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## Event Report

# “The Promise of the Private Sector for Development in Africa”: A Chazen Lecture by Shantayanan Devarajan

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*On November 11, 2008, Columbia Business School and the Jerome A. Chazen Institute of International Business welcomed Shantayanan Devarajan, chief economist of the World Bank’s Africa region. “The Promise of the Private Sector for Development in Africa” was the fourth annual Jerome A. Chazen Lecture, which brings business leaders to campus to lend their perspective on topics of importance within the global academic and business communities. Mr. Devarajan discussed the challenges facing private-sector development in Africa and the critical role of the government. He also showcased some of the success stories in the continent. Amir Ziv, vice dean, Samberg faculty director and professor of accounting at Columbia Business School, introduced Mr. Devarajan.*

Development in Africa is one of the most critical issues the world faces in the 21st century. Shantayanan Devarajan began his lecture by stressing his strong personal commitment to resolving this issue: “If you can’t solve it, you might as well be in another profession.”

Africa has made progress in recent decades thanks to “good luck and good policy” Mr. Devarajan said. The continent’s economic growth has continued to accelerate since the 1990s, with recent growth averaging about 6 percent. The growth was fueled by a certain degree of “good luck,” such as increasing commodity prices. The main agricultural products, the “three Cs”—coffee, cocoa and cotton—also experienced significant growth. During the same period, there have been significant improvements in the continent’s macroeconomic policies. Many African countries reduced their interest rate to manageable levels, below 10 percent. While 13 African countries saw

their inflation rate above 20 percent, it is only Zimbabwe and Ethiopia that suffer from such a high inflation rate today. Although economic growth in Africa was expected to slow to about 6 percent in 2008 and 2009, compared with 6.5 percent in 2007, the magnitude of the downward revision caused by the recent financial crisis was much lower for African countries compared with that for other nations, Mr. Devarajan explained.

Despite these successes, private-sector investment has not taken off in Africa, causing puzzlement and frustration among those working in this field, including Mr. Devarajan. Many believe that private-sector development is key to enhancing economic growth. Africa, however, remains the region with the lowest rate of private investment as a percentage of gross domestic product (GDP) in the world, lagging behind other developing regions.

### **Impediments to Private-Sector Growth in Africa**

According to Mr. Devarajan, there are three main factors that hinder the growth of private-sector development in Africa: infrastructure, skills and policy.

Africa’s infrastructure deficit is critically high, especially in the energy sector, with generating capacity at around 12 percent. Many parts of the continent suffer from a shortage of power, poor road conditions and a scarce supply of clean water. The lack of proper infrastructure impinges on the private sector by drastically increasing the cost of doing business. For many African countries, electricity is a significant portion of the indirect costs of doing business (indirect costs generally include electricity, bribes, transport and security, and they add to the overall cost of doing business).

Meanwhile, the lack of sufficiently skilled entrepreneurs and managers hinders improvements in efficiency and the ability to scale up local businesses. Although Africa has one of the lowest wage rates in the world, the impact of low labor productivity results in higher unit labor costs compared with those in China and India. Africa’s private sector is dominated by small firms: nearly 70 percent of the firms in Africa are in the micro and small categories, compared with 20–30 percent in Asia. Many of these small firms lack the managerial skills that are necessary to break away from “subsistence entrepreneurship” and to export and compete in the international market.

Besides the lack of infrastructure and skills, policy has yet to stimulate private-sector growth in Africa. According to Mr. Devarajan, trade reforms in Africa are an “unfinished agenda.” Tariffs remain at some of the highest levels in the world, restricting much-needed trade activity. Many of the regional economic communities have failed to achieve an increase in trade and economic development because of what Mr. Devarajan described as a “spaghetti bowl”: a web of trade

agreements made up of multiple memberships in various trade blocs. Such complex arrangements create further subregional trade challenges, with overlaps and different sets of rules for the continent.

### Government Leadership

Underlying each of the three factors, Mr. Devarajan explained, is some form of government failure, often resulting from the “best of intentions backfiring.”

Looking at infrastructure, it is the prohibitive cost of transporting goods that prevents private companies from efficiently conducting business in Africa. Mr. Devarajan makes an interesting point about the difference between transportation prices (the rates charged by a transport company to the shipper) and transportation costs (the costs the transport operator incurs, including vehicle-transport operating costs and other indirect costs, such as license fees). It is the transportation prices that are much higher in Africa than in other regions, while transportation costs are at similar levels to those in other regions. Government regulations to protect local trucking companies prevent competition and result in monopoly pricing. In this case, building more roads will not reduce the costs of transportation, and reform of the trucking industry faces political challenges.

A skilled labor force is crucial for private-sector development. The shortage of skilled labor in Africa has been a hindrance to business, and the problem stems from low enrollment rates across all education levels, especially at the tertiary level. Some examples of government failures are declining quality caused by lack of financing and low efficiency, as well as the mismatch between skills training and labor-market demand. But, Mr. Devarajan explained, many of the regulations are difficult to remove for political reasons. The public university system is free, yet it is structured to allow more children from wealthy families to study than those from low-income families. Introducing a tuition charge, Mr. Devarajan said, would “instantly set off a riot,” despite the possibility of making education more available to less privileged students.

As a result of such government failures, Africa continues to have the least business-friendly regulations in the world, despite its dire need for private investment. African countries on average rank 138 out of 181 countries on the World Bank’s Doing Business Indicators. The number of days required to complete a business activity (e.g., building permit, property registration, etc.) makes it challenging to entice private businesses to enter Africa.

In order to help attract foreign investment and expertise, Mr. Devarajan advocates that governments in Africa invest strategically in infrastructure and human resources, design and implement sound policies and provide a stable macroeconomic environment.

## Success Stories

Africa remains a difficult labor, physical and political environment, yet there have been some notable successes. There are a number of governments that have implemented reforms to facilitate growth in the private sector. Mr. Devarajan highlighted that the Angolan government successfully reduced the time required to start a business by creating a one-stop shop, and the Democratic Republic of the Congo lowered property-registration fees. Among some countries, the World Bank’s Doing Business Indicators have created a healthy rivalry, with countries competing to see which has improved its rating more. These changes are not insignificant, and they send a positive message to potential investors.

In other cases, successes were led by private companies. Mr. Devarajan showcased some private-sector success stories, ranging from gorilla tourism in Rwanda to the horticulture industry in Kenya to the apparel industry in Lesotho. In the case of gorilla tourism in Rwanda, the company managed to spur tourism around unique assets (gorillas) targeted to specific clients (e.g., prosperous dentists in New York) in a postgenocide country. Much of the success came from privately implementing the key building blocks (e.g., infrastructure development and the expansion of human capacity) without relying on the government. While this kind of independent business model can lead to success, it is also limited by scale from having a countrywide economic impact. On the other hand, the Kenya and Lesotho examples included some support from the government: attracting strategic investors with favorable investment terms and allowing investors to bypass bureaucratic processes. Perhaps the key to success lies somewhere between the private and public sectors, if not in the collaboration of both.

## The Promise of Africa

Can Africa succeed in 21st century? Mr. Devarajan concluded the lecture by stating, “The government is both the problem and the solution to unleashing the private sector in Africa.” The key to enhancing private-sector growth and to delivering a meaningful development impact in Africa is the governments’ ability to remove the underlying obstacles to having better infrastructure, higher-level skills and sounder policies.

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