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Good Growth and Governance for Africa: Rethinking Development Strategies

Introduction and Overview

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I. The Task

When the countries of Sub-Saharan Africa achieved independence in rapid succession starting with Ghana in 1957, there were high hopes for the region. A group of outstanding leaders would inspire to bring a new era to a sub-continent long suffering from colonial exploitation and developmental neglect. What has happened since has been disappointing: whilst standard economic theory predicts a convergence in economic outcomes, with those countries with lower per capita incomes growing faster than those with higher, there has been divergence, particularly for Sub-Saharan Africa, with incomes per capita in the region stagnating over 1960-2000 (as the gains of the first two decades of that period were wiped out in the next two) and poverty increased when in the rest of the world per capita incomes more than doubled and in some of the most successful developing countries increased four-fold or more (see the figures in Section II). Only the few years before the global economic crisis of 2008 brought respite to this picture of gloom for Africa, as annual growth soared to some 6% during 2006 and 2007, with only the East and South Asian regions exceeding it by a significant margin, but even this period of optimism appears fragile and built on soaring resource prices as much as anything else. This naturally raises the question: Why has the economic growth performance of Sub-Saharan Africa (hereinafter Africa) been so disappointing and more to the point, what are the policy options for reversing that trend? What are the possibilities and policies for Africa to achieve sustained, rapid economic growth and associated structural transformations and begin to catch-up?

These were the questions posed to a group of experts on development, including many specialists on Africa, convened as the “Africa Task Force,” by the Initiative for Policy Dialogue with the support of Manchester University’s Brooks World Poverty Institute and the Japanese Aid agency, JICA. This volume contains the first set of papers reflecting their discussions.

As Africa emerged from colonialism, East Asia was the region in trouble and turmoil: with extensive involvement and destruction in World War II followed by the Chinese revolution (1949), the Korean war (1950-52), insurgency in the Malay peninsula in the 1950s, the bloodbath in Indonesia (1967-68), and the Vietnam war that spilled over into Laos and Cambodia and continued for over three decades. A widely held view at the time contrasted Africa’s promise with Asia’s pitfalls. Thus, just a half century ago, Nobel Prize economist Gunnar Myrdal visited Asia, whose economies then were doing little better than Africa since that time. Even his rich and sophisticated work shared the view

that that continent's prospects were rather dismal.¹ History, of course, proved him wrong, and his timing couldn't have been worse: the continent was just beginning the most rapid period of sustained growth seen anywhere in the world at any time. Stiglitz had been one of the leaders of the World Bank study done in the early 1990s to understand what was responsible for that success, *The East Asia Miracle* described the important role that government had played in promoting savings, education, technology, and entrepreneurship as well as regulating finance and ensuring that financial markets served the needs of society—a view markedly different from that embodied in the “Washington Consensus”² market fundamentalist views entailing a very limited role of the state; the prevailing doctrines at the time in the World Bank and the IMF. (The recent crisis has, of course, bolstered the critique of market fundamentalism.) These ideas have been encapsulated in the notion of the *developmental state*.

Given the disappointing results of reforms that relied excessively on markets, one of the central issues addressed by the task force was *could government play a more active role in promoting development? If so, what should it do? What are the governance requirements of a more activist state? What lessons could Africa glean from the experience of Asia?* There are, of course, many differences between the two regions, leading some to suggest that the experiences in one were of little relevance to the other. Most of the participants in the Africa Task Force disagreed with that conclusion.

But there was one fundamental issue that clearly had to be addressed, and that was governance: Did at least some of the states of Africa have the capacity to play the roles that they would have to play? How could one square accusations of corruption, part of the standard explanations for Africa's failures, with the tasks to be performed by the Developmental State or its more common and feasible variant, the “Developmentalist State”.³ That is why the task force addressed not only the economics of the developmental state, but also its institutional and political dimensions. The consensus of the task force had a strong note of optimism: governments could—and some in fact were—actively promoting development in much of Africa. Success was not around the corner; many difficulties lay ahead; but, especially with well designed assistance from the more advanced industrial countries—and a favorable global economic environment--

¹ Gunnar Myrdal (1968). *Asian Drama: An Inquiry into the Poverty of Nations*. New York: Twentieth Century Fund.

² As Kwesi Botchwey has remarked, “John Williamson ... has said that he did not intend for the policy prescriptions he called the Washington consensus to become a definitive, exhaustive framework to be applied in all developing countries. But quick fixes have a universal appeal and brilliant summaries and intuitions tend to be turned into broader formulas—often over the protests of their inventorsso it was that in Sub-Saharan Africadevelopment strategies in the 1980s and 1990s were defined by structural adjustment programs based on the policies that came to be known as the Washington consensus.” Kwesi Botchwey, “Changing Views and Approaches to Africa's Development” in T. Besley and R. Zaghera (eds), *Development Challenges in the 1990s: Leading Policymakers Speak From Experience*. (World Bank, 2005), p.44.

³ The full-fledged development state refers to the state that governed the market-- in Robert Wade's memorable phrase—extensively and refers to Korea, Taiwan and Japan. Other countries have grown rapidly with a less stringent version of interventionism (e.g. Malaysia, Thailand, Brazil) and could be referred to as “developmentalist states”.

there were good prospects for sustained growth and poverty reduction in several African countries.

The puzzle of Africa's growth has, of course, been a subject of intense debate, and alternative views blaming poor governance, an unfortunate location (geography), or history (colonial legacy), especially after the failure of the simplistic formula of "get prices right, privatize and liberate the magic of the market". As we explain below, most of the members of the Task Force found these explanations or, at any rate, the importance often accorded to them, unpersuasive. Unfortunately, too much of the policy discourse on Africa has been too dominated by these perspectives.

The need to widen the policy debate and space in Africa and some crucial ways of doing so are the dominant themes of the collection of essays that follow. In this introductory chapter, we will not only draw on them and aim to pull together many of their threads but also try to reflect some of the highlights of the rich and wide-ranging discussions that took place in meetings of the Task Force.⁴

There was, of course, no unanimity of views, and later in this introduction, we comment on one key debate. The discussion was lively and at times contentious.⁵ But what was clear was that it was imperative that new strategies be placed on the policy agenda for African countries, if the region is to break out of its "low-growth-and-low expectations equilibrium". And faster growth was necessary to make adequate progress in reducing poverty: if Africa is to reach the Millennium Development Goals (MDGs) even a few years after 2015, approximately a growth rate of around 7 percent is required, a number that corresponds to the *best* performance that average has been able to achieve⁶.

Complexities of African Development

The question of interpreting Africa's developmental experience is not as simple as starkly posed above because of the diversity of African countries and their experiences. The region includes the fastest growing economy in the world during 1960-2000: Botswana. It also includes the long-standing success story of Mauritius and other

⁴ These meetings benefited not only from the participation of the authors of the papers included here, other scholars and staff of development agencies but also a number of distinguished past and present African policy makers. One of them, Kwesi Botchwey, formerly finance minister of Ghana, is a co-chair of the Task Force .. For a list of participants see Annex

⁵ The broad thrust of the discussions coincides with that of this volume, reflecting not only the fact that the contributors to this volume were participants in the meetings but also that several of their contributions benefited from the debate, including critical questioning of their positions. They also benefited from comments by a number of referees who were kind and generous enough to provide comments on various papers included here and who remain anonymous to the authors. For that reason we cannot name them but would like to express our deep gratitude to them.

⁶ Africa's GDP growth averaged at least 7 percent in three years since 1960: in 1969 (7.0%), 1970 (7.8%) and 1979 (7.2%). More recently the figure was around 6 percent in both 2006 and 2007

countries that have experienced fairly rapid growth of 5 percent or more over longish periods of a decade or so such as Mozambique, Ethiopia, Tanzania, Uganda and Ghana. There is also great diversity on such counts as size, natural and human resources, ethnic configurations and regime types.

