



José María Figueres, former President of Costa Rica, tells how the Costa Rican economy improved through sound microeconomic policy.

Lessons from Costa Rica

JOSÉ MARÍA FIGUERES,
FORMER PRESIDENT OF COSTA RICA

For successful development, macroeconomic stability is very important. I cannot think of any examples of countries that have been able to grow on a sustained basis without low inflation and cautious budgetary management. But boosting income per capita over long periods of time requires much more: credible efforts to improve the quality of public institutions, reforms to create a friendlier environment for the private sector, concern for issues of equity and distribution, and providing opportunities to enable citizens to actively participate in the life of the nation.

Thus, in Costa Rica, an early focus on macro stability—to address some fiscal fragilities—was quickly followed by policies and action programs in the areas of education, physical infrastructure, foreign direct investment—which we considered to be a central driver of growth—as well as policies aimed at supporting research and scientific and technological development, environmental protection, and the development of tourism.

Only an approach that is comprehensive in nature and that has at its primary motivation a concern for the wellbeing of the entire population can hope to earn the people's trust, so essential if policies are to go beyond the stage of formulation and begin to make a difference in people's daily lives.

We need to move our societies forward along a competitiveness framework for sustainable development. This will involve not only an overall upgrading in our economic performance, but must be complemented by an improvement of indicators of social wellbeing through more sustained investment in human development.

What did the above mean in practice in Costa Rica's case? The following come quickly to mind:

- a constitutional amendment to provide adequate funding to education (6 percent of GNP), enabling the entire population to gain access to a modern educational system that lives up to international standards—a prerequisite to enhance the country's competitiveness
- measures in the area of preventive health and pension reform to strengthen the country's inefficient safety net and safeguard its financial sustainability

▼ SEE COSTA RICA ON B2

A Good Business Climate: Missing Key to Economic Growth

The failure of efforts to end poverty in Africa, Latin America, the Middle East, and Asia has led the international development community to search for the missing key that has left millions locked out of economic growth in the 1980s and 1990s.

Many experts now say that key lies in the lack of local laws to protect private property; to allow people to start their own businesses; to enter into secure contracts; to use their land and property as capital to raise cash; and then to invest it in seeds, tools, raw materials, or even education.

These are called "microeconomic" factors because they affect the way individuals operate in the larger "macroeconomic" environment.

For two decades, the economists of the World Bank, USAID, other donor nations, and development groups believed that getting the macroeconomic conditions right—such as a floating currency, low interest rates, low tariffs, and balanced budgets—would lead to growth and lift poor countries from poverty.

While many did profit immensely from this "Washington consensus" on sound macroeconomics—Thailand, Malaysia, Chile, and Costa Rica are among the most successful examples—many countries remained mired in poverty.

Some economists compare good macroeconomic policies to a beautiful, clean soccer field. Others say a smooth field doesn't guarantee good play; strong, agile players and a fair referee are needed for that.

They say that for businesses to compete

and grow, workers must be healthy and educated; owners must feel secure in their property rights; and managers need simple, fair government regulations that aid rather than hinder trade.

Structural macroeconomic adjustments, such as allowing currencies to float on the world market and balancing government budgets, are needed, but are not enough to spur economic growth.

Economic crises in Argentina, Bolivia, and other countries showed that macroeconomic reforms alone did not produce stable economic growth.

Development scholar Hernando de Soto of Peru says strong property rights is the missing ingredient in many poor countries. Without title to his land, a farmer cannot borrow against it and invest in more productive technology.

José María Figueres, former president of Costa Rica, says that for a country to be "competitive" globally it must invest in people's health and education.

The World Bank found that high-income countries tend to have strong property rights and creditor rights but simpler and less expensive regulations than poorer countries. Too complex regulations often force people into the "informal" economy, where employees are unregistered and businesses operate without paying taxes.

