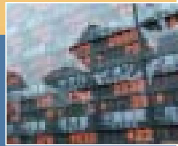
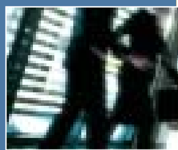
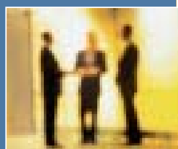
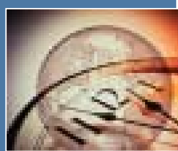
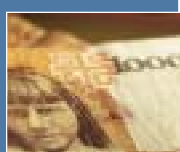
The IDB Business Climate Initiative

2005 Annual Report



Inter-American Development Bank

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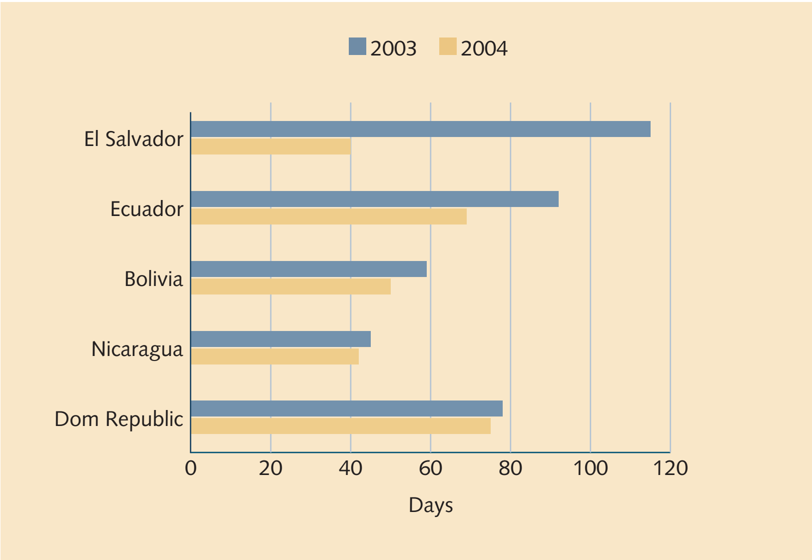
The State of the Business Climate in Latin America and the Caribbean

Indisputably progress has been made since 2003, when the Inter-American Development Bank group (IDB group) launched its Business Climate Initiative (BCI). Brazil's new bankruptcy law halves the time required to go through the proceedings from ten to five years, a reform of the company registry in El Salvador shortened procedures by 75 days, and a number of countries including Dominican Republic, Jamaica, Honduras and Ecuador moved to decrease considerably the cost of company registration. Custom procedures were the focus of reforms that shortened the processing time in Peru, Colombia and Guatemala. Throughout the region there is a renewed sense of optimism boosted by economic trends that are the best they have been in 25 years. Inflation rates that are the lowest since the 1960s, a 19 percent jump in exports demonstrates a vigorous capacity for trade, commodity prices are strong, and economic growth is projected at 4.5 percent for 2006.

In particular, five countries have made business start-up 29 percent faster on average: in El Salvador business start-up now takes 40 days, cutting the time from 115 days. Ecuador cut the time from 92 days to 69 days. Bolivia from 59 to 50 days, Nicaragua from 45 to 42 days. Dominican Republic from 78 to 75 days (see Figure 1).

FIGURE 1: STARTING A BUSINESS - TIME (DAYS)



Source: Doing Business Database.

Furthermore, progress was made in 2005 regarding the costs associated with starting a business. The more cumbersome and costly the registration process, the less likely it is that many entrepreneurs will register businesses. Fifteen countries have reduced start-up costs. Among them, Ecuador, Nicaragua, Argentina, Brazil, Haiti, Honduras and Bolivia have cut costs between 11 percent and 20 percent (see Figure 2). Despite these improvements, the Latin America and the Caribbean is still the third most expensive region in the world with a business start-up cost of 56 percent of GNI per capita, compared with a 6.8 percent cost in OECD high-income countries, and 13.5 percent in Europe and Central Asia.

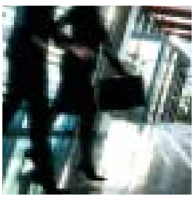
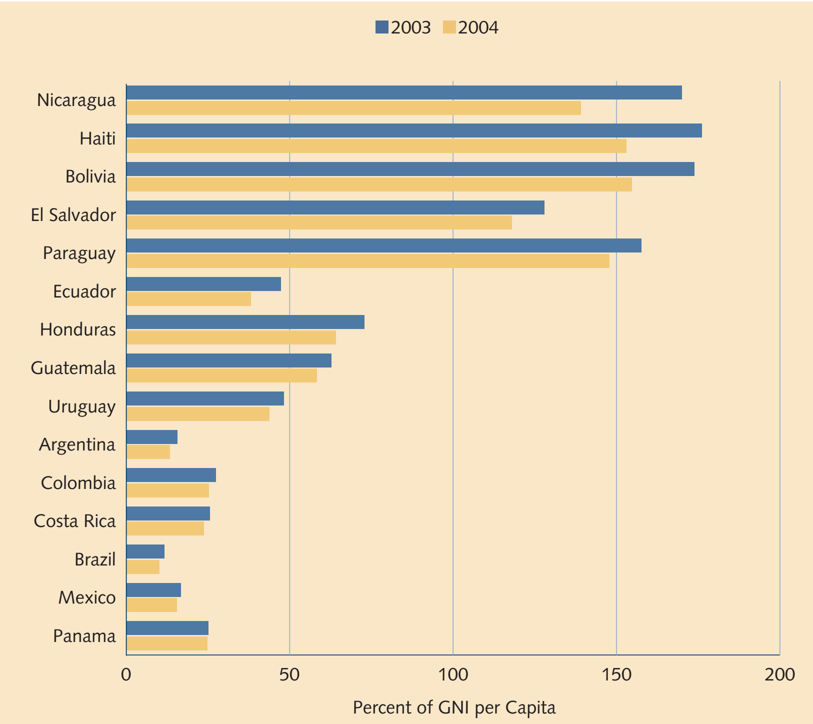