The answers to the question of inadequacies of policies and how to overcome them is, of course, complicated by the fact that there are a myriad of country-specific or idiosyncratic factors that affect economic performance. The crucial factors determining economic outcomes may have little to do with economic policies. In particular, civil conflicts and failed states are not contexts that are amenable to the sort of policy solutions we are seeking to illuminate. Economic difficulties and mismanagement may or may not contribute in varying degrees to such political meltdowns in particular cases but beyond a point, political failure rules. Economic success may prevent political collapse but it cannot cure it. We have little, if anything to say for such contexts as those of today's Somalia and Eritrea or Mugabe's Zimbabwe or Mobutu's Zaire in Africa (or for that matter such as those of Burma, North Korea or Haiti elsewhere). However, for such post-conflict states as Liberia or Ethiopia, the policy options we propose are likely to be of relevance as serious, committed, developmental regimes embark on rebuilding the economy or moving beyond reconstruction to a path of accelerated development. At any rate, it is the economic policy options for these types of regimes -- whether post-conflict or not -- that we are concerned with. That Africa has and has had many such regimes is clear from many of the contributions to this volume (e.g. those of Mkandawire, Mushtaq Khan, Sen and te Velde, Hanatani and Watanabe), something that sweeping generalizations about problems of governance in Africa ignore.

But still, there is a stylized or "average" African case, which can be useful for engaging in the sort of broad discourse on development strategies that we aimed for. (Much of what we have to say is also relevant to low-income, least developed or late-comer economies in other regions of the world.)

The fact that so many of the countries have succeeded in creating reasonably "good governments" and adopting reasonably "sound policies" (as defined by, at least, conventional standards) and yet have failed to attract non-extractive foreign direct investment or even promote domestic investment has been a major source of concern. Of course, those countries willing to give away their resources for a low enough price can always find some company to take them. But these typically bring relatively few jobs, and often bring harm to the environment. Similarly, if a country gives away a telecom concession at sweet enough terms, it can find an interested investor. The concern is that there has been too little of the kind of investment in manufacturing or service sector that would give rise to sustained growth and job creation.

In this introductory essay we seek to describe and explain Africa's growth, putting its experience within a global context. Section II discusses Africa's lost quarter century, while section III provides a brief contrast with successes in other parts of the world. Section IV briefly describes alternative hypotheses for Africa's dismal performance. Each, of course, has strong policy implications. If the problem is poor

governance, then the fault lies not in the economic policies or in the market, but the public sector, and the remedy is either “fix” the state, or to make sure that it does not get in the way of the market. Such an interpretation has been at the center of one of the main approaches of the international community combined with a belief that government failure almost always trumps market failure. Section V argues against that view in that problems of governance are not always irredeemable and the right question to ask is in what contexts what particular mix of measures to improve governance and markets and in what ways would be appropriate. Section VI suggests, to the contrary, that it has been policies that have over-relied on unfettered markets and excessively restricted the role of the state, inhibiting it from fulfilling its core developmental responsibility, combined with the neglect of the governance reforms needed to enable the state to fulfill those responsibilities that may have played a role in Africa’s failures. Finally, section VII discusses a few other aspects of public policy that are critical to Africa’s success, some of which will be taken up in subsequent volumes.

Before beginning our analysis, there are two more preliminary notes: discussions of policy, especially those from the international economic institutions (the World Bank and the IMF) typically talk about “good policies” and “good institutions.” It is the failure to have good policies and institutions that are usually given center stage in the explanations of Africa’s failures. But the global financial crisis has shed new light on these long standing platitudes: Before the crisis, while defining what is a “good” institution or “good” policy might be difficult, if asked to give an example, a common response would have cited those of the U.S. as exemplary—though, to be sure, its persistent deficits would mean that it would not be given an A+. Indeed, in the East Asia crisis, the countries of that region were told to adopt American style capitalism, with its bankruptcy, corporate governance, and financial regulations. Now, most observers would have to admit that there were major deficiencies in both its policies and institutions. Critical institutions were captured by special interests. The policies adopted—and advocated by the international financial institutions and many OECD governments, notably the US Treasury—contributed to creating the crisis and its rapid spread around the world. The faith in independent central banks has come under attack for lack of transparency and conflicts of interest; the system of self-regulation is a model of what should not be done, as public confidence has eroded. The lesson is that we should be less confident about what we mean by good policies and institutions; and that we should be even more modest in our belief that exact replicas of institutions and policies that may have worked in one context would be as successful in another.

The second observation is that neither the recent growth rates nor the changes in economic fundamentals and structures in Africa that have accompanied this higher growth are adequate in relation to both what is needed and what has been achieved in successful cases, including the African star, Botswana. And Africa remains too dependent on what happens outside of its borders, as the recent slowdown resulting from the global financial crisis illustrates.

This book suggests a set of policy reforms that we believe may be able to meet these higher ambitions. It is based on the notion that long term success rests on societies’

“learning”—learning new technologies, new ways of doing business, new ways of managing the economy, new ways of dealing with other economies. The “old” policies (which we glibly refer to as the Washington consensus policies, described at greater length below) focused on improving economic efficiency *within a static framework*. But the essence of development is dynamic. What matters, for instance, is not comparative advantage as of today, but dynamic comparative advantage. If Korea had focused on its static comparative advantage, it would arguably still be a country of rice farmers.

We also argue that we need to think about governance in a way which is markedly different from the way that it has been thought about in the past. Successful development requires that the state play an important role. Failed or failing states with dysfunctional and egregiously corrupt governments obviously cannot do that. But much of the discussion on governance has focused on restricting and restraining the state, not strengthening it to enable it perform the roles it needs to perform as a catalyst for growth and development.

These are the two simple but powerful messages of this book.

II. A Disappointing Record

On average, and in most countries of Africa, per capita income in 2000 was not much above its level in 1960 and lower than in 1970. Even after the improved growth performance of the region after 1995, per capita income on average had barely reached the level of the early 1970s by the later part of the first decade of the new millennium. (See the figures at the end of this section). Other features of this disappointing performance are noted below. But the reasonable average annual growth of around 5 percent achieved during 1960-75 and the acceleration of growth in the past decade to roughly that level once again show that Africa is not by any means doomed to economic stagnation or decline that characterized the quarter century or so that these periods of reasonable growth bookend. This is the more so given the ample scope for improving policies that are the focus of this volume and that are made more compelling by not only the modesty of the growth itself, but also its nature, including notably the lack of economic or export diversification (see below). Moreover, even the accelerated growth of 1995-2005 remains below the rates achieved during 1960-80 or 1965-75.

This stagnation is related to the lack of diversification of the economy as a whole. The share of manufacturing has been generally declining since 1980 (as has employment in the formal sector): at 14.3 percent on average the share of manufacturing in GDP in 2006 was actually lower than the 15.9 percent reached in 1965. Relatedly, there has been little success in exporting manufactures and in attracting foreign direct investment (FDI) in non-extractive industries. Much of the growth of the past decade is accounted for by extractive activities in non-renewable resources – metals, minerals, above all oil. Such growth is of questionable value, if all or most of the income generated by using non-renewable resources is consumed or wasted rather than used to create assets. Yields in agriculture have also stagnated, and this has had important adverse implications for the

reduction of poverty. But the stagnation in agriculture is not a surprise, given the low levels of investment. The level of irrigation remains far below that of Asia: only 4 percent of arable and permanent cropland, compared with 39 percent in South Asia and 29 percent in East Asia. Relatedly fertilizer use of 13 kg per hectare in Africa contrasts with 90 kg in South Asia and 190 kg in East Asia.⁷ Africa is still to benefit from a “green revolution.”