For its report, *Doing Business in 2004*, the World Bank developed quantitative measures for comparing the speed and cost of starting a business, hiring and firing workers, enforcing contracts, getting credit, and

closing a business in 133 countries. The next report will look at property registration and corporate governance.

Doing Business builds on previous work by de Soto as well as the "investor roadmap" that USAID helped develop in the early 1990s. Used in 23 countries, investor roadmaps identified constraints to entering the market and expanding businesses nationally and often uncovered hidden obstacles specific to certain cities and provinces.

By measuring the number of days needed to register a company or settle a contract dispute, the *Doing Business* report makes cross-country comparisons easy.

"*Doing Business in 2004* gives a lot of countries benchmarks to measure themselves against that we didn't previously have in a comprehensive manner and thus should be very useful," said USAID Deputy Assistant Administrator Jay Smith.

Poor scores already have spurred some countries into action, including France, Morocco, Nicaragua, and Argentina, said Simeon Djankov, who led the research for the World Bank.

"What gets measured, gets done," Djankov said.

This special insert highlights lessons learned about the impact of business regulation through empirical research. It draws on USAID work to illustrate the concepts.

Many of the examples come from Eastern Europe, where countries transitioning to a market economy were forced to rethink all aspects of business regulation and enforcement. ★

NGOs Help Free Farmers, Businesses from Regulations

In order to reform the rules and regulations that block business and stifle economic growth in many countries, USAID funds nongovernmental organizations (NGOs) that work with local companies and communities to spot where policies need to be changed.

In Sri Lanka, for example, a volunteer from International Executive Service Corps advised a coalition of businesses and government agencies how to draft, lobby, and enact laws to protect intellectual property rights—critical before foreign investors will get involved in a country.

In Russia, Financial Services Volunteer Corps volunteers donated time and expertise to show banking officials how mortgage lending works. The BashEkonombank in Ufa used the training to add mortgage lending to its portfolio. Volunteers also advised on internal policies and procedures for mortgage lending and selling mortgages on the secondary market.



Paul Stewart, TechnoServe.

A worker sorts coffee beans in King'ori, one of 11 Tanzanian villages where TechnoServe helped establish central pulperies. These are processing facilities where farmers collectively remove coffee cherry skins, wash, and then dry coffee. The result is a higher quality, more consistent product.

▼ SEE NGOS ON B2

NGOs Help Free Farmers, Businesses

▲ FROM B1

In Tanzania, where coffee is the major agricultural crop and the number-two export after gold, the private voluntary group TechnoServe has worked since 1998 with about 7,000 coffee producers. But all 400,000 coffee growers eventually benefited from policy reforms TechnoServe's local partners pushed through.

Looking at this program in greater depth reveals how foreign aid programs can help reform microeconomic obstacles to free markets.

Working around Mount Kilimanjaro in the north and in the southern highlands, Tanzania's small coffee farmers grow 95 percent of the country's coffee. Coffee trees are up to 70 years old, and their yields are among the lowest in the world.

The country's coffee exports have fallen steadily since 1995, as world supply has grown and coffee prices have dropped. Tanzania's 100-year-old coffee communities have been struggling to live on the falling incomes.

The coffee growers' association and the Tanzania Coffee Board, an industry group, recommended lower taxes and simpler licensing and permit requirements to lower costs and make the sector more competitive.

TechnoServe first started working with small coffee farmers to improve quality and increase yields. The next step was to work with local growers to set up in 2001 the Association of Kilimanjaro Specialty Coffee Growers.

The association not only provides technical assistance, credit, and marketing

services to 4,500 owners of small farms organized into 62 business groups, it also represents its members. Thus far, the association has participated in a coffee tax study and pioneered a new direct export marketing channel made possible by regulatory reform.

Tanzania had the highest taxes on coffee producers and the lowest rate of reinvestment, compared to five similar coffee-producing countries.

The coffee growers' association and the Tanzania Coffee Board, an industry group, recommended lower taxes and simpler licensing and permit requirements to lower costs and make the sector more competitive. With help from TechnoServe, they held workshops to discuss the issue with government officials and build support for change.

