eligibility.

Why Micro and Small Enterprises Matter

According to Vicki Tsiliopoulos, "a nation's competitiveness depends on its ability to create and maintain an environment that sustains more value creation for its enterprises and more prosperity for its people. Nations do not directly generate more value, but rely on enterprises to do so. Comprising the majority of businesses throughout the world, micro and small enterprises (MSEs) play a critical role in a nation's competitiveness."

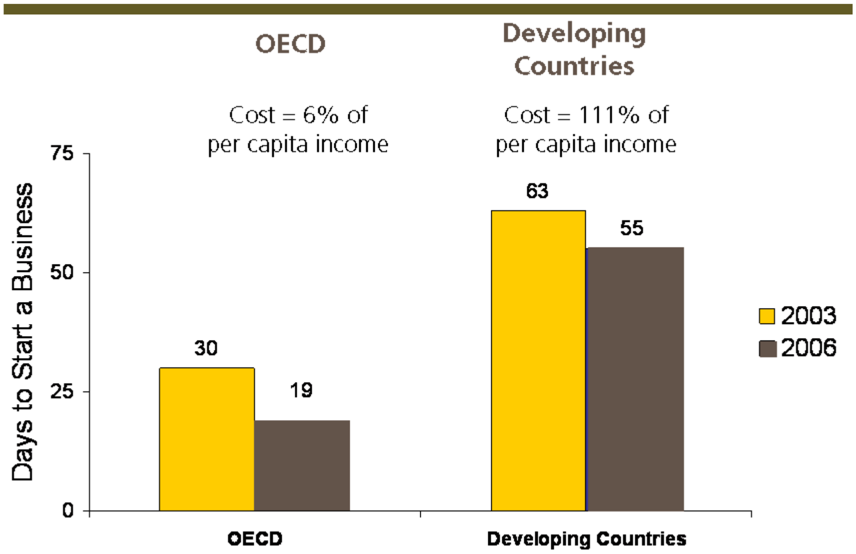
One example of the possible economic contribution of MSEs is Bangladesh's shrimp industry, the country's second largest export industry, which employs more than 600,000 people and generates more than $300 million in annual revenues. More than 90 percent of the firms involved are microenterprises. Bangladesh's footwear industry provides another example. In this case, the country's largest shoe exporter faced constraints that affected its competitiveness—constraints that it was able to overcome only after successfully making backward linkages to MSEs that enabled it to increase exports.

A third example is Guinea Bissau, where the export of raw cashew nuts to Asian markets have traditionally accounted for 98 percent of export earnings. The country had been unable to capture the added value that came from processing the nuts until MSEs involved in processing helped it to tap that added value, sell more than $550,000 worth of processed nuts to international and regional markets, and secure contracts and letters of intent from international buyers to purchase up to $2 million dollars of kernels that meet international quality standards.

According to Ms. Tsiliopoulos, microenterprises enjoy a number of advantages that can provide opportunities for fostering economic growth. These include flexibility, low production costs, access to land and local resources, and unique products that appeal to niche markets in Europe and the U.S. However, their potential contributions may be limited by constraints such as high transaction costs, limited capacity, difficulty meeting international quality standards, and inefficient value-chain governance.

The benefits of microeconomic reform include as much as 2.2 percent faster economic growth and a reduced burden on government budgets of as much as 1.8 percent.

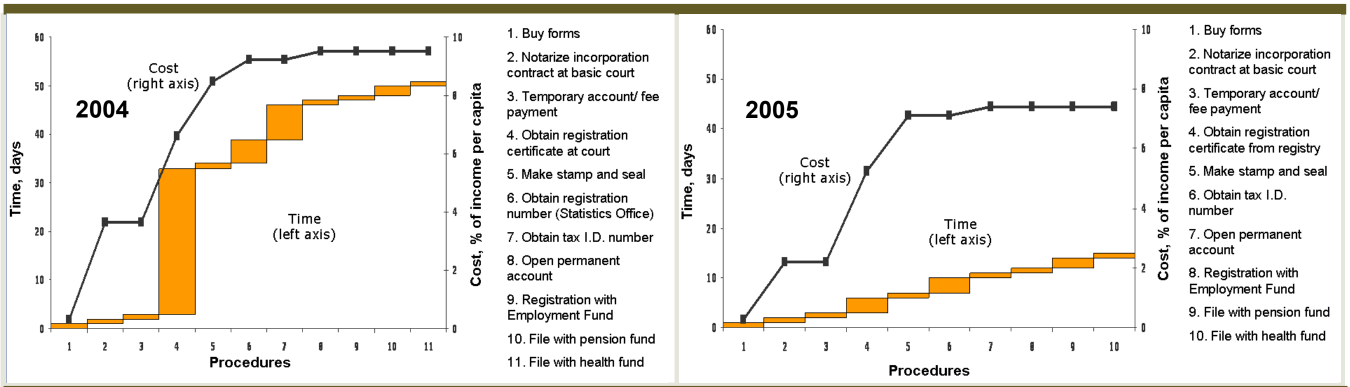
Figure 1: Gap in Cost and Time to Start A Business



New Tools Aid Policy Reform

The World Bank's *Doing Business* reports have become an important tool in demonstrating the benefits of and helping countries realize microeconomic policy reform.