Whilst it is difficult to measure learning and the acquisition of technology directly⁸--what we argue is central to sustained growth-- all these trends suggest there has been precious little of that. Moreover, the global crisis that broke out in 2008 highlights the vulnerabilities of commodity-dependent African economies and the importance of breaking out of the “structural stagnation” of Africa.

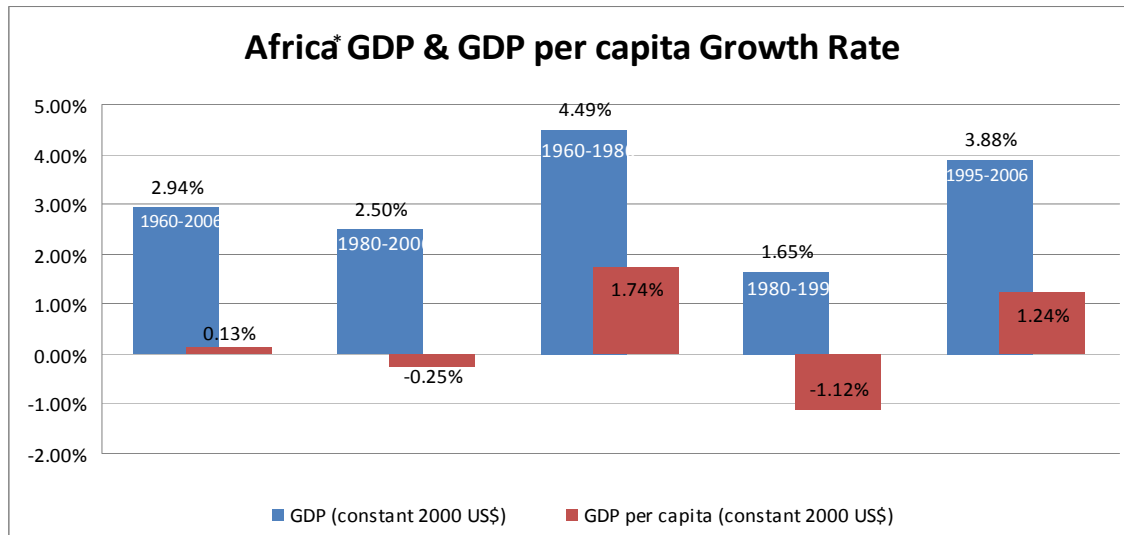
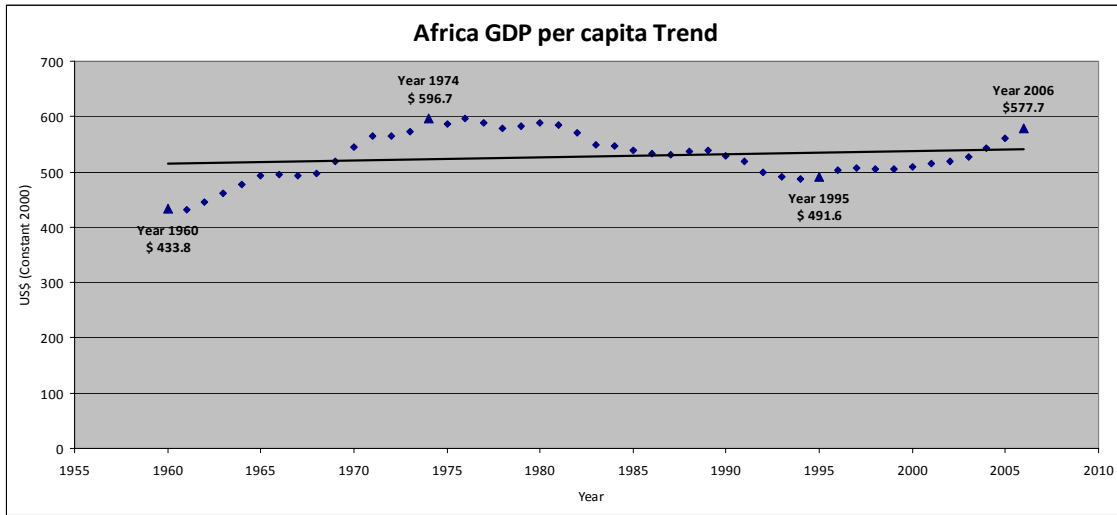
There are, of course, a myriad of country-specific factors that affect economic performance. Learning lessons of success and failure involves not merely documenting and interpreting policy lessons but adapting them to particular country contexts. This is as true in Africa as it is in East Asia, where the mix of policies varied considerably across countries and over time (as emphasized, for example in the contributions of Hanatani and Watanabe and of Ohno and Ohno). There are controversies in interpreting lessons and on the extent or perhaps even the need to reform the reforms.

There is, for instance, a broad consensus that some of the policies pursued by many African states contributed to the problems facing many of the countries by the late 70s or early 80s: highly overvalued exchange rates, macroeconomic instability, irrational and extreme protection, un-or-counter productive rent seeking, bloated bureaucracies and public sectors, and dysfunctional financial sectors became all too common. Frequently, extensive and excessive interventions were undertaken without regard for the governance capacity to design and implement them effectively.

To the extent that the Africa version of the “Washington Consensus” served to highlight these deficiencies and tilt the balance towards the market, it served a useful purpose. But it went too far in the other direction. From a neglect of government failure the policy pendulum swung too far to the other extreme of neglect of market failure. As discussed below (especially in section V), neither economic theory nor history provides a case for unfettered markets. The results of many of the reforms and conditionalities in Africa were that when government programs were cut back, markets often did not arise to fill the gaps; when regulations were stripped back market performance often did not improve in the ways predicted. In many cases, welfare was reduced, growth impeded, and poverty increased.

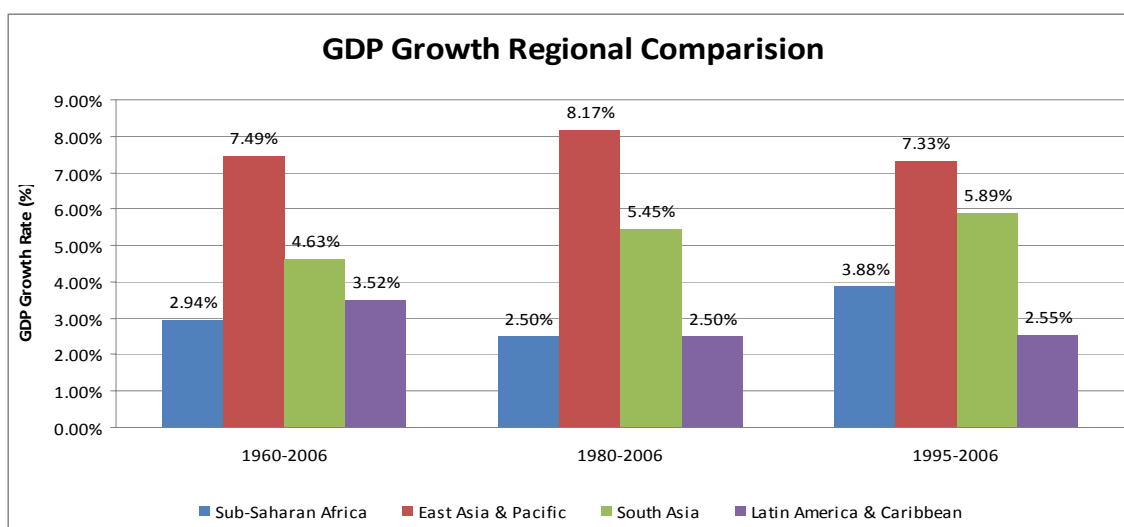
⁷ Refers to 2002, whilst in 2000 the area under cereals using improved varieties was 24 percent in Africa, 77 percent in South Asia and 85 percent in East Asia. All these data are from World Bank (2007), *World Development Report 2008: Agriculture for Development* (Washington DC).