Six months later, the finance ministry announced that local and national government taxes would be harmonized and brought down from the combined 21 percent taxation rate.

The association also worked with the Tanzania Coffee Board and others to bypass the national auction and sell directly to specialty buyers. The first direct coffee smallholder grower-to-roaster sale took place in March 2004, when an international roaster purchased 23,280 pounds of washed Arabica coffee beans from five of the Kilimanjaro Specialty Coffee Growers Association's business groups.

The 645 growers involved in that first sale received a 50 percent higher price than other association members at the domestic auction and twice the amount that nonmembers were able to get for their coffee.

"To provide jobs and higher incomes in rural communities, a good business environment is essential for small and medium businesses to thrive," said John Taylor, TechnoServe's interim president and CEO. ★

Lessons from Costa Rica

▲ FROM B1

■ a break in the traditional election-year expenditure cycle, preempting the need for the next administration to start its tenure in office with an unpopular tax package

■ policies implemented in the areas of the environment and biodiversity, opening opportunities for development in scientific research and ecotourism and boosting foreign direct investment

■ innovative contractual schemes to encourage public-private partnerships—for instance in the context of the modernization of our main international airport

■ improvements in the climate of competition between private and public banks and for electricity pricing as well as

improvements to the efficiency of public procurement and the fight against contraband

Finally, with the attraction of INTEL and the subsequent emergence of a cluster of high tech companies, a new engine of growth for Costa Rica was created.

In the end, the aim of economic and structural reforms is to enable the public to participate in and benefit from the fruits of growth and development. The process is long, the challenges are many, and good political leadership involves offering a vision of transformation that can capture people's imagination. ★

José María Figueres was president of Costa Rica from 1994 to 1998.



Ben Barber, USAID

Costa Rican policies implemented in the areas of the environment and biodiversity opened opportunities for ecotourism and boosted foreign direct investment.

STARTING A BUSINESS

Investor Roadmap Points Way to Reform

In 2000, an entrepreneur wanting to open a business in Romania had to submit 83 pages of documents and obtain 23 or more approvals, authorizations, licenses, and permits from various ministries, agencies, and the town hall. It took more than 100 days and often cost more than \$500.

This labyrinth, which included stops at the ministries of labor, health, agriculture, environment, and the fire brigade, was mapped out with USAID funding by IRIS, the Center for Institutional Reform and the Informal Sector, and was one of the many USAID-funded "investor roadmaps" done by several organizations around the world.

Within a year or two, paperwork was down to 20 pages; ministries could approve simultaneously, instead of one

after the other; and the cost was brought down to \$120–250, depending on business type.

In June 2000, IRIS shared its "red-tape analysis" with local governments, and, together with USAID/Romania and the U.S. Embassy, challenged 80 cities to remove five common municipal obstacles in six months' time.

Twenty-nine cities responded, and, by December 2000, four met the requirements, including eliminating the mayor's personal approval of business registrations and streamlining construction approvals. IRIS gave the cities additional technical assistance and the embassy invited them to a reception for U.S. business leaders.

The winning cities—Giurgiu, Timisoara,

Cluj-Napoca, and Iasi—also were invited to the monthly meetings of the American Chamber of Commerce in Bucharest. Soon a group of mayors and local chambers of commerce began pushing for national change.

In 2001, the national government responded with an improved business registration process that reduced the steps involved as well as paperwork and fees.

USAID began designing and funding investor roadmaps about a decade ago. The roadmap is a tool for spotting costly and unwieldy administrative requirements that burden domestic and foreign-owned businesses and hamper economic growth.

When starting a business means spending months and years applying for permits,

licenses, identification numbers, authorizations, and approvals, scarce investment capital as well as energy and time is wasted without producing anything of value.

