SUPPORTING BUSINESS
ENVIRONMENT REFORMS

PRACTICAL GUIDANCE
FOR DEVELOPMENT AGENCIES

ANNEX: SUPPORTING BUSINESS ENVIRONMENT REFORMS WITHIN INDUSTRY SECTORS



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Supporting Business Environment Reforms:
Practical Guidance for Development Agencies

Annex: Supporting Business Environment Reforms within Industry Sectors

Donor Committee for Enterprise Development (DCED)

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PREAMBLE

In 2008 the Donor Committee for Enterprise Development (DCED) published guidance for donor and development agencies in their support of business environment reform in developing countries, entitled *Supporting Business Environment Reforms: Practical Guidance for Development Agencies*.[1] Since this publication, increasing attention has been given to a number of specific and closely related topics, which have been published as annexes to the original guidance.

This Annex focuses on how donor and development agencies can support business environment reforms within specific industry sectors. It is based on the findings of a Technical Report commissioned by the DCED Business Environment Working Group as well as on broader experiences of DCED members.[2]

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[1] Available from: http://www.enterprise-development.org/wp-content/uploads/DonorGuidanceEnglish.pdf

[2] The Technical Report examined sector-based business environment reforms in four broad sectors: Pharmaceuticals, Renewable Energy, Horticulture, and Mining Supplies.

White, S. (2015) Supporting Sector-Focused Business Environment Reform in Developing Countries, Donor Committee for Enterprise Development, Cambridge: Available from: http://www.enterprise-development.org/wp-content/uploads/DCEDBEWGSectorBERReport2015.pdf

KEY MESSAGES

- National **policy frameworks guide reforms** and help **coordinate** the many government, private and civil society actors involved in sector reform and development.
- The **multi-dimensional** nature of many industry sectors demands **integrated, coherent and well-coordinated policy responses** to the needs of private firms spanning all national government ministries and municipalities.
- **Regional policy frameworks** on the **harmonisation** of trade and investment regimes can open up national sector markets and value chains.
- Many developing-country governments **lack the capacity** to effectively coordinate a comprehensive and integrated set of policies and strategies; donor and development agencies should **not overlook the challenges of policy implementation**.
- Many sector reform efforts are hampered by **anti-competitive behaviour**, especially by current incumbents dominating the sector, subsector or value chain; this may include subordinate government agencies and officials who resist change. It is often necessary to identify and respond to the **political-economic obstacles** to reform while **promoting open markets**.
- **Political will and commitment** is essential, both at the **highest and lower levels of government** where resistance and intransigence can hinder reform.
- Many **new policy, legal and regulatory instruments** are being designed to respond to specific sector dynamics.
- **Laws and regulations** need to be **clear, coherent and consistent** with the national policy guiding reform and development; **too often this is not the case**. This includes coherence across national and **subnational (local)** laws and regulations.
- Poor legal and regulatory frameworks can be a result of a **government's lack of understanding** of the **practical problems and opportunities** private firms face within a specific sector or subsector. **Sector-based public-private dialogue** should be used **more frequently**. It should be **well structured, regularly monitored** and involve a **diverse range of industry actors**.
- The **lack of investor clarity** on government processes and procedures, as well as the **length of time** it takes for investors to comply with legal and regulatory requirements are common problems.
- **Industry regulators** play an important role in ensuring competition within key industry sectors. However, they are often hampered by a **lack of capacity** (i.e., most regulatory authorities are under-staffed and under-resourced), **inadequate skills and a lack of autonomy from government.**
- **Standards and quality assurance** are critical elements of sector-oriented business environment reform. There are often problems with the systems and facilities required to effectively **monitor standards, test products and prosecute** those who are selling sub-standard or counterfeit products.

INTRODUCTION

Most business environment reform programs focus on general reforms designed to improve conditions for all private enterprises. However, increasing attention is given to supporting specific industry sectors or subsectors, particularly those, which governments identify as "priority sectors" because of their strategic nature, high-growth potential or capacity to create significant numbers of jobs. Private sector development within industry sectors or subsectors has typically focused on industrial development policies and programs, as well as cluster development or value chain improvements. Within this context, business environment reform plays a supporting and complementary role.