FIGURE 2: STARTING A BUSINESS - COST (% OF GNI PER CAPITA)



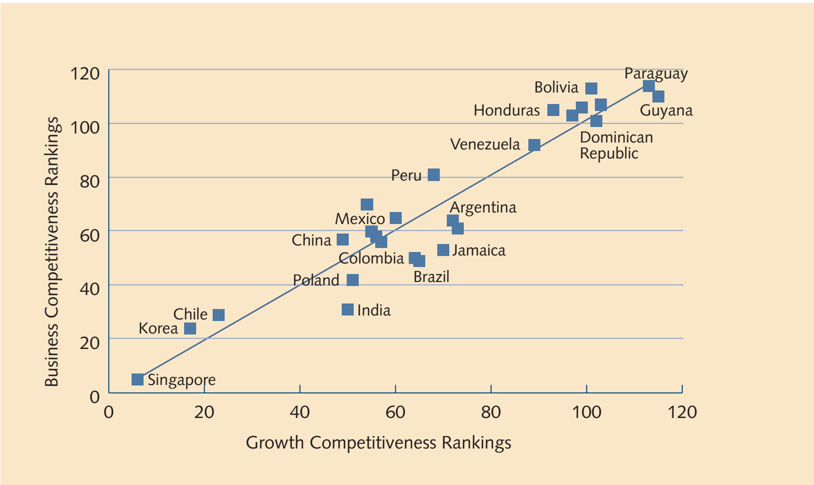
Source: Doing Business Database.

In spite of progress, it is clear that much remains to be done. Latin American businesses are still hampered by some of the lowest levels of access to capital, the most rigid labor laws, the highest taxes, and the most burdensome rules to register or dissolve companies. More importantly, 40.6 percent of the population, a staggering 213 million people, remains poor, and 88 million of them (16.8 percent of the total) live in conditions of extreme poverty (defined as less than US$1 per day). Prominent among the failures that give rise to a widening poverty gap are issues relating to the lack of support for private sector development in the region, such as lagging investment in basic infrastructure, inadequate institutions, and a business climate that favors informality and creates high administrative and economic burdens for the private sector. Crippling bureaucracies, widespread corruption and an ineffective judiciary clearly hamper the functioning of the private sector.

Furthermore, inadequate secured transaction frameworks, insufficient fiscal policies, and weak infrastructure create further obstacles for investors. By producing goods and services, creating jobs, being a significant source of tax revenues for governments, businesses play a fundamental role in economic growth and poverty reduction.

The significance of the business climate for competitiveness and economic growth is underscored by the high degree of correlation that there is between the rankings on the Business Competitiveness Index and the Growth Competitiveness Index.[1] The first index focuses on the underlying microeconomic factors that determine economies' current sustainable levels of productivity and competitiveness, including the sophistication of company operations and strategy and the quality of the overarching national business environment in which they are operating, while the second index has a more macroeconomic approach and measures the quality of macroeconomic environment, the state of the public institutions, and the level of technological readiness.

FIGURE 3: GROWTH AND BUSINESS COMPETITIVENESS RANKINGS



Source: World Economic Forum, Global Competitiveness Report 2005-2006.

1 Source: World Competitiveness Report of the World Economic Forum.

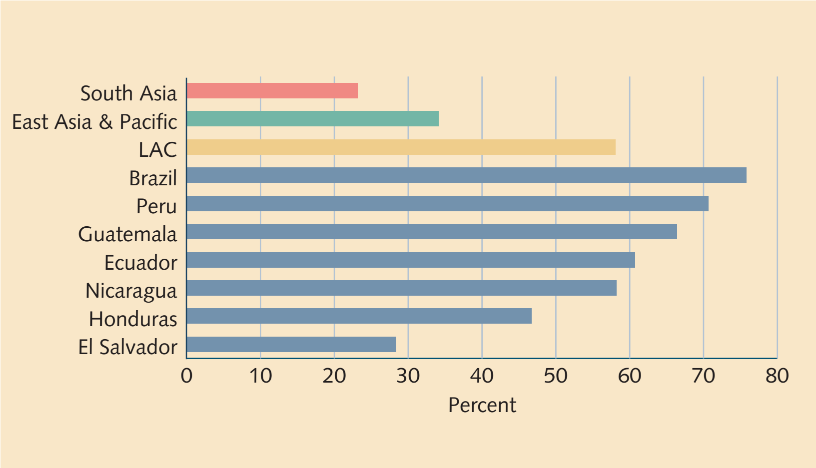
According to the latest Global Competitiveness Report, Argentina, El Salvador, and Uruguay improved their rankings on the Business Competitiveness Index: Argentina benefited from improving measures of innovative capacity, and Uruguay improved through reductions in bureaucracy and reliability of police services. Nevertheless, both countries rank lower than their 2002 levels. Middle-income countries falling in competitiveness rank include the Dominican Republic, and Brazil, due to persistent bureaucracy, corruption, and foreign ownership restrictions. According to the most recent Global Competitiveness Report, micro-economic failures "account for 80 percent of the variation across countries in the level of GDP per capita…, and nullify macroeconomic and social programs."[2] As a nation's standard of living is determined by the productivity of it's economy, it is clear that factors that hamper the well functioning of the private sector have deep repercussions on a country's ability to compete in a global market: highly successful countries such as Singapore and Korea score very well in terms of the Business Competitiveness Index.