Typically, the roadmap traces the path an investor takes from having an idea to putting it into production. The roadmap charts every interaction with government agencies to set up a business. Mapping out the complex steps, using arrows and boxes, shows government officials how their policies and actions hurt business development.

If a government initiates reform, roadmap projects encourage officials to consult with business groups and get their reactions to proposed changes in laws and regulations. ★

Titling Land Unleashes Credit, de Soto Says



Hernando de Soto.

Hernando de Soto thinks people can escape from poverty if they get legal title to their homes and land, which can then be used to obtain credit, and more than 30 heads of developing countries seem to agree.

"Four billion of the world's 6 billion people are outside the legal economy," said de Soto in a recent *FrontLines* interview in Mexico City.

The "extralegal economy" that de Soto hopes to mine for development ranges from women selling food and handicrafts in street markets to hundreds of millions of peasants

farming land to which they have no legal title.

Not only are these people unable to get credit, home equity loans, or other sources of cash to expand their businesses, but the government can't tax them to raise funds for schools, sanitation, and roads—the building blocks of modern prosperity.

"Developing countries have large black markets or extralegal economies where most citizens live and survive," said de Soto, whose book, *The Mystery of Capital*, has been translated into 25 languages.

"If we can't integrate them [into the legal, formal economy], they can't prosper and live in peace," he said.

De Soto also said that without legal titles and formal addresses to send bills and collect payments, the power, water, and phone companies can't provide service. And government can't collect taxes or even conduct a census to measure needs for schools.

Countries that have asked de Soto's organization, the Institute for Liberty and Democracy (ILD), to help reform property and business laws include Pakistan, Afghanistan, Egypt, Mexico, Guatemala, Honduras, Tanzania, Nigeria, Ghana, Ethiopia, Russia, Kazakhstan, Georgia, the Philippines, Thailand, and Sri Lanka.

Beginning in his native Peru in 1984, de Soto said, a \$17-million USAID investment plus \$38 million from the World Bank created property titles worth \$9.4 billion.

After titling half the homes in urban shantytowns, their values rose an average of 30 percent and, in each house, one more person was able to go to work or school because homeowners no longer feared squatter takeovers, said de Soto.

"The people we titled use home equity mortgages to raise \$200 million to \$300 million a year," he said.

Some 400,000 businesses were brought into the legal sector, creating 600,000 new jobs and bringing the government \$1.5 billion in taxes over three years, he said.

De Soto learned to persuade local authorities and interests to allow property rights titling but entrenched opposition came from bureaucrats and officials—public and private—who needed to be "dragged" into the

new system.

The ILD also helps create new forms of collateral, mortgage systems, and contract laws, as well as new financial instruments to store the value of people's assets, including shares of corporate stock, patent rights, promissory notes, bills of exchange, and bonds.

His move onto the world stage with his titling philosophy came with U.S. support. "We wouldn't exist without USAID," which continues to provide about \$6 million a year to the ILD, he said.

He admits that in Peru success was only in the urban areas and not yet in the countryside. However, in El Salvador "we saw the first real rural success, and now we are ready to do Haiti and Egypt," he said. ★

ENFORCING CONTRACTS

Experts Cut Red Tape

Many businesses in developing countries are bogged down in endless court disputes because they have no better way to enforce contracts, resolve disputes, and work out their differences.

"Specialized commercial courts are associated with faster and cheaper enforcement in wealthier countries. Out-of-court resolution mechanisms are a better short-term solution in countries with only a rudimentary judiciary."

DOING BUSINESS IN 2004, WORLD BANK

As a result, many businesspeople won't work with people they don't know, never expand their circle beyond their known contacts, and fail to grow into efficient production and service industries.

So development experts are helping countries simplify and improve their contract resolution systems in two different ways: settling disputes outside court through mediation and arbitration and improving the efficiency and openness of court systems.

In Zambia, for example, more than 1,800 employment and 50 business disputes are settled each year through court-ordered mediation and private arbitration set up with U.S. assistance over the past four years.