Sector-oriented or "vertical" business environment reform aims to stimulate private sector growth within specific industry sectors or subsectors. This report is located within a collection of other related reports the BEWG has prepared. The BEWG's work on industrial policy and quality infrastructure are particularly relevant in this regard.

In recent years, the DCED has published two annexes to its 2008 Donor Guidance, which are relevant to this Annex. The 2013 Annex entitled, *Complementing Business Environment Reform through Industrial Policy Support*, highlights the complementary roles played by industrial policy and business environment reform.[3] While these approaches share a common objective, "to generate economic growth, increase livelihoods, create more and better jobs, and reduce poverty", they employ different methods. Where business environment reform aims to reduce business costs and risks, and promote competition, industrial policy addresses market failures and supports the transformation of the economy. The 2014 Annex entitled, *Supporting Quality Infrastructure in Developing and Transitional Economies*, deals with the policy and institutional framework governing regulations and standards.[4] Here again, business environment reform and quality infrastructure perform complementary roles.

Sector-oriented business environment reforms draw on donor experiences in industrial policy and quality assurance. They also intersect with the work of donor and development agencies in supporting strategic value chains and industry clusters. While the nature of industry sectors, subsectors and value chains varies—along with specific business environment barriers and constraints—this Annex provides a general approach to working with governments and the private sector to support sector-oriented reforms.

PRINCIPLES FOR SUPPORTING SECTOR REFORMS

When supporting business environment reform within specific industry sectors, donor and development agencies should, in partnership with developing-country governments and the private sector:

- Support national policy frameworks to build agreement among public and private actors on the need and purpose of reform, strengthening coordination and integration within and across industry sectors and subsectors.
- Use regional policy frameworks to guide regional market reforms and harmonisation to open up new market opportunities—drawing on rigorous assessments of the policy, legal and regulatory barriers to regional trade.

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3 Available from: http://www.enterprise-development.org/wp-content/uploads/DonorGuidanceAnnexIndustrialPolicy.pdf

4 Available from: http://www.businessenvironment.org/dyn/be/docs/285/dced_bedonorguidanceannexqualityinfrastructure_2.pdf

- Build the capacity of governments and sector institutions to improve coordination and implementation.
- Support increases to the demand for reform by the private sector through improved public-private dialogue in order to address anti-competitive behaviour and open up markets for increased competition.
- Nurture the political will for sector reform and encourage this to filter down through all levels of central government management and administration and to subnational government structures.
- Support the creation of new policy, legal, regulatory and finance instruments designed to respond to the specific sectors, value chains and business models (e.g., feed-in-tariffs schemes).
- Support the drafting of improved policies, laws and regulations, at all levels of government, ensuring they are focused on the problem to be addressed, clearly written, can be efficiently implemented or enforced, and are consistent with the overall thrust of government's reform efforts.
- Improve the quality of regulatory governance by building the capacity of regulators and strengthening testing and accountability mechanisms.
- Strengthen industry representation and public-private dialogue by helping small-scale enterprises within the sector or subsector or along the value chain to become better organised and represented in industry associations and more engaged in dialogue structures.
- Support industrial policy interventions that improve access to finance and information to help small-scale enterprises within the sector, subsector or value chain obtain the resources they require to expand and exploit the opportunities created by sector-oriented business environment reform.

COMMON ISSUES AFFECTING VERTICAL BUSINESS ENVIRONMENT REFORM

Sector-oriented BER focuses on common constraints or challenges facing the development of industry sectors. These are discussed below.

Policy Reform

A national policy framework is essential. Policies guide government interventions and identify reforms, which help coordinate the many actors involved in sector development. This includes the many levels of government as well as private and civil society actors. Donor and development agencies work with developing-country governments to ensure their policy frameworks are up-to-date, responsive to sector needs and opportunities, and relevant within the global economy.