⁸ Total factor productivity growth (TFPG) is one indicator that could be used in principle, but in practice it is fraught with serious problems of data, especially in least developed countries and also sensitive to the specification of the production function. It is highly doubtful that reasonably reliable estimates of TFPG can be made in most, if any, African countries (with the possible exception of South Africa).



*Referring to sub-Saharan Africa.

Source: World Bank, *World Development Indicators*, data base



III. Global Experience: The Cases and Ingredients of Success

Africa's poor performance is especially disturbing when seen in a global perspective. The period of African stagnation corresponded to a period of rapid growth in East Asia. The causes of that growth have been the subject of extensive discussion, including an important study by the World Bank itself, *The East Asian Miracle*.

A more recent study, the Growth or Spence Commission (as it is often referred to and what we label as GSC) has revisited the issues on a global scale and seeks to extract policy lessons from the experience of 13 countries which achieved annual growth rates of 7% or more for at least 25 years.⁹

The countries and their periods of sustained growth at the rates that GSC concerns itself with are as follows: Botswana 1960-2005; Brazil 1950-80; China 1961-2005; Hong Kong 1960-97; Indonesia 1966-97; Malaysia 1967-97; Japan 1950-83; S. Korea

⁹ Whilst GSC devotes a chapter to country contexts in which it looks at the implications of its analysis for Sub-Saharan Africa; small economies and those rich in natural resources; it does so in a rather broad brush manner (e.g. only 7 pages on Africa) especially in comparison with its carefully detailed and nuanced general discussion of growth issues. The Report does not aim to fully engage directly with the growth debate in Africa, for example on the role of geography it simply notes that many countries are landlocked with a muted suggestion that that is part of the reason for Africa's disappointing growth performance but does not examine the issue in any detail (we examine this issue later). This reflects the fact that its focus is broad, ambitious and general or at any rate considerably more so than that of the Africa Task Force. The Commission's report is mindful of the dangers of excessive or excessively rapid capital account liberalization but does not pay much attention to other aspects of the financial sector (e.g. domestic financial restraint; directed credit or the role of DFIs).

1960-2001; Malta 1963-94; Oman 1960-99; Singapore 1967-2002; Taiwan 1965-2002; and Thailand 1960-97. Nine of these thirteen countries are East Asian. Of the remaining 4, only one is of significant size (Brazil), only one is African (Botswana), and two are in distinct circumstances: one is on the border of Europe and tiny (Malta), the other an oil sheikdom. The Report in its own words, “is about sustained, high growth of this kind: its causes, consequences and internal dynamics.”¹⁰ And, by and large, the story of sustained high growth is the story of East Asia. In a sense, the Spence Commission reinforced the motivation of the African Task Force: Were there lessons from that experience (or more accurately, those experiences) that were applicable to Africa—with appropriate adaptation?

The Commission’s analysis is wide-ranging, highly nuanced, eclectic and context-sensitive in a very marked and possibly deliberate contrast to the over-simplified certainties of the “Washington Consensus,” the set of policy prescriptions that had dominated the international economic institutions’ policy advice in the 80s and 90s (see the discussion below). Its broad canvass and the diversity and distinction of its membership¹¹ are amongst its virtues but they do inevitably also lead to a tendency to “two-handedness”. Nonetheless, it also has some clear and potentially strong messages; perhaps the central one being the context-specificity of what constitutes good and bad policies (though it does identify some that are *always* good or bad without sacrificing much of its non-dogmatic character). Its unorthodoxy even goes so far as not to reject outright the case for industrial policy in any circumstance.

GSC notes the diversity of the experiences of the 13 countries but adds that “a close look at the 13 cases reveals five striking points of resemblance: 1.They fully exploited the world economy 2.They maintained macroeconomic stability 3.They mustered high rates of savings and investment 4. They let markets allocate resources 5.They had committed, credible and capable governments”¹² The markets that it speaks of, though were not unfettered and GSC adds that aside from Hong Kong, “Other governments in our list were more hands on, intervening with tax breaks, subsidized credit, directed lending, and other such measures.....(these) may have helped them to discover their comparative advantagebut they did not defy their comparative advantage”.....this self-discovery “involved trial and error(and) may have been helped along by the government’s hand”¹³

These can also be said to be among the lessons of the *East Asian Miracle*. In a sense, the Spence Commission reinforced the findings of the earlier study—not surprising given the dominance of the East Asian countries in the success cases. The GSC though is refreshingly free of the encumbrance of trying to make its analysis conform to institutional positions, which the final version of the East Asia Miracle study tries to do.¹⁴

¹⁰ Ibid, p.1.

¹¹ In the GSC Report’s own words: “It reflects the views of 19 well-known and experienced policy, government and business leaders, mostly from the developing world, and two renowned economists” (p.1)

¹² Ibid, p21

¹³ Ibid, p.25

¹⁴ The published report appears to try to make its analysis to conform as much as possible to the then prevailing orthodoxy in the World Bank by going to great lengths to emphasize the difficulties for other

Adding Brazil and Botswana enhances, of course, the importance of the perspective advanced in this book, *the developmentalist state*, one which takes an active role in promoting development. In both of these countries, governments played a central role in promoting growth. Brazil adds one important wrinkle: it pursued what was essentially an import substitution policy as opposed to export led growth (though it did not neglect exports) during the period of rapid growth that the GSC focuses on. (There is one other way in which Brazil changes the picture presented in the East Asia Miracle. That book emphasized the importance of education and equality. Brazil through most of this period performed relatively poorly on both counts; more recently, it has performed better on both). What is essential is “learning,” and an appropriately designed import substitution policy can be the basis of technological advances and export diversification, as Brazil has repeatedly shown. (The Spence Commission seems to implicitly disagree with the Washington Consensus view of the lost decade—it was the inevitable result of flawed import substitution policies. As Stiglitz¹⁵, Rodrik¹⁶ and Ocampo¹⁷ have argued elsewhere, it was mainly the result of the macro-economic disturbance brought to Latin America by America’s monetary policies, sometimes referred to as the “Volcker shock¹⁸”).

Botswana brings to the fore another lesson, of especial importance to Africa: natural resources do not have to be a curse. If appropriately managed, they can be a blessing. But the fact that there are so few natural resource countries on the list of success cases is a reminder how difficult that is.¹⁹

What is notable in the list of policies leading to sustained growth are some things that are not there. The “expanded” Washington Consensus policies (expanded beyond the list of prescriptions formulated for Latin America, in Williamson’s original paper defining the Washington consensus²⁰) did not include capital and financial market liberalization—something that most of the success cases treated with caution; and it did not include clear systems of property rights—how could it, when among the most successful cases was China, where they are just now becoming more precisely defined. Indeed, contrary to the “property rights school,” several of the success cases began with large land reforms. But while property rights may not play the pivotal role that Hernando DeSoto has suggested, deficiencies in property rights system can be a hindrance to growth, and that may be the case in some African countries.

countries in emulating East Asian style interventions (they were deemed to be particularly daunting for Africa) and to downplay the role of some interventions, e.g. it argues that industrial policy did not make much of a difference in East Asia.

¹⁵ Joseph Stiglitz (2006), *Making Globalization Work*, W.W. Norton & Co, p.36.