A good business climate provides not only opportunities and incentives for firms to invest and expand, but it allows the dynamic force of private initiative to be unleashed and innovation to take place. Private sector growth, therefore, depends largely on the way government policies and behavior shape the business climate, and how competition in the marketplace disciplines productive factors. Businesses look at local factors such us property rights, regulation, taxes, finance, infrastructure, trade, labor markets, corruption, and other areas to evaluate opportunities and incentives to invest. For that reason, government policies and behaviors play a key role in shaping the business climate by removing unnecessary costs, risks, and barriers.

In particular, the countries of Latin America stand out in national comparisons for reporting higher levels of policy uncertainty than any other region in the world: for example, nearly 90 percent of Guatemalan firms report that regulations are not interpreted consistently. The comparable figures for Peru and Brazil are 79 and 66 percent, respectively. However, in South Asia, only 2 percent of firms report policy uncertainly as a problem.

2 Porter, M., Building the Macroeconomic Foundations of Prosperity: Findings from the Business Competitiveness Index. World Competitiveness Report 2005-2006. World Economic Forum, Geneva, 2005.

FIGURE 4: ECONOMIC AND REGULATORY POLICY UNCERTAINTY

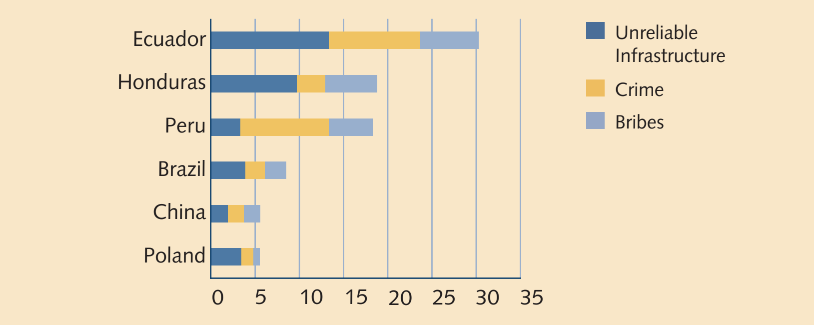


Source: World Bank, Enterprise Surveys.

In a worldwide comparison of the costs that entrepreneurs have to assume to produce their goods or provide their services, businesses in the region clearly have a competitive disadvantage because of the multitude of charges and costs that stem from regulatory and infrastructure inadequacies: high among the extra charges that Latin American business have to bear is corruption, as well as inadequate infrastructure that causes service disruptions. Corruption is reported as the second most severe constraint in the region,[3] adding between 5 and 10 percent of cost to production. In a global market, this creates a significant competitive disadvantage for companies operating in the region (see Figure 5).

3 Hallward-Driemeier, M., and D. Steward, How Do Investment Climate Conditions Vary Across Countries, Regions and Type of Firms? World Bank, Washington, 2004.

FIGURE 5: COSTS RESULTING FROM BUSINESS CLIMATE FAILURES AS A PERCENTAGE OF SALES



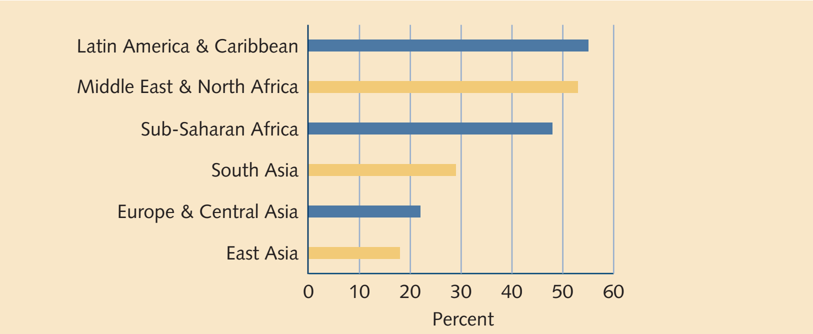
Source: World Bank ICS data.

Furthermore, recent worldwide comparisons indicate that countries in the region have largely neglected investment in infrastructure. A comparison of the growth rate for infrastructure density in Asia and Latin America, shows that during the 1980-1997 period the number of telephone lines per worker increased 64 percent more in Asia than in Latin America, the stock of electricity generation assets increased by over 100 percent, and the road network by 43 percent. During the period this infrastructure gap is estimated to account for a 25 percent of the GDP disparity that has been widening over time. A comparative survey of firms in China and Brazil[4] reveals that interruptions in utility services have significant negative effects on total factor productivity by causing idle labor and wasted capital inputs, and that especially outages in electricity saddle Brazilian companies more than Chinese ones. Losses from electrical outages can surpass 10 percent of sales, rapidly eroding already low margins. When added together, problems with electricity, telecommunication and transport are reported as a constraints by over 60 percent of firms operating in the region.[5]

4 Subramanian, U., W.P. Anderson and K. Lee, Measuring the Impact of the Investment Climate on Total Factor Productivity: The Cases of China and Brazil. Working Paper 3792. The World Bank, Washington, D.D., 2005.

5 Hallward-Driemeier, M., and D. Stewart, How do Investment Climate Conditions Vary Across Countries, Regions and Types of Firms? The World Bank, Washington, D.C., 2004.

