Chapter 7
The Nexus between Governance Infrastructure and the Ease of Doing Business in Africa

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ABSTRACT

This chapter examines how each element of "good governance infrastructure" may influence the "ease of doing business" for a sample of 41 African countries from 2005 to 2012. The empirical results from GMM and other estimation methods reveal government effectiveness, political stability, rule of law, regulatory quality, and absence of corruption are robust determinants for creating conducive business atmosphere, taking into account other factors such as human capital, physical infrastructure, and the level of development of a country. Nevertheless, no evidence has been found for voice and accountability to significantly affect the ease of doing business. This implies that a government may enhance political stability, rule of law. Government effectiveness and low level of corruption is likely to create a more favorable business atmosphere despite offsetting deficiencies in voice and accountability.

INTRODUCTION

After a long period of stagnation in the 1970s and 1980s, Africa has re-emerged in the 21st century as a continent alive with opportunity, driven by such factors as: improved governance, better macroeconomic policies, management and business environments, abundant human and natural resources, urbanization and the rise of the middle class, and good economic performance and market potential. According to Mckinsey Global Institute (2010), Africa is one of the most rapidly growing economic regions in the world in which consumer spending in Africa that was $860 billion in 2008 is projected to grow to at least $1.4 trillion by 2020. More than 40% of Africans now live in the major urban areas (up from 28%), which has created a growing labor force and a rising middle class. According to Gekonge (2014), in 2008, 126 million African households had incomes above $20,000 a year—a level that enabled them to buy houses, cars, appliances, and branded products. Another 27 million households earned $10,000 to $20,000. In addition, 41 million households

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reported incomes of $5,000 to $10,000—the level at which families start spending more than half of their income on non-food items. Furthermore, it is estimated that by 2020 the total number of households in all the three segments will reach 128 million households. This trend in household income makes Africa one of the fastest growing consumer markets of this decade (Chironga et al., 2011). Therefore, there is huge business potential in Africa that is dissipating in other parts of the world particularly in the developed world.

Similarly, the McKinsey report estimates that by 2030, the continent's top 18 cities will have a combined spending power of $1.3 trillion. The business climate is also a lot brighter due to government actions to end political conflicts, and to improve macroeconomic conditions throughout the continent. Moreover, trade between Africa and the rest of the world has increased by 200% since 2000. Similarly, private investments in Sub-Saharan Africa now exceed direct aid, thereby fostering long-term stability in both large and small countries. As the *Economist* (2011) noted, "Africa could be on the brink of an economic take-off, much like China was 30 years ago and India 20 years ago," though its officials think major poverty reduction will require higher growth than today's—a long-term average of 7% or more. Furthermore, according to Moyo (2009), In Africa, labor is cheap averaging US$350 a month and large quantities of raw materials are available at significantly low cost. Moreover, with regional integration gradually advancing, resulting in standardized trade and investment procedures, entry into large portions of Africa will be at considerably low business startup costs. Furthermore, and relative to South East Asia, doing business in Africa would be cheaper—in terms of communication and transportation—to the USA and Europe because Africa is much nearer to the USA and Europe than South East Asia is to the two regions. The telecommunication industry is growing rapidly in Africa as African consumers demand more and better communication services. Internet use is becoming widespread and the use of the mobile phone has expanded considerably (Rasco and Bernstein (2007). As the population and per capita income continue to rise, the telecommunication industry appears poised to grow quite rapidly in the coming decade in Africa.

Likewise, many African countries have made significant progress in reducing the cost and burdens of doing business through a number of reforms such as setting up one-stop institutions for investors, streamlining licensing procedures, reducing the cost, duration and procedures for creating or expanding an existing business and reducing the tax burden on businesses (World Bank, 2013). Accordingly, of the 50 economies making the most improvement in business regulation for domestic firms since 2005, 17 are in Sub-Saharan Africa. Rwanda particularly stands out as having consistently improved since 2005. By the same token, the World Bank (2013) found that from June 2011 to June 2012, 28 of 46 governments in Sub-Saharan Africa implemented at least one regulatory reform making it easier to do business—a total of 44 reforms. Among other reform activities, most of the African countries have managed to reduce the time and documents required to export and import through their ongoing customs modernization program. They also reformed their business regulation regarding trading across borders. According to the Economic Commission for Africa (2009), constitutional provisions and legislation have been adopted in many African countries to enforce business contracts and protect individual property rights, including intellectual property rights and shareholders' rights. Many countries have also simplified court procedures to increase the efficiency and reduce the cost of enforcing business contracts. Furthermore, a number of countries have either adopted national codes on corporate governance or promulgated regulations on the operations of corporate entities, while others have enacted measures to ensure international credibility in accounting and audit practices.