¹⁶ Dani Rodrik (1999), *The New Global Economy and Developing Countries: Making Openness Work*, Overseas Development Council, p.75.

¹⁷ Ocampo’s many relevant writings include: Enrique Cárdenas, José Antonio Ocampo, and Rosemary Thorp (editors) (2000), *An Economic History of Twentieth-century Latin America: Industrialization and the State in Latin America: The postwar years*, Palgrave.

¹⁸ This refers to Paul Volcker’s role as Chairman of the US Federal Reserve Bank, in the sharp rise in interest rates in the US in the later part of the 1970s to fight inflation.

¹⁹ See McCartan, Sachs, and Stiglitz, *The Resource Curse*, for a more extensive discussion of these issues.

²⁰ Williamson, John (1989) “What Washington Means by Policy Reform”, in: Williamson, John (ed.): *Latin American Readjustment: How Much has Happened*, Washington: Institute for International Economics.

Finally, the task force discussions noted that there may be more agreement about what should be on the list of policies that contribute to growth than the specifics: everybody can agree that good macro-economic policy is not only desirable, but almost necessary. Growth is impossible with Zimbabwe levels of run away inflation. But, beyond avoiding such extremes, what constitutes “good” macro-economic policy is a subject of intense debate. To many central bankers, it has meant focusing on keeping inflation rates low. While the fad among central bankers twenty five years ago was monetarism, that fad has faded and been replaced by inflation targeting. Many of the success cases took a very different tact. They realized that what mattered was the real economy—stability of growth as much as that of prices-- and good monetary policy entailed having access to an adequate supply of capital. As Stiglitz *et al* argue in *Stability with Growth*²¹ policies that tolerate low to moderate levels of inflation may actually lead to more stability of the real economy and higher rates of growth.

IV. Interpreting the African Experience

There are three strands of work interpreting Africa’s experience, focusing respectively on Africa’s distinct circumstances (its geography or its natural resources); what has been done to Africa and the global environment in which it finds itself (changes in international prices, IMF programs), and its own policies (the failure of governance.) This book takes the view that while geography may affect levels of per capita income, or even growth, geography is not destiny. So too failed states have played a role—but arguably they can be as much consequence as cause, a consequence of low and falling or stagnant income and of policies which argued for a minimalist state. At any rate what we are concerned with are the policy options for African states that have *not* failed and that have or can have reasonably adequate governance.

An important strand of research has emphasized Africa’s geography as an impediment to its growth. This is even echoed, albeit somewhat faintly, in the report of the Growth/Spence Commission. The argument²² is that landlocked countries are at a disadvantage because of lack of access to global markets and trade, and that isolation is even more true for mountainous countries. Tropical countries have the further problem of a disease burden. Every country begins life with advantages and disadvantages. We noted that many African countries have a rich endowment of resources, and that on average, that has served as an impediment to growth. But that need not be the case, as landlocked Botswana shows so forcefully. By the same token, the example of

²¹ Joseph Stiglitz, José Antonio Ocampo, Shari Spiegel, Ricardo Ffrench-Davis and Deepak Nayyar (2006), *Stability with Growth: Macroeconomics, Liberalization and Development*, Oxford University Press.

²² This is discussed further below where we comment on the the AERC research project that has spawned amongst other publications, Benno Ndulu, Stephen O’Connel, Robert Bates, Paul Collier and Chukwuma Soluda (eds)(2008), *The Political Economy of Economic Growth in Africa 1960-2000* (Cambridge University Press). See also Augustin Fosu’s chapter in this volume and Jeffrey D Sachs & Andrew M Warner (1997), "Sources of Slow Growth in African Economies," *Journal of African Economies*, vol. 6(3), pages 335-76, October.

Switzerland, a landlocked mountainous country, shows that geography is not destiny. Nor is it likely that Mongolia would have grown more rapidly if this landlocked country had had a corridor to the sea.

Countries cannot, moreover, change their geography. The relevant question is, given their geography, what policies and institutions can best promote growth. Indeed, in the light of the improvement in African growth performance since the late 1990s, with a number of landlocked countries recording annual growth rates of some 5% or so, there is the question of the significance of the whole geography debate.

The passion generated by the debate is reflected in one African participant being moved to comment that “in the 80s we were told to get our prices right; then we were told to get our policies right; then to get our institutions right; then to get our history right; and now we are being told to get our geography right but where on earth can we move Africa to?” The example of Ethiopia was cited where the new, rapidly growing exports of flowers and leather goods were based around Addis Ababa rather than cities much nearer to the coast so that “geography doesn’t even work within a country”. Resource-poor, landlocked Ethiopia was attempting to emulate East Asia with some success, and its policy makers did not consider geography to be an insuperable or even all that important a barrier (Prime Minister Meles Zenawi and his Economic Adviser, Ato Newai Gebre-Ab participated in two meetings, though not in their official capacities).

The position of the “geography-growth-skeptics” is more precisely interpreted as follows. Geography is, of course important: it affects the availability of natural resources, transport costs, irrigation potential, infrastructure costs, disease burden and so on. Geography is multi-dimensional and simply focusing on one or other element like being landlocked is too simplistic. Geography may well be an important explanation of why some countries are poorer than others. It may have even played a role in past growth or technical change. Indeed, there may well be some validity to the Jared Diamond view²³ that in the distant past, the East-West Axis and contiguous land mass of Eurasia facilitated trade and knowledge flows as compared with the North-South axis and physical barriers of Africa and the Americas.

But so what in terms of policies and future growth potential in this age? Are transport costs that important and measures to reduce them that difficult or expensive? At worst, being landlocked means a somewhat higher requirement for such investments for any given growth and/or wages and land rents will be lower than they otherwise would be. It may well argue for aid donors to provide more assistance for investments in overcoming such infrastructural barriers in land-locked countries, *ceteris paribus*. And once these “adjustments” are made, even if levels of income are lower, why should *growth* be lower? Indeed, if changes in technology that reduce transport costs will differentially benefit geographically disadvantaged countries, that will allow them to have growth rates that are faster than average.

²³ Jared Diamond (1999), Guns, Germs, and Steel: The Fates of Human Societies (W.W. Norton, New York and London)

Perhaps the main underlying concern of this school is the danger of an excessive focus on geography having the two related effects of (a) distracting attention away from the policies and institutions needed to realize a country's growth potential; and/or (b) camouflaging the past failings of policies and reform conditionalities inspired by the Washington consensus.

The view that geography has, at most, limited relevance for determining growth would seem to be supported by the following estimates based on the data in the book by Benno Ndulu and his co-authors.²⁴

Africa: Average Annual Growth in Real GDP Per Capita, 1961-2004 (percent)

	<u>Mean (unweighted)</u>	<u>Median</u>
Coastal Resource Rich (9 countries)	0.86	0.86
Coastal Resource Poor (15 countries)	0.88	0.70
Landlocked Resource Rich (2 countries)	2.89	...
Landlocked Resource Poor (14 countries)	0.79	0.76
All Coastal (24 countries)	0.87	1.33
All Landlocked (16 countries)	1.05	1.02

On the face of it, this seems to suggest that this particular cut at geography does not make much of a difference, or at least is not the *determining* factor. If anything, the most startling and perhaps the most notable feature of these data is that the average growth rate of landlocked countries was significantly faster than that of coastal countries in Africa over the 43 years! Amongst the sub-category of resource-poor countries whilst the average growth rate for the landlocked ones is slightly lower than for the coastal ones, the median is higher. Of course, the hypothesis that geography is important maintains that *holding everything else constant*, countries with "adverse" geographies perform worse. Interestingly, Ndulu *et al.* use econometric techniques to conclude that geography plays a more important role than suggested by this data.