FIGURE 6: INADEQUACIES IN INFRASTRUCTURE REPORTED BY FIRMS



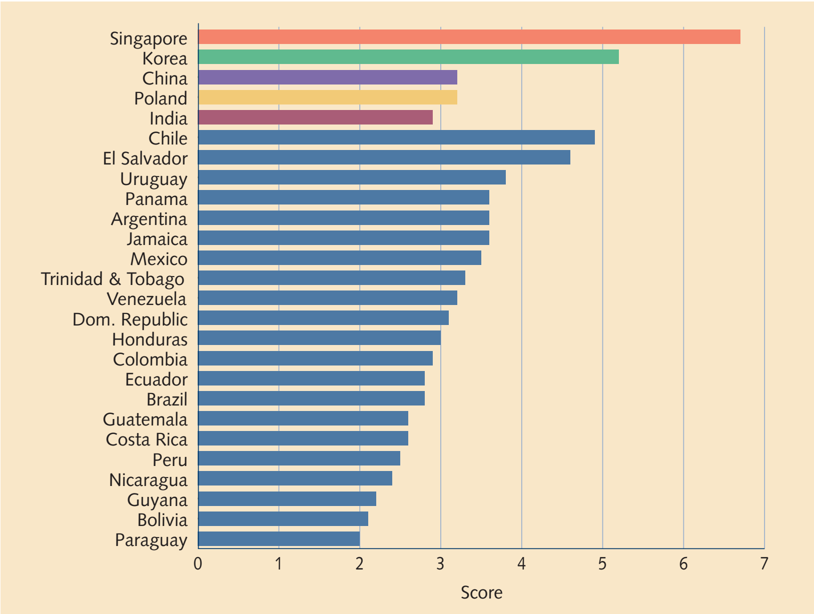
Source: World Bank ICS data.

It is easy to see why entrepreneurs in the region report the state of infrastructure in the region as an obstacle: a comparison of the stock in the region with other medium income countries clearly shows that almost every country lags its comparators, with the exception of Chile and El Salvador. Closer scrutiny of the data indicates that cross-country and in-country regional differences are to be observed among these averages: in Costa Rica, 98 percent of households have electricity, while in Peru only 69 percent. Furthermore, coverage disparities between urban and non-urban areas are even more striking: rural access to water in Brazil and Chile is 58 percent and 59 percent respectively, even lower than that in poorer countries such as Burundi (78 percent) and Zimbabwe (74 percent).[6] In Colombia, a third of the rural population does not have access to the road network: the region as a whole is trailing significantly other part of the world in providing access on a timely basis, and reliability of services adds another layer of problems local entrepreneurs have to overcome. Throughout Latin America and the Caribbean, 125 million people lack access to safe water, 200 million people are without adequate sanitation and about 70 million people do not have reliable rights to use to electricity:[7] this not only affects the stubborn levels of poverty experienced in the region, but also the ability of non-urban communities to engage in productive activities and create jobs and livelihoods where they live.

6 Fay, M., and M. Morrison, Infrastructure in Latin America and the Caribbean: Recent Developments and Key Challenges. Volume 1: Main Report. The World Bank, Washington, D.C., 2005.

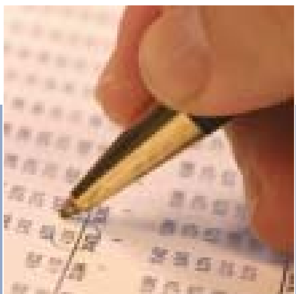
7 Source: World Bank data.

FIGURE 7: OVERALL INFRASTRUCTURE QUALITY



Source: World Economic Forum, Global Competitiveness Report 2005-2006.

In addition, regulations directly effecting trade are also still a bottleneck in many countries in the region: days to clear customs both for import and for export are nearly double OECD's averages, and nearly all of the countries surveyed in Latin America and the Caribbean come in the bottom half of rankings in this area.



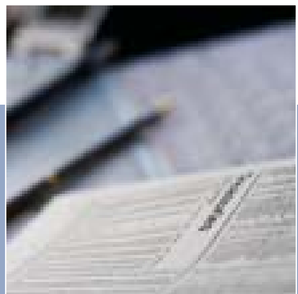
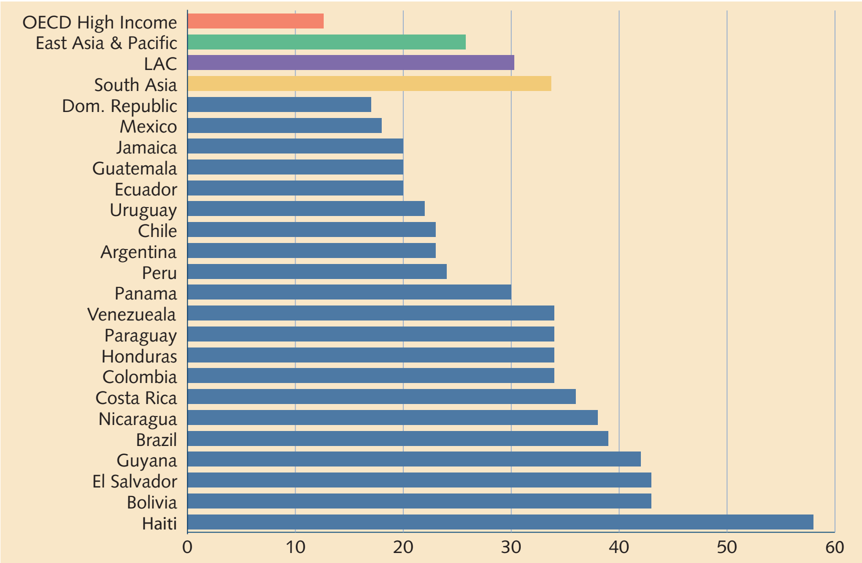
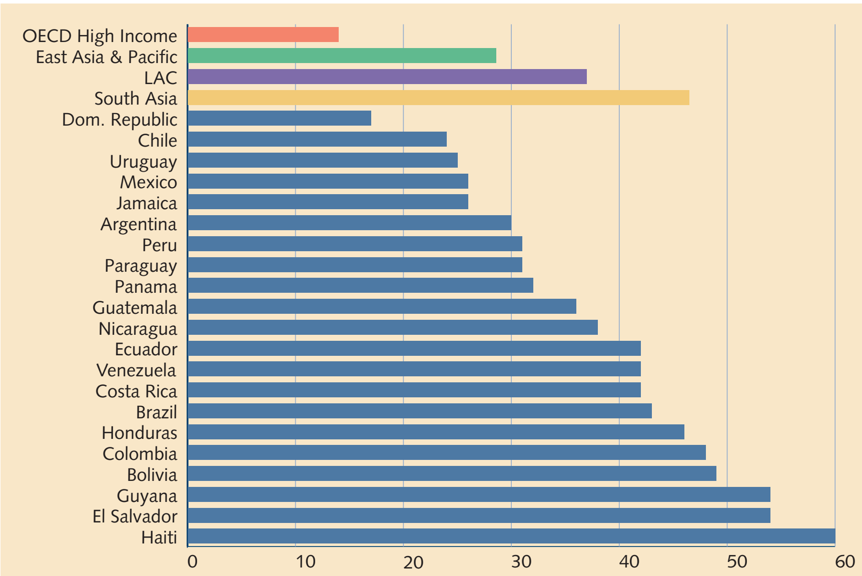


FIGURE 8: TIME FOR EXPORT (DAYS)



Source: Doing Business database.