Figure 2: Business Registration Process in Serbia in 2004 and 2005



These reports quantify the extent of regulatory obstacles to growth in 155 countries worldwide through easily understood benchmarking indicators. These indicators draw attention to aspects of a country's microeconomic environment that remain in need of reform and also highlight reforms that have improved the business environment. The indicators, which are updated annually, cover the topics of business entry, employment, contracts, credit rights and credit information-sharing systems, bankruptcy, licensing, property registries, corporate governance, trade infrastructure, and tax policy.

Ms. Cogan explained that the *Doing Business* reports have proved to be a positive incentive for reform for a number of reasons. "They are easily understood by non-economists. They not only identify problems, but suggest solutions, and the benchmarks get the attention of both policymakers and the media. In addition, the methodology is replicable and transparent."

USAID's *Investors' Road Maps*, which help government officials identify administrative barriers to investment and make the necessary reforms to institutions, regulations, and laws, are another useful tool for policymakers. *Investor's Road Maps* have been completed for more than 40 countries since the first one was developed for Ghana in 1995.

Ms. Tsiliopoulos pointed out other steps that, along with establishing a business-friendly, enabling environment through micro economic reforms, positively affect MSE success. These include "providing strong and numerous linkages between MSEs, larger firms, and buyers; providing support services in ... financing, business development, and information and communication services; and analyzing value chains to identify opportunities and address threats."

Businesses in developing countries may face three times the administrative costs, spend twice the time dealing with bureaucratic procedures, and enjoy half the protection of property rights compared to businesses in advanced countries.

About the Speakers

As Senior Competitiveness Advisor in the Bureau for Economic Growth, Agriculture and Trade at USAID, **Amy Cogan's** work focuses on providing technical support for field missions and advancing the understanding of best practices in topics of competitiveness. Ms. Cogan manages USAID's activities with the World Bank's Doing Business project and the World Economic Forum, and researches work on cluster initiatives in developing countries. She holds a degree in Economics from the College of William and Mary and an MBA from the Harvard Business School.

Vicki Tsiliopoulos is the Chief Operating Officer at EnterpriseWorks/VITA, a non-profit organization that provides business development programs for small agricultural producers and microenterprises. Over her 20 year career, she has supported financial services development in Benin, Chad, Guinea, Morocco, and South Africa; promoted trade and investment in India, China, and Thailand; facilitated NGO strengthening in Honduras and Zambia; and worked on natural resource management in Guinea and Madagascar. Her degrees include an M.A. in Economics from American University and a B.A. in Economics and Political Science from the College of Wooster.

- Reforming outdated, inappropriate regulations, as well as instituting or improving regulations regarding international standards, can have a positive impact on economic development, so long as MSEs also receive resources to meet such standards. Helpful resources include assisting MSEs to understand the importance and value of quality standards, linking them with other businesses and buyers in a relationship of trust, and establishing business associations and local labs and testing facilities run by the MSEs themselves.
- The reluctance of formal financial institutions to extend credit to MSEs can be overcome by ensuring that bank officials understand typical MSE business cycles, are willing to accept moveable assets as collateral for loans, and have access to information regarding the credit-worthiness of potential clients.
- While the effects of environmental and health regulations are usually positive, regulations regarding labor may be less so, particularly regulations relating to hiring and firing workers. For example, regulations that prevent the hiring of part-time or temporary workers can pose problems for seasonal businesses such as agriculture and tourism.
- Small farmers can be encouraged to enter the formal sector when lead buyers are willing to provide business development services, financing, and inputs such as seeds and fertilizer.

IRG Speaks Out

- *The Wall Street Journal* recently published a "Letter to the Editor"on Global Energy Security by **Charles Ebinger**, Senior Energy Advisor, Energy and Environmental Management Division. He was also interviewed by Reuters and CBS Market Watch on the same topic.
- The Global Village Energy Partnership recently appointed **Matthew Mendis**, Corporate Vice President and Managing Director, Energy and Environmental Management Division, to its Board of Directors.
- **Pradeep Tharakan**, Manager, Energy and Environmental Management Division, co-published an article entitled "Morphological traits of 30 willow clones and their relationship to biomass production" in the March 2005 edition of *Canada Journal of Forest Research*.
- **John Acree,** Senior Manager, Relief and Reconstruction Division, recently participated in a panel discussion at George Washington University's Elliot School of International Affairs entitled "Beyond Development: Cross-Cutting Issues from the Field."

About the IRG Discussion Forum

The IRG Discussion Forum, a monthly event, addresses issues affecting international development. Each session is informal, with guest speakers and attendees participating in a personal capacity. For comments, questions, or information on the Discussion Forum, contact discussionforum@irgltd.com or call IRG at 202-289-0100.

International Resources Group (IRG) is an international professional services firm that helps governments, the private sector, communities, and households manage critical resources to build a cleaner, safer, and more prosperous world. Since 1978, IRG has completed over 650 contracts in more than 135 countries, delivering high-quality, cost-effective services that promote positive economic growth, institutional and social change, and intelligent use of resources—human, physical, environmental, and financial. IRG's international development staff include world-renowned specialists who have pioneered many of the analytical techniques employed in their fields. IRG's ability to provide management, economic, and technical advice is further enhanced by the diversity, cross-cultural experience, foreign language skills, and management capabilities of staff based in the Washington, DC, headquarters, corporate offices in India and the Philippines, and 20 project-dedicated offices around the world.

INTERNATIONAL RESOURCES GROUP
1211 CONNECTICUT AVENUE, NW ◆ SUITE 700 ◆ WASHINGTON, DC 20036 ◆ UNITED STATES
TEL: 202.289.0100 ◆ FAX: 202.289.7601 ◆ WEB: WWW.IRGLTD.COM