At any rate, no matter how, to what extent, and in what ways geography is important, it does not eliminate the need for development strategies or policies. Geography may pose special issues: what can such countries do to compensate for these disadvantages most effectively? There is ample scope for such societal choices to make a difference to the growth performance of African countries. The analysis and the policy options presented in this volume are just as applicable to land-locked as to other countries.

The second strand of explanations focuses on what has happened to Africa. At independence it was left with little human or physical capital; the colonial experience arguably weakened its institutional and social capital. Some suggest that Botswana's

²⁴ Benno J. Ndulu (with L. Chakraborty, L. Lijane, V. Ramachandran, and J. Wolgin), Challenges of African Growth: Opportunities, Constraints, and Strategic Directions (World Bank, Washington, D.C., 2007)

success is not an accident: during the colonial period, it was bereft of resources, so benefited from benign neglect, which put it in a better position to grow with the end of colonialism. In these interpretations, the years after independence political colonialism was replaced by economic colonialism, as Western powers took the resources paying a fraction of what they were worth. The international economic institutions helped manage this new economic exploitation, as they encouraged privatization and liberalization. These account, on this view, for the deindustrialization of Africa, noted in the statistics of the previous section. The development strategies foisted on Africa led to heavy dependence on commodity exports, which made the countries of Africa vulnerable to global commodity prices. When prices were weak, as they were in the 80s, Africa performed poorly. When prices were strong, as they were in the middle of this decade, Africa performed well.

These development strategies included an almost exclusive focus on primary education at the expense of higher education, which inhibited the region's ability to close the knowledge gap—as important as the resource gap in explaining the low level of per capita income. Structural adjustment programs limited public investment in a region that was suffering greatly from inadequate infrastructure. If East Asia's success was partly because of the role of the state in promoting development—"the Developmental State"—structural adjustment policies weakened the state, and hence the ability of the State to perform these vital functions. The market—and the colonial powers—had failed to develop the region in the colonial period; and the market failed again in the "neo-colonial" era of structural adjustment.

The third strand of explanations of Africa's growth experience focuses on policies and governance: flawed policies and weak institutions. (In some parts of Africa, failed states and conflicts made development a virtual impossibility.) This notion was behind the structural adjustment programs of the IMF and the World Bank in the 1980s. It was hoped that by following the "Washington Consensus" policies focusing on privatization, deregulation and liberalization, and price stability African countries would enjoy high growth rates. It was perhaps not surprising that the adherents of these policies and conditionalities manifesting them, would try to shift the blame for Africa's failure to grow to Africa itself. There is a general consensus today that the Washington consensus policies have failed, not only in Africa, but around the world. As a package, they were neither necessary nor sufficient for growth; and too often, even when they brought a modicum of growth, it was not inclusive with the benefits going to relatively few. One of the objectives of this book is to explain why, in the African context, these Washington consensus policies failed. Rather than enhancing long term sustainable growth, they may have had just the opposite effect.

When it became increasingly apparent that the policies were failing, the adherents of neo-liberalism or the Washington Consensus increasingly focused on "governance," or institutions. They had, of course, a hard time defining what was meant by good institutions. (Before the crisis, if one had asked most of the IMF economists whether the central banks and regulatory agencies in the United States and Europe were good institutions, they would surely have said yes -- so would many, if not the majority of

other economists. Afterwards, it was clear that these institutions failed to perform well their central tasks, and one of the explanations commonly put forward is that they were captured by financial interests. Capture is, of course, a mark of “failed” institutions.) They have an even harder time defining how one creates and maintains good institutions. As we explain in Section V, the papers in this volume argue that the standard discussion of governance is as misdirected as that of “good policies.”

One contribution in this volume, in particular offers a fundamentally different perspective from the dominant one informing most of the chapters: the one by Augustin Fosu. His paper and the first one of the two contributions by Mushtaq Khan make for a particularly interesting contrast.

Analytic studies

Whilst both on average and in most countries, performance on growth, structural change and poverty reduction in Africa has been disappointing in the “lost quarter century”, the reversal of the trend of falling per capita income in the past decade or so has raised the question of whether this recent acceleration is mainly another turn in the familiar African cycle of boom and bust, reflecting trends in commodity prices and the international economy, or as some have argued, represent a belated vindication of the “Washington Consensus” or at any rate, its reformed version. The latter view implies that the dominant policy agenda does not need to be altered in any particularly radical manner.

This volume contains several studies which try to parse out the relative roles of the various factors affecting African growth. The answers have strong policy implications. Augustin Fosu’s contribution to this volume provides support to the view that the growth is the result of policy reforms. His paper in this volume arose out of a major research project, “Explaining African Growth” of the Africa Economic Research Consortium (AERC).²⁵ Their work places considerable emphasis not only on the role of geography but also what the AERC project refers to as “syndromes” in the growth experience of African countries.

Noting the stop-go history of growth in Africa, one strand of the AERC growth project seeks to look at what explains the ending and beginning of growth episodes.²⁶ The anti-growth syndrome is said to consist of some combination of (i) excessive regulation (e.g. the “bad old days” in Ghana and Tanzania); (ii) inappropriate redistributive policies (e.g. once upon a time in Burundi); (iii) sub-optimal inter-temporal allocation of natural resource rents (e.g. Nigeria); and (iv) state failure (e.g. Zaire, Liberia). Avoiding this syndrome is deemed to be a “near necessary” condition for

²⁵ Paul Collier, who also played a key role in this project, also made a presentation to the first meeting of the Task Force.

²⁶ in addition to Augustin Fosu’s chapter here, see also Augustin Kwasi Fosu and Stephen O’Connell “Explaining African Growth: The Role of Anti-Growth Syndromes”, August 4, 2005 (posted on the IPD website for the Africa Task Force Meetings).

growth and “near sufficient” for preventing a growth collapse. And it was estimated to add two percentage points to per capita growth.

Whilst this analysis was of considerable interest, its value in providing answers to how to get on the path of sustained, rapid growth was seen by several commentators as somewhat limited. One comment was that what we need is a better understanding of how to get and stay on the path of rapid growth, whilst what the anti-growth syndrome showed was that “if you stop doing stupid things you could get an extra 2% growth”. At any rate, we really need to parse more carefully the different elements of the anti-growth syndrome since in some sense many of the fastest growers in East Asia could be said to have at least some elements of the syndrome, such as “excessive regulation”, to a comparable degree as African “non-growers”. This was so, in this view, not only in the original four East Asian “miracle” economies but subsequently in such countries as Malaysia, Thailand and Indonesia. And perhaps this was the case even more so in the biggest and brightest growth star, China, and the other two great success stories of the past 25 years or so, India and Vietnam. The World Bank’s business environment surveys, which focus on many aspects of the syndrome, consistently rate these countries poorly e.g. China and India were ranked 91st and 115th out of 155 countries in 2006. Moreover, in light of the global financial crisis, or even the East Asian crisis a decade earlier, insufficient regulation can be as much of a problem as too much regulation so the issue is not so much whether regulation is excessive or not but rather what constitutes an appropriate regulatory framework.

The other aspect of the AERC project that received a great deal of attention was the distinction it made among different African countries based on geography. This strand of the AERC project is also reflected in the Ndulu *et al.* book referred to above²⁵. It distinguished three groups of African countries: (a) resource rich; (b) resource poor landlocked and (c) resource scarce coastal. Each of them roughly accounts for about one-third of Africa’s population. For the first group, the central issue is said to be how to manage public expenditures and deal with the resource curse. The second group was said to be pretty much a distinctive African phenomenon with not particularly promising prospects. Their growth is especially dependent on their neighbors: they need to get their neighbors to get their act together. The third group was deemed to be the one with the option of attempting to emulate East Asia or pursuing “non-natural-resource-export-led” growth.