FIGURE 9: TIME FOR IMPORT (DAYS)



Source: Doing Business database.

It is thus not surprising that in international comparisons of competitiveness the region not only performs behind its comparators, but has been slipping from the rankings over the past few years. World Economic Forum's data shows that, of 21 Latin American countries covered by the index, 16 countries have fallen in the rankings and only 4 have improved compared to their rankings in 2004. As in previous years, Chile tops the charts for the region and is among the top 30 worldwide, and only Uruguay, Colombia, Argentina and Honduras have made progress.

TABLE 1: LAC GROWTH COMPETITIVENESS RANKINGS

COUNTRY	2005	2004
Chile	23	22
Uruguay	54	55
Mexico	55	48
El Salvador	56	53
Colombia	57	64
Trinidad and Tobago	60	51
Costa Rica	64	50
Brazil	65	57
Peru	68	67
Jamaica	70	65
Argentina	72	74
Panama	73	65
Venezuela	89	85
Honduras	93	97
Guatemala	97	80
Nicaragua	99	95
Bolivia	101	98
Dominican Republic	102	72
Ecuador	103	90
Paraguay	113	100
Guyana	115	–

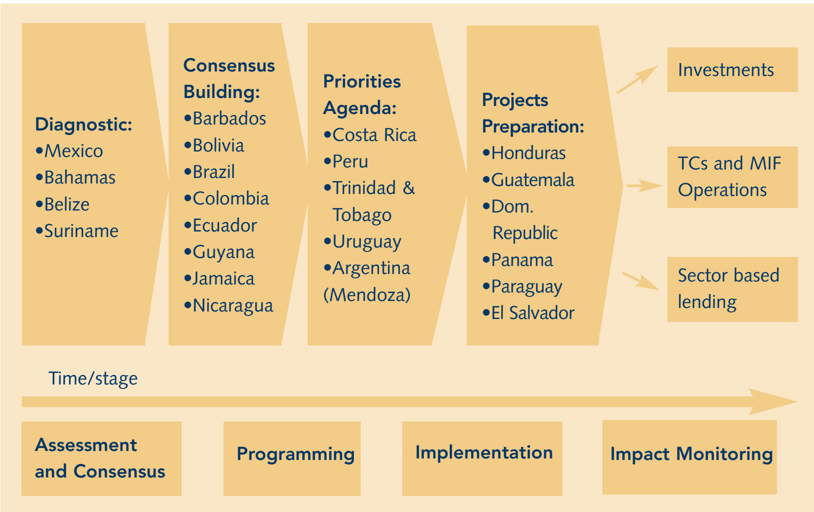
Source: World Economic Forum, Global Competitiveness Report 2005-2006.

Status of Implementation of the IDB's Business Climate Initiative

During 2005, the BCI focused more on operations rather than identification of the problems areas. In many cases mobilizing governmental and private sector support to remove obstacles was instrumental in shaping the action plans that will guide future work. During the year four more countries (Brazil, Dominican Republic, Mexico and Panama) joined the initiative, bringing the total number of countries that have adhered to 24. In addition, in three large countries (Argentina, Brazil and Mexico) a focus on the sub-national level will be used to address local impediments to private sector development.

Overall, diagnostic work was completed for most countries, and the consensus building and validation phase was finalized for ten countries, five action plans were finalized, and numerous project were identified and are now in the implementation phase. Eighteen projects that have BCI components were approved during the year, for an amount of US$9.25 million. In addition, several other projects that are directly related to BCI, such as modernization of customs, modernization of tax systems, and rationalization of registration procedures (ventanilla única), were also undertaken. The graph below summarizes the stage reached by each of the countries involved in the initiative, and it gives a quick summary of the progress made on the ground.

GRAPH 1: BCI IMPLEMENTATION STATUS BY COUNTRY



In general, the expectations about the BCI activities are growing among all stakeholders. Although, progress in the implementation of the BCI in the region has been uneven from country to country due to the divergent contexts, progress is supported by a growing awareness of the impact of such reforms on the overall economic outlook of the country.

The diagnostic phase allowed a number of collaborations with other multilateral and bilateral institutions: one example, is the collaborative effort with the World Bank, funded by the BCI Special Budget Initiative, that led to the preparation of an Investment Climate Assessment (ICA) for Costa Rica. Diagnostic work for this country was also carried out on small- and medium enterprises (SME) lending and the concessions framework. In addition, the Bank has approved a technical cooperation program to finance, together with the World Bank, the Business Climate Enterprise Surveys to complement the work being done to collect baseline data on individual countries' business climate by the Bank and by other multilateral agencies and bilateral donors. This type of surveys provide a systematic review of the realities found by local businesses and firms, and capture data on a broader set of issues than any other available study. Moreover, the collaborative effort is part of a broader cooperation among multilateral organizations to carry such surveys worldwide and provide a global public good product that would allow benchmarking across regions. Furthermore, The Latin American Competition Forum, co-organized by the IDB with the OECD, as well as the Peer Reviews undertaken jointly by the two institutions with a number of member countries (Mexico, Peru, Brazil, and Chile) although is not to date part of the BCI initiative, are two additional and important examples of collaborative efforts to contribute to the improving the business climate in the region.