Before Zambian courts began referring employment disputes to mediation, such cases gathered dust for more than three years until they were heard. With mediation, cases are settled within a month of referral.

The law association and Zambian Bar promoted arbitration, worked with the government to get a law passed, and won industry support to set up the Zambian Center for Dispute Resolution.

Dispute resolution centers have also been set up with U.S. help in Uganda, Senegal, and elsewhere.

The other way to liberate businesses from long court disputes is to create simpler processes within the court system. These tend to be faster and cheaper. They are also more likely to be seen as fair, according to a survey of more than 10,000 businesses in 82 countries reported in the World Bank's *Doing Business in 2004*. Specialized commercial courts are associated with faster and cheaper enforcement in wealthier countries.

Out-of-court resolution mechanisms are a better short-term solution in countries with only a rudimentary judiciary. ★



In November 1990, a member of the Caudevilla Cooperative received registered title from Peru's Minister of Agriculture, Enrique Rossl Link, as rural property registry officials and ILD advisors looked on. The farming cooperative north of Lima was the site of ILD's pilot rural registration program.

NUMBER OF PROCEDURES TO ENFORCE A CONTRACT

The fewest...

Australia 11
Norway 12
United Kingdom 12
Zimbabwe 13
Denmark 14
Jamaica 14
Switzerland 14
Tanzania 14
Tunisia 14
Taiwan, China 15

...and the most

Angola 46
Paraguay 46
Cameroon 46
Mexico 47
Sierra Leone 48
Chad 50
Oman 54
Puerto Rico 55
Congo, Dem. Rep. 55
Burundi 62

Source: *Doing Business in 2004*

Women's Rights Key to Their Business Success

In Kenya and other patriarchal societies, built-in barriers block women from owning and inheriting the property they use or manage. This traditional male dominance forms a microeconomic obstacle to growth.

In Kenya, only 5 percent of women own land, while 80 percent of them work the land. Women contribute 80 percent of all farm labor but hand the income over to fathers, husbands, and brothers who own the land.

Without titles, women cannot grow their business or buy, sell, and mortgage the land they till.

Kenya's Draft Constitution, completed by the National Constitutional Conference in April 2004, includes greater rights for women. Work on the new constitution began in earnest following the election of President Mwai Kibaki in December 2002.

The Center for Gender and Development, an NGO funded by USAID's Office of Women in Development, got women's views on property and inheritance rights, recommended changes to the Constitutional Review Commission, and encouraged women to participate in the commission process.

Another commission reviewing land law adopted several of the center's recommendations, including that at least one-third of land board members should be women.

Since customary or traditional law predominates in rural areas, amending the country's laws will not be enough, said USAID/Kenya's Sheila Karani. Rural women are often subject to customary law, mainly because they are married under it. They tend not to know what the official laws say, nor can they afford legal counsel, she said.

"Women and men have an equal right to inherit, have access to and manage property."

DRAFT CONSTITUTION OF KENYA 2004, CHAPTER 6, BILL OF RIGHTS, SEC 37(2).

For instance, when the in-laws of a Kenyan widow grab land and property from her, she may not be aware of her rights or lack legal counsel. The problem is acute, given the country's high HIV/AIDS infection rate, which is killing many working adults.

The Education Center for Women in Democracy, another Agency-funded NGO, employs 30 paralegals who counsel women on their legal rights. The center also has developed a radio program to inform isolated communities about women's legal rights. ★

CLOSING A BUSINESS

Bankruptcy Cheaper, Faster in Rich Countries

When a business can't pay its bills and undergoes bankruptcy, it can be restructured, sold as an ongoing concern, or have its assets liquidated to pay off debts.

In many countries, though, a business can languish for many years without clear resolution for owners, workers, or creditors. When bankruptcy procedures aren't used or drag on, insolvent companies hurt the local economy.