Two of the chapters in the recent anthology on Africa, edited by John Page and Delphin Go supports the view that policy reforms were central, though obviously high export prices helped: “The analysis confirms a trend break in the mid-1990s, identifying a growth acceleration that is due not only to favorable terms of trade and greater aid, but also to better policy.....as a result the likelihood of growth deceleration has declined significantly. Nonetheless, the sustainability of that growth is fragile, because

²⁵ Reproduced in summary form in the GSC report Commission on Growth and Development (2008) *op.cit* .pp74-75.

economic fundamentals, such as savings, investment, productivity, and export diversification remain stagnant.”²⁷

The Go and Page analysis is an important contribution to the debate on the relative roles of endogenous (policy) and exogenous (commodity prices) factors in the acceleration of growth in the region, prior to the global crisis that broke out in 2009. The study focuses on the period, 1975-2005 in identifying a break in the growth trend after 1995. It ascribes key importance to the policies; but the picture is likely to get muddier if one goes back to 1960 or 1965, then 1960-75 would be a period of reasonable good growth followed by a growth collapse in 1975-95 and then again a resumption of fair growth after 1995. Over this longer period the story of trends and breaks in them is more complicated. Another problem is that in the shorter period of 1975-2005, there is also a “trend break” in commodity prices corresponding to that in GDP, and that clouds the implications for the endogeneity of the “trend break” in growth that this research identifies. But there have also been “improvements” in policies, notably with respect to macroeconomic stability and exchange rates. The two relevant policy questions are: (i) is the improvement in growth rates a result of the elimination of distortions caused by previous policies—implying a one time gain—or the result of a policy environment which is more conducive to sustained faster growth (to the kind of learning that we focus on in section VI below); and (ii) can the policies be “bettered” further (whatever that might mean)?

Suffice it to say that at this juncture, there is little consensus on these matters. The standard methodology used by economists for ascertaining quantitatively the relative importance of different factors has, itself, come under attack. Such studies look at the differences in performance (for instance, as measured by growth rates) in different countries and/or different periods and relate it to different “explanatory” factors. Critics focus on deficiencies in measurement both of the performance variables (GDP)²⁸ and the explanatory variables, the problem of causation (does trade cause growth or growth trade), the problem of simultaneity (the oil price shock of the 70s lowered real income of oil importing countries and resulted in inflation.), and the problem of “omitted variables” (some third factor explains why some countries responded to the oil price shock by allowing more inflation; it was not the inflation itself, but this omitted third factor, which is to blame for the poor performance.) Advocates of the methodology say that, notwithstanding these concerns, it is the best or “least-worst” way of sorting out the relative roles played by different factors.

²⁷ Delfin Go and John Page (eds) (2008), *Africa at a Turning Point?* (World Bank.), pp 2-3.

²⁸ See, for instance, the recent report of the International Commission on the Measurement of Economic Performance and Social Progress appointed by President Sarkozy and chaired by Professor Stiglitz (sometimes referred to as the Stiglitz Commission), at <http://www.stiglitz-sen-fitoussi.fr/en/index.htm>

IV. The State and the Market: In Theory and Practice

Development policy has been the subject of intense debate over the past quarter century. As we have seen, policies advocated by one group (the Washington consensus policies) are seen by its critics as actually hindering growth. There are many issues in this debate, e.g. what are good macro-economic policies? But one overriding issue is the role of the state. What has been variously termed as “market fundamentalism”, “neo-liberalism” or the “Washington Consensus”²⁹ saw the government more often than not as an impediment to growth. Its advocates worked to limit its role, and to strengthen markets.

Indeed, the standard “Neo-classical growth theory” that underlay these policy prescriptions argued that markets by themselves would lead incomes of poorer economies to converge to that of the richer ones. The scarcity of capital in the poor countries will attract investment, to the point where differences in returns—and per capita output—are eliminated.

Both theory and evidence have not been kind to the Washington consensus ideas. The underlying model was based on assumptions of perfect information, perfect competition, and a full set of markets (perfect capital and risk markets). None of these assumptions are good even for a developed country; they are particularly ill suited for most developing countries. More to the point, research during the past three decades showed that the results of the analyses—including the policy implications—were not robust. Even a little bit of information imperfections had very large consequences for the functioning of markets. Markets are not even in general constrained Pareto efficient. In practice, convergence remains the exception rather than the rule³⁰.

The experience in East Asia suggested that government was at the center of any successful development. Governments need to play a role in all markets—creating the rules of the game that allow markets to function, including a legal system that enforces property rights (appropriately defined) and contracts (appropriately circumscribed); ensuring competition and regulating financial markets. East Asia’s experience is similar

²⁹ As Kwesi Botchwey has remarked, “John Williamson ... has said that he did not intend for the policy prescriptions he called the Washington consensus to become a definitive, exhaustive framework to be applied in all developing countries. But quick fixes have a universal appeal and brilliant summaries and intuitions tend to be turned into broader formulas—often over the protests of their inventorsso it was that in Sub-Saharan Africa ...development strategies in the 1980s and 1990s were defined by structural adjustment programs based on the policies that came to be known as the Washington consensus.” Kwesi Botchwey, “Changing Views and Approaches to Africa’s Development” in T. Besley and R. Zaghera (eds), *Development Challenges in the 1990s: Leading Policymakers Speak From Experience*. (World Bank, 2005), p.44.

³⁰ See the contribution of Robert Wade in this volume. A more detailed discussion of the facts and implications of divergence in the world economy is found in Lant Pritchett (1997), “Divergence, Big Time,” *Journal of Economic Perspectives*, vol. 11(3), pages 3-17, Summer.

to that of the countries that are now developed: the state has played a much more activist role than allowed by the neo-liberal perspective.³¹

Advocates of the minimalist role for the state might agree on the *theoretical* importance of the government dealing with externalities and providing public goods, but even these roles are often downplayed. (Coase, for instance, argued that these could be dealt with through bargaining arrangements³².) And the critics of government worry, at least as much about government failure as about market failure; government interventions should, in their view, be exercised with great circumspection, and in general, the less the government does to hinder the “invisible hand” of the market the better.

In the neoclassical models underlying the Washington consensus policies, there is no room for technology acquisition or learning since technology and knowledge is assumed to be exogenous and freely available to all economies; hence the structure of the economy is irrelevant: whether an economy produces computer chips or potato chips does not matter.³³ But what countries produce or export matters a great deal as different activities have differing learning and technology intensities and linkages with the rest of the economy. Learning and acquiring technology is central to “catching up”. The externalities associated with learning and their public good dimension means that the market will undersupply them. The potential returns to state interventions to correct this inherent deficiency of markets can be and often have been extremely high.

Thus, while the Washington consensus policies focused on ensuring that a country’s resources were efficiently allocated—given a particular level of knowledge (and even here, their conclusions were also flawed because of the failure to take into account market imperfections), the impacts of economic structure on societal learning may be far more important, especially in the long run. Solow argued, for instance, that some seven eighths of all the increase in per capita output was the result of improvements in efficiency. Yet the Washington Consensus models pretended that these improvements were unaffected by decisions, for instance, about whether a country produces rice, potato chips, or computer chips. There may be trade-offs between dynamic growth and static inefficiency. The Washington Consensus models were framed in such a way that the issue was never considered.

Given the pervasiveness and seriousness of market failures both in theory and in practice, the continued influence of the overly market-friendly Washington Consensus orthodoxy in one of its many variants (emphasized, in particular by the contributions of

³¹ See Ha-Joon Chang’s *Kicking Away the Ladder: Development Strategy in Historical Perspective* (Anthem; 2002) and *Bad Samaritans: The Myth of Free Trade and the Secret History of Capitalism* (Bloomsbury; 2008). Chang also argues that the even in the case of Britain’s industrial revolution the role of government was much more extensive than allowed in the interpretation of history that makes it conform to the neo-classical or neo-liberal view.