In order to facilitate and speed the validation process for diagnosing issues and formulating BCI action plans, the Bank also increased its reliance on, and use of, public-private consensus building mechanisms, such as National Competitiveness Councils, and the development of private sector advisory boards that work with the Bank's Country Offices. Some examples of highly successful partnerships with the private sector have emerged in Belize, Dominican Republic, Guatemala, Honduras, El Salvador, and Panama, among others.

The IDB group has also experienced successful cooperation with several governments in the preparation of the BCI action plans that detail the obstacles that need to be removed as a matter of priority, and the specific interventions that will be taken to address them. Four action plans were completed for El Salvador, Paraguay, Uruguay, and the Dominican Republic. In addition, an action plan proposal for the Province of Mendoza in Argentina was finalized and it is expected to be signed during the first trimester of 2006. Numerous other countries have started discussions regarding their action plans and it is foreseen that several others will be in place by mid-2006 so that teams can quickly move forward to complete them.

TABLE 2: SAMPLE OF IDENTIFIED ACTIVITIES

COUNTRY	ACTIVITIES
Bahamas	Targeting the problems of costly and time consuming licensing, the activity aims at increasing the transparency of licenses' issuance and shortening permit processing through the Bahamas Investment Authority.
Colombia	Targeting the issue of enforcing contracts, the activity aims at rationalizing the documentation required and improving efficiency of processing through the Implementation of Tramitometro.
Ecuador	To improve the timely processing of custom procedures, the activity aims at modernizing the customs information system to incorporate risk profiles and the automatization of most processes.
Honduras	To tackle the issue of access to credit for private companies, the activity aims at improving the framework for secured transactions so that the whole process, from registering and publicizing collateral, to executing a security interest function smoothly.
Jamaica	To improve the access to arbitration for small enterprises, the activity aims at improving access to commercial courts through a reform of the Arbitration Act .
Panama	Updating the legal code for maritime activity to permit increased activity in cargo, flagship activities, and new financing techniques based on international legal standards for the sector.
Paraguay	Targeting the cost and time it takes to meet all export requirements, the activity created a Ventanilla Unica for exporters.
Peru	To deal with weak land and property rights, the activity aims at lowering registration, titling and formalization costs through implementation of legislative and institutional reforms.
Uruguay	Because of the poor utilization of Free Zones, the activity aims at improving the transparency of application of Free Zone regulations by improving controls and tightening their regulation.

Within the project implementation phase, the IDB group approved various pilot projects, not all of them specifically pertaining to the BCI, but closely related to achieving the same objectives. The Bank group provided support through other operations that, although were not specifically designed as part of the BCI, include activities directed to improve the business climate. In 2005, approximately 16 loans and technical cooperation loans were approved for an amount of US$961 million. Additionally, 30 technical cooperation programs were approved for up to US$11 million. These operations have covered a very wide range of topics, including, alternative methods for dispute resolution, judicial system reform, secured transactions, reduction of red tape, development of financial markets, promotion of competition, infrastructure development, fiscal reform, trade, technology and innovation, among others.

As a result of the action plans already developed, a number of projects were identified to address regulatory, institutional and market barriers to business activity, and some of them were selected for development in a pilot phase in 2005. These projects include work on facilitating government purchases from small and medium enterprises and support for the Competition Authority in El Salvador; creating a unified legal framework for the maritime sector in Panama; and development a faster registration process for firms and a new legal framework for incorporation in the Dominican Republic. Additional, reform activities were carried out to improve port and airport administration, enhancements to the institutions regulating labor training and science and technology, among other issues (El Salvador).

Furthermore, a pilot program was launched on developing a secured transactions framework for Honduras. This project aims to facilitate better access to credit for the private sector through the creation, perfection and execution of security interests. Addressing the problems faced by businesses and people to use collaterals requires a new law, procedures, and reforms in the registries. To date, a diagnosis on the current status of the secured transactions system and draft legislation *Ley de Facilitación de Acceso al Crédito* have been prepared in conjunction with the government authorities. During 2006, the Bank will move forward to complete the implementation of this project.

BOX 1: IMPROVING THE EXPORT PROCESS IN PARAGUAY

Engaging the private and the public sector in the dialogue and action for reducing export procedures from 30 days to less than 1 day

One of the identified obstacles in the diagnostic in Paraguay was the export process, which was described as cumbersome and time consuming due to the multiplicity of export registries and the amount of intervenient public agencies in the process.

The Bank's team in collaboration with the head of the *Unidad de Ambiente de Negocios* worked to remove the coordination problems between the Ministry of Economics and Industry and the National Customs. The inclusion of this obstacle during the *validation process* and its inclusion in the *BCI action plan*, raised awareness among public officials regarding the priority of the issue for the private sector. As a result, the coordination problems were rapidly resolved and by the end of 2004 the unification of the export register *(Registro Único de Exportadores)* was completed, converting what used to be 20 different registers into a one-stop shop register for exporters.

During 2005 the second component of the export procedure *(despacho de exportación)* for 5 products (meat, soy, cotton, corn and leather), representing 80% of total exports, was computerized gaining in transparency and saving time. In fact, before the creation of the *Ventanilla Única de Exportadores* the procedure for exporting meat, for example, used to take between 25 and 30 days because it had to be approved by 16 different agencies in a sequential procedure. Now, the agencies are connected online in an automatic approval procedure, which requires less than one day to obtain the certifications needed to export meat.

OVERALL ASSESSMENT OF THE INITIATIVE FOR THE REGION

The Initiative is moving ahead throughout its different implementation phases. It has been very well received by the private sector in the countries where the BCI was introduced. However, this positive reception has been accompanied by a reminder to take into account the critical role of a public sector leadership needed to support and undertake the BCI activities.