In Serbia and Montenegro, bankruptcy cases typically last seven years. In neighboring Bosnia-Herzegovina, where modern laws were recently adopted, the process is faster. But one problem in both former socialist countries is a general unfamiliarity with secured lending and bankruptcy procedures.

In Bosnia-Herzegovina, USAID hired development contractor Chemonics to develop courses, manuals, and handbooks on how to implement the country's new collateral and bankruptcy laws. Training on basic corporate finance and bankruptcy procedures will be offered to judges, lawyers, and trustees who are appointed by the courts to oversee insolvent businesses.

Countries that give creditors top priority are most likely to save viable businesses and liquidate bad ones, according to the

World Bank's *Doing Business in 2004*. In systems where creditors know they won't be repaid if a business files for bankruptcy, the temptation is to block debtors from declaring bankruptcy, although it might offer the best hope for the business surviving in some form. And lenders who don't get repaid hesitate to take risks such as lending to new businesses.

"Developed countries have more efficient bankruptcy procedures, especially in their duration. All 10 of the jurisdictions with the fastest procedures are high-income countries."

DOING BUSINESS IN 2004, WORLD BANK

To address the problems in Serbia, USAID's mission recently announced a three-year, \$12.8 million project to strengthen commercial courts as well as a \$3.5 million award to the National Center of State Courts to help improve case management and court administration. ★

GETTING CREDIT

Bulgaria's Stored Grain Is Credit Base for Loans

Bulgaria's banks are lending farmers money against stored grain under a USAID program that helped introduce a grain warehouse receipts system aimed at helping farmers obtain loans for their business needs.

The first step was to teach public warehouse operators how to maintain warehouses and grade wheat, barley, corn, and sunflower against strict, international standards. Well-run warehouses protect farmers from high postharvest losses and enable them to time the sale of their grain.

Working with the government, the World Bank, financial institutions, and industry, ACDI/VOCA, a USAID-funded NGO, helped draft legislation and licensing procedures to turn stored grain into bankable property. The National Grain Service was established to inspect the licensed warehouses and confirm that they grade and store grain correctly.

ACDI/VOCA and the Bulgarian grain industry won government support and convinced bankers to use grain as collateral.

More than 47 warehouses are now licensed to issue receipts for 470,000 metric tons of grain they store. The receipts specify the quantity and quality of grain each farmer deposited at the warehouse.



Volunteer Gordon Schmidt, left, from Henderson, Nebraska, and client Todor Toporov, work on a grain storage bin auger in Toporov's shop in Silistra, Bulgaria.

The European Bank for Reconstruction and Development helped fund a guarantee or "indemnity" fund to protect bankers if, for any reason, grain claimed as collateral in case of default was not of the quality and quantity specified in a warehouse receipt.

Guarantee fund managers, bank loan officers, and warehouse inspectors got special training. ACDI/VOCA volunteers such as retired banker Frank Ziegler of

Minnesota worked closely with bankers, showing them how to adapt their banking policies and procedures to use this new type of collateral.

Most important was the psychological aspect. Volunteers such as grain industry consultant Si Matthies and Texas grain-elevator operator Don Graham convinced their Bulgarian colleagues that a grain receipts system could work.

Since 1999, about \$20 million in credit has been extended against grain warehouse receipts in Bulgaria without defaults on loans issued against warehouse receipts.

"It takes a week for a creditor to seize and sell collateral in Germany, Ireland, Tunisia, and the United States. But it can take five years in Bosnia and Herzegovina, Brazil, and Chile."

DOING BUSINESS IN 2004, WORLD BANK

Strong creditor rights and more information sharing—principles followed by the Bulgarian reformers—are associated with lower default rates, according to studies cited in the World Bank's *Doing Business in 2004*.

ACDI/VOCA has helped introduce grain warehouse receipts or similar systems in Hungary, Poland, Croatia, Kazakhstan, Macedonia, Romania, Russia, and Serbia. It is currently working on similar projects in Ukraine, Ethiopia, and Kenya. ★