Effective sector policy frameworks respond to the multi-dimensional nature of industry sectors and subsectors. While one line ministry will lead and coordinate government efforts, there are many other line ministries and agencies involved. This requires an integrated and coherent response to the challenges faced by private firms within a defined sector or subsector.

Donor and development agencies can help developing-country governments set targets against which sector policy and reform outcomes can be monitored and refined. These should be formulated and jointly monitored in partnership with private sector and subsector actors.

Sector-oriented business environment reform policies complement and support industrial development policies and programs. However, there are instances where this is not the case. For example, the review into renewable energy found many cases of disconnect between industrial policy initiatives and the legal and regulatory frameworks private investors were required to comply with. Often, different arms of government deal with different aspects of sector development: regulation, industrial development, human resources, trade, etc. Sector-oriented policies can be developed to bring these together and reinforce multiple elements.

A common and persistent challenge for developing-country governments is the implementation of policy. Many governments lack the capacity to effectively coordinate the comprehensive and integrated set of strategies required for successful sector development. To address this, realistic policies should be formulated: consistent with government capabilities and resources, and with relevant timelines. Strike a balance between long-term vision and short-term responses to current challenges.

Sector-oriented reform requires a strong commitment to change from the highest level through to all levels of management. While high-level political will is essential, such as from the president, prime minister or finance minister, this should extend deeper into the lower levels of government where resistance and intransigence typically hinder reform. Because reform implies change, there are many who resist it, including subordinate government officials and agencies (e.g., inspectors, regulators). Thus, policy reform requires champions at all levels to lead and support the reform effort.

Because many strategic, growth sectors or subsectors extend beyond national markets into regional and global value chains, national policy frameworks can focus on helping domestic private enterprises become more outward focused and improve their access to new markets. To this end, donor and development agencies are supporting governments at national and regional levels to open up new market opportunities by reducing the costs of cross border trade. This includes regional policy frameworks to guide the harmonisation of regional trade regimes.

Finally, public procurement and subsidies are powerful policy instruments influencing sector development opportunities and private investment. These instruments can be used to create new market opportunities for local firms, provided they are consistent with and connected to national policies for sector development.

Legal and Regulatory Reform

The legal and regulatory regime shapes public governance of the sector. In many cases, reformers find discrepancies between the aspirations of national policy and the reality of the legal and regulatory framework. Often, these are not aligned. Many private businesses and investors are reluctant to invest in specific sectors or value chains where there is no clarity on government processes and procedures. This affects the length of time it takes investors to comply with legal and regulatory requirements and can undermine investment opportunities. Often, government rhetoric, which aims to entice investors into priority or strategic sectors, does not match the reality. Private enterprises face cumbersome compliance procedures and hidden costs. Donor and development agencies can work with developing-country governments to help them see the big picture and to structure reforms that connect policy aspirations with business realities.

Coherence is also required across national and subnational laws and regulations. Often, there are disconnects between laws and regulation at the national and local levels, causing confusion among businesspeople and investors, and raising costs. Local municipalities play an important role in sector development. Local planning and zoning, the issuance of construction permits, along with other land use and business permits and licenses can have a dramatic impact on the cost of doing business within specific sectors.

Increasingly, donor and development agencies are working with developing-country governments to design sector-specific legal and regulatory instruments based on the dynamics of the sector or subsector and its business models. For example, the development of feed-in-tariffs and net metering systems encourage increased private investment in the renewable energy sector, while tax incentives and the exclusion of tax on raw materials can be used to stimulate the local manufacturing sector. These instruments are designed in response to careful analysis of the sector, subsector or value chain, including regular dialogue with industry actors and emerging new private sector entrants.

The 2008 Donor Guidance identifies a number of Functional Areas for business environment reform. A diagnosis of the sector, subsector or value chain business environment will identify the most relevant barriers or constraints to private investment. Some value chains may extend beyond a single sector or subsector.