Coordination among the different Bank's Departments and the IIC and MIF to implement the BCI, was improved to ensure close internal collaboration and efficient use of resources. Private Sector Liaisons in each Country Office and Private Sector Networks were also brought in as internal resources to make sure that all relevant means would be activated to make the initiative a success.

An important element in the implementation process has been the creation of an integrated approach to support private sector activities among the various windows of the Bank group. The key element for this coordination has been private sector missions and consultations with the private sectors that have led to the preparation of the Strategic Guidelines in Support of the Private Sector. In 2005, Guideline documents were prepared for El Salvador, Guatemala, Honduras, Panama and the Dominican Republic and these served as inputs to the Bank's policy dialogue and Country Strategies in the respective countries.

BOX 2: CASE STUDY – EL SALVADOR

The Bank has made a coordinated effort to design a private sector program that uses the various instruments in a coordinated and coherent fashion. The initial work involved a review of existing diagnostics, including studies by the World Bank, USAID, and local institutions such as FUSADES. Following this was a private sector mission that included all the lending windows of the Bank group. The result of this effort was a Guideline document that outlined the key areas for Bank intervention, namely: (i) improvement in the regulatory framework for public-private activities; (ii) development of a national innovation and training strategy; (iii) improving the legal framework for investment; (iv) developing longer-term financing sources; (v) facilitating private investment in infrastructure, and (vi) support for economic integration efforts. As a follow on to this effort, a BCI Action Plan was prepared to identify potential projects that reduce red-tape, improve institutional performance, and lower transactions costs for businesses. The Action Plan identified 3 key areas of intervention that were ready for rapid launch, feasible, and cost effective, these were: (i) a one-stop shop for imports to reduce processing from its current level of 8 days; (ii) facilitation of purchases by the government from PYMES by reducing the costs for their participation in government procurement bids; and (iii) support to the Competition Authority to ensure a rapid launch to the activities of the newly created institution. By year-end the support to the Competition Authority was funded by a technical cooperation and work was begun on the government procurement project, culminating in preparation of a financing proposal for consideration by the Bank group. Parallel work on developing a venture capital mechanism for innovation was also launched as part of the strategic approach set out in the Guidelines, with a technical cooperation project support work by FUSADES to develop Fundación Innova.

MIF CONTRIBUTIONS TO THE BUSINESS CLIMATE INITIATIVE

The Multilateral Investment Fund provides significant technical assistant support for operations that include activities directed to improve the business climate of the LAC countries. In 2005, the MIF approved 16 technical cooperation programs to support better regulations, taxation, access to financing, infrastructure, trade, foster skilled workforces, facilitate resolution of commercial disputes and others. Below are a brief description of some MIF specific interventions.

Within the region, the private sector suffers from constraints on its access to efficient, transparent, independent and predictable justice, which increased its transaction costs and discouraged. To mitigate the shortfall in justice services and to improve the conditions for private sector development, the MIF has approved during the year two projects to support alternative dispute resolution mechanisms (ADR). These new technical cooperation programs increases the MIF's ADR portfolio to 20 projects. According to an evaluation undertaken by the Office of Evaluation and Oversight (OVE) in 2002,[8] "the results of the MIF's ADR portfolio have been very positive. Its intervention in the market was a key contribution to promoting the use of ADR for the resolution of commercial disputes. It has had a strong impact on the change in the region's legal culture and on universalizing the use of ADR."

The first ADR project approved during the year will establish within the Chamber of Commerce and Industry of Haiti, an operational and sustainable Center to provide ADR services. In addition, it will build an awareness of ADR as a way to resolve commercial disputes, develop local capacity through a training program, and promote the establishment of strategic alliances with other private sector institutions and universities. The other technical cooperation program will support the design and implementation of a sustainable specialized labor conciliation and arbitration service under the Ministry of Labor and Social Security in Honduras.

In addition to the ADR projects, the Bank has approved 4 projects to improve the justice system. One of the programs will assist Chile to increase the efficiency and quality of the services the Corporación Administrativa del Poder Judicial (CAPJ), an agency of the Supreme Court, provides to the judiciary, thereby enhancing service within the justice system in Chile. The program is expected to produce significant benefits for the strengthening of judicial management, which will result in improved service delivery within the justice system. Also, three technical cooperation programs for Bolivia, Costa Rica and Guyana were approved in this area.

8 Office of Evaluation and Oversight. MIF Projects: Alternative Commercial Dispute Resolution Methods. MIF/GIN-78-2, November 2002. Document presented to the MIF Donors Committee.

BOX 3: CREATION OF COMMERCIAL COURTS IN PERU

One of the main obstacles to private sector development identified in Peru is the slow and uncertain judiciary system along with the limited extra-judicial alternatives for business conflict resolution. This results in poor enforcement of contracts in general and dramatically increases the costs and risks of doing business.

The Bank through a Competitiveness Policy Based Loan (PE-0239) has supported the creation of specialized commercial courts which have proved to be a viable alternative worth replicating. Seven such courts were established as a condition of the competitiveness program. In the 10 months since they started to operate (April 2005) an average of 355 commercial cases have been processed and resolved by each commercial court. Previously, the average time to execute a bank guarantee in a civil court was approximately 32 months, while the average execution time in the newly created commercial courts has been cut down to 6 months. This action is expected to have a major impact in alleviating some of the main difficulties faced by businesses.

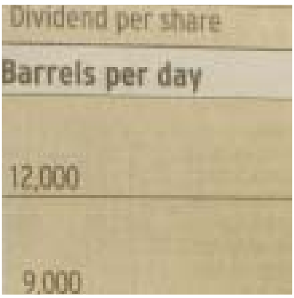
Although the seven commercial courts currently functioning represent a clear step in the right direction, there is a need to expand the number of courts to at least 14 in the area of Lima, plus some others in selected cities to maintain their current processing time and quality of service.