A number of common areas are likely to emerge from this analysis: taxation, commercial law and justice (including contract law), land tenure and administration, access to finance, intellectual property rights, and the registration of new products (e.g., pharmaceutical, agricultural, technological). Donor and development agencies can help their partner governments and the private sector to learn from international best practice in these fields and ensure reforms are carefully integrated with other government and market reform efforts.

The regulation of regional markets affects investor behaviour and increasingly regional business environment reforms are used to harmonise and streamline regulations across regions. These reforms can open up new market opportunities and value chains for greater private sector participation, including small and medium-sized enterprises.

Despite this, many governments continue to try to formulate legal and regulatory reforms without close consultation with private businesses and investors. A poor legal and regulatory framework can be the result of government's lack of understanding of the practical problems or opportunities private firms face within a specific sector. Regular, structured dialogue between the government and a diverse range of sector actors is essential. So too, is well-researched evidence on the dynamics of the sector and the potential impact a new or revised law or regulation would have on the sector. Here, the use of regulatory impact assessments is recommended.

Regulatory Authorities, Standards and Quality Assurance

Industry regulation is a critical issue for all sectors. Increasingly, regulatory authorities in developing economies are established to oversee sector markets and promote competition. However, not all developing-country regulators are effective. For example, some regulations and standards in pharmaceutical manufacturing were found to be unnecessarily costly, inefficient and biased against local producers. Donor and development agencies support reforms to help regulators improve their technical capacity and connect them to international best practices and standards.

Often, effective regulation is hampered by a lack of capacity. Most regulatory authorities are under-staffed and under-resourced. In some cases, regulators are not independent enough from government. Sector-oriented business environment reform requires a sound understanding of the role of regulation and regulatory authorities within a globally competitive market system.

Standards and quality assurance are critical elements of sector-oriented business environment reform. In many cases, the improvement of strategic value chains is hampered by a country's ability to set, test for, and ensure compliance with industry standards. National industry standards should be aligned with international standards. In many developing countries with a strong agricultural sector, the improvement of sanitary and phyto-sanitary standards is especially important.

Many small enterprises in the agriculture sector in developing economies struggle to meet the growing set of standards required to enter world markets. To address this, significant improvements in the national policy, legal and regulatory framework are required as well as in national standard setting and testing. While lead firms, such as national exporters and multi-national enterprises, play an important role in helping local firms comply and link local producers to international markets, there is a high demand for public investment into improved standards, testing facilities and enforcement mechanisms.

Donor and development agencies work with regulators and other partners to help improve the way they monitor standards, test products and prosecute those who are selling sub-standard or counterfeit products.

Institutional Arrangements

Sector institutions are responsible for the implementation of government policy, the enforcement of laws and regulations, the setting and monitoring of standards, and the mechanisms through which government and the private sector interact. Donor and development agencies should map and understand the wide range of actors involved in industry sectors and value chains.

Just as policy, legal and regulatory reform requires high-level, reform-oriented leadership, so too do sector institutions. Successful institutional reform requires senior-level leadership to guide institutional redesign and management in a coordinated, integrated and pragmatic manner. Donor and development agencies can support the design and implementation of change management processes to build a common vision for change and address resistance.

Good coordination across government ministries, departments and agencies is essential. For example, developing opportunities in the mining supply sector was found to require good communication and coordination across the government portfolios associated with minerals, energy, industry, commerce, labour, and the environment.

Government policies, laws, regulations, and institutions could be better informed if sector-based public-private dialogue was used more frequently and made much more inclusive (i.e., representing the full diversity of the sector business community).

Because of the integrated nature of development strategies and reforms, many public, private and civil society stakeholders are involved and need to be carefully managed. Sector-oriented business environment reform requires a communications and stakeholder management strategy targeting key actors.

CONCLUSION

Donor and development agencies are encouraged to include an examination of the business environment when undertaking a sector, subsector or value chain analysis. Sector-oriented business environment reform can bolster and complement other market and industry development programs and initiatives.