Another technical cooperation project approved will create a sustainable and efficient one-stop window for private sector services that reduces the time and cost of procedures for the registration and operation of companies and professional activities in the Municipality of Cuenca, Ecuador.

LESSONS FROM IMPLEMENTATION

The experience acquired by the IDB group in the design of competitiveness programs and stand-alone technical cooperation and grants activities, demonstrate that work in the area of business climate requires a programmatic approach in order to be successful. At the same time, the breadth of topics covered requires setting clear targets and the identification of strategic partners. For example, work with firms in specific sectors or geographical areas require a bottom-up approach to define issues and identify specific sector barriers to investment. These partnerships should include public and private participation to ensure the greatest degree of coordination and effectiveness. Additionally, it is clear that the measures should be demand driven and consensus-based to ensure that they provide resources to priority activities and have the "political will" needed to sustain them over time. In this regard, when feasible, cost sharing approaches are ideal to guarantee that the partners are committed to obtaining results of specific interventions.

Legal and regulatory challenges will require various policy and institutional reforms to be applied over a period of time: change takes time and in some cases the adjustments required infringe upon the vested interests of categories that will resist sternly any threat to their traditional modus operandi. Thus, this initiative cannot be seen as a collection of disparate projects, but rather as a process set in motion to achieve incremental improvements over time. Thus effective monitoring tools need to be developed to track and follow up on individual initiatives. Further, benchmarking and best practices need to be identified and shared with public and private sector actors.



As a result, the importance of identifying the appropriate counterparts in the private sector and developing credible and effective mechanisms for dialog and project preparation has become very apparent, as ownership of those changes by stakeholders is critical to maintaining momentum and focus. The BCI takes advantage of existing consensus-building efforts between the public and private sector as tools to further its broader policy goals and ensure continuity, and wherever possible attempts to foster an increase in the public-private dialogue that is required to make sure that proposed changes have the intended results of facilitating private sector development.

Because of their complexity BCI projects also requires a more rapid and flexible response from the IDB group than traditionally associated with grant and lending programs, and the demands for 'micro' level reforms requires targeted, smaller scale interventions that demand shorter project cycles than those traditionally associated with Bank operations. As the Bank group encounters those challenges, it has strived to overcome them by reacting in a flexible and innovative manner.

Finally, it should be recognized that the BCI has proven to be an effective tool to both identify and catalyze the demand for improvements in the business climate from the private sector, and closer work with these constituents has become part of the Bank group's ongoing dialogue with its local partners. Dialogue about issues concerning BCI is already providing input to Strategic Guidelines in Support of the Private Sector, and is linked closely to the Country Programming efforts. It is also hoped that the program will continue to promote the development of new and innovative approaches to apply lending and non-lending instruments and achieve effective and measurable reform, as the Bank strives to grow closer to its markets.

One of the BCI goals is to support actions that would bring results in the shortest possible timeframe. Teams working on this initiative are learning that in order to get the countries engaged in the process, to carry out the diagnostics, work with the stakeholders, develop an action plan and then design and implement projects, is time consuming. In this regard, the current 3-year timeframe for the BCI may prove to be limiting and should be evaluated as the work program moves forward.

Conclusion and the Year Ahead

While it will not produce the large volumes of lending that the bank can achieve through its other activities, the BCI scores very high in terms of effectiveness and impact on the ground. Research on the impact of development assistance to emerging markets, and the experience of foreign direct investment in Latin America and the Caribbean, suggests that simply increasing financial flows will not provide lasting and cost effective solutions, nor ensure the competitiveness of the countries in the region. By contrast, strengthening the role of the private sector, and allowing the release of the dynamic force of private initiative, offers tangible and sustainable opportunities to sustain economic growth. Thus, directing substantial efforts to improving the business climate in the region offers a powerful means to engaging the business community in harnessing synergies and making sure that unnecessary obstacles saddling the private sector in the region are removed. Only in this manner can the competitiveness of the region be improved.

A good business climate is good for any investor, and governments wanting to reduce poverty and inequality should pay special attention to how excessive regulation and inefficient procedures disproportionately affect small firms. Because of the way in which local specific factors affect the opportunities and incentives for firms to invest and create jobs, problems affecting private sector performance have a disproportionate impact on microenterprises and SMEs (known as MSMEs), which lack the means to overcome unjustified costs, risks and barriers to competition. For instance, inadequate infrastructure tends to have a much larger impact on MSMEs than on large companies because smaller firms tend to rely more on public services and are less able to absorb the costs imposed by market inefficiencies. Many firms and workers in Latin America and the Caribbean have no choice but to operate in the informal sector because of the very high costs involved in complying with laws and regulations, and addressing these issues would prove to boost employment and reduce poverty, as it has been observed in other regions, such as East Asia.

With the Business Climate Initiative, the IDB group is committed to assisting its member countries in the identification and removal of obstacles to the well functioning of their private sectors, and thus to the economic growth of the region. In all, 2005 was a pivotal year, in which the first results have been achieved, and numerous lessons learned are prompting adjustments in how the IDB group works on business climate issues. Because of the significant information and feedback from clients, all available diagnostics, including Action Plans developed, form an important input for the Strategic Guidelines in Support of the Private Sector and the programming activities of the Bank. In effect, the BCI has become an important link between the private and public activities of the IDB group.

For the year ahead, implementation of the measures identified is clearly the priority, and scaling up of project related activities will be closely monitored. IDB's poverty reduction mandate demands that the Bank succeeds in its support of the private sector development, and BCI is central to such efforts. Going forward, monitoring and evaluation of the measures implemented will take a more prominent role, as demonstration of precisely where reforms are working and more improvements are needed will be required to ensure that the initiative is reaching its objectives, and that the measures proposed are efficiently removing the obstacles they are designed to address.

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