³² Ronald Coase (1960), “The Problem of Social Cost.” *Journal of Law and Economics* 3 (October): 1–44.

³³ Michael Boskin, Chairman of the Council of Economic Advisers under the first President Bush, famously declared, “It does not make any difference whether a country makes computer chips or potato chips.”

Wade, Mushtaq Khan, Meles Zenawi, and Jomo and von Arnim in this volume) is typically justified by the judgment that the risks and costs of government interventions to correct market failures, whether through restrictions (regulations) or through market-fortifying interventions (such as assistance in finance or technology) are greater than those of market failure. This judgment may or may not be clouded by ideology and/or the interests of the rich and powerful but that is another matter, which need not concern us, except to note that it is not just policies of interventionism but also of market liberalization that are susceptible to the political economy of “capture”³⁴: in the end governance rules.

At any rate, when does government intervention make matters worse than market failures and what constitutes an appropriate balance between the roles of the market and the state is a contextual matter: it depends above all on the type and varieties of market failures to be addressed, the particular policy of intervention and the institutional framework, especially pertaining to governance. In countries at early stages of development, both market and government failures tend to be more common and more serious than in more developed countries.³⁵ This suggests that there are both higher risks and rewards to correcting the errors of markets in such economies. Foregoing the rewards is hardly likely to be the answer to rapid development; rather how to minimize the risks and maximize the rewards should be a central issue for policy design.

That this, in sum, is an important lesson of history and thus that the neo-liberal or Washington consensus view is not only based on faulty or outmoded models but is also ahistorical, is one theme running through many of the essays in this volume, as it did in much of the Task Force discussions. Another one is that despite the recognition of its limitations and failures and attempts to curb some of its excesses, the Washington Consensus retains sufficient influence to make the orthodox policy discourse on Africa part of the problem. Hence, a radical overhaul of the policy options on the table and the perspective that informs them is necessary if Africa is to achieve sustained rapid economic growth and associated structural transformation. Beginning such an overhaul was indeed one of the objectives of the IPD Africa Task Force.

As noted in section II, Africa’s economic crisis did originally reflect, in large measure, mistaken policies that often went to the extreme of neglecting such fundamentals as a modicum of macroeconomic stability, avoidance of highly overvalued exchange rates, inappropriate and counterproductive interventions in markets, bloated public sectors and disregard of government failure. It is understandable why Africa turned away from the market in the years after independence: markets had not brought much to Africa. The companies that had come to Africa had come to exploit it, to take its land and natural resources aided by colonial rule. They had not brought broad-based, inclusive development. After such a long, dark history, who wouldn’t have sought an

³⁴ This is a common allegation of the root causes of the financial crisis that erupted in 2008; there is a consensus that there was too little regulation of derivatives and that the policy of not regulating derivatives was a result of political capture of regulatory agencies, the Administration, and legislative processes.

³⁵ Some might dispute this claim: looking at say, the contrast between the US and Asia in contributing to both the current economic crisis and to recovery from it.

alternative course? But in the end, “African socialism”, in most of its variants, too was disappointing. It did not bring the benefits hoped for. As pointed out above, to the extent that the African variant of the Washington Consensus served to correct these deficiencies and tilt the balance towards the market, it served a useful. But it went too far in the other direction: from a neglect of government failure the policy pendulum swung to the other extreme of neglect of market failure. Worse still, it undermined important capacities of the state, which also inevitably has to play a central role in early stages of development.

We have outlined in Section II, how the results of reforms and conditionalities based on mostly unfettered markets had resulted in unintended consequences. For example, where government marketing boards were abolished the result often was that they were replaced with local monopolies: while before, farmers were squeezed to help support the state, now they were squeezed but by local mafias.

The dissatisfaction with the results of “market fundamentalism” and the ensuing debates are not, of course, confined to Africa. A new strand of literature was born out of the disappointing growth in many countries, especially of Africa and Latin America. We previously noted the earlier World Bank study on the East Asian Miracle (which itself was slightly toned down version of the background work by outside experts)³⁶ and the Growth/Spence Commission report. Another important contribution to this literature is the World Bank study, *Economic Growth in the 1990s: learning from a Decade of Reforms*³⁷. However, the extent to which this study is having an impact on the dominant policy discourse and practice, especially in IFIs, remains an open question and there is a risk that it might meet the same fate as the World Bank’s study on the East Asian miracle³⁸, whose implications for Africa were ignored in the policy prescriptions and conditionalities dominated by the Washington Consensus (see Robert Wade’s chapter). Other recent publications that have contributed to advancing the debate on policy options for Africa for sustained growth and structural transformation and that have informed the work of the Task Force, include first, the aforementioned report of the Commission for Africa initiated by the UK government, also known as the Blair Commission;³⁹ (three of its members participated in meetings of the Task Force); and a study by JICA on Asian lessons for Africa⁴⁰ (several of whose authors also participated in the Africa task Force

³⁶ See, for instance, Joseph E Stiglitz & Marilou Uy (1996), "Financial Markets, Public Policy, and the East Asian Miracle," *World Bank Research Observer*, vol. 11(2), pages 249-76, August.

³⁷ See, in particular, World Bank (2005) *Economic Growth in the 1990s: Learning from a Decade of Reforms* (World Bank, Washington DC).

³⁸ World Bank (1993), *The East Asian Miracle*, (Oxford University Press, New York).

³⁹ The Commission for Africa, *Our Common Interest: Report of the Commission for Africa*, May 2005. <http://www.commissionforafrica.org/english/report/introduction.html>

⁴⁰ Masafumi Kuroki & Atsushi Hanatani (2008), "Asian Lessons for Africa and TICAD IV" Presentation at IPD Task Force on Africa in Addis Ababa, 10-11 July 2008. Also see presentations by Kuroki and Hanatani in JICA/JBIC International Workshop Report, *Role of Government in Promoting Sustained and Accelerated Growth in Africa and Lessons from Asian Experiences*, May 2008, http://www.jica.or.id/english/publications/reports/study/topical/aid/aid_02.pdf

The Commission for Africa included a heavy representation of African policy makers and sought to mobilize increased aid, less conditionality and an eclectic policy agenda in support of a more ambitious growth effort for Africa. The JICA report was prepared in the context of the fourth Tokyo International Conference on Development (TICAD IV) in 2008, where there was also renewed interest in accelerating growth in Africa and the lessons for Africa from Asian experiences.

Our focus in this book is more narrow and selective on some key overarching issues for Africa's growth agenda, especially (i) the appropriate role of "industrial policy" (or more accurately learning, industrial and technology policies); and (ii) governance.

VI. The State and the Market: Policy Options for Africa

VI.1 Learning, Industrial and Technology (LIT) Policies

In the 50 odd years since Solow showed that the bulk of growth in the advanced economies was accounted for by productivity increases, very little work had been done on learning, especially how societies learn in the process of development and how that can be accelerated.⁴¹ This neglect is in marked contrast to the attention given to allocation of resources; and the neglect is particularly significant in policy analyses.

⁴¹ In the years immediately after Solow's classic study, there were a number of studies analyzing "endogenous" determinants of the rate of technical progress and the allocation of resources to research and development. These include Arrow (1962a, 1962b), Uzawa, Shell, Nordhaus, Atkinson and Stiglitz, and Stiglitz (1975). In the late 70s, there was a resurgence of interest in these topics, and Schumpeterian innovation theory more generally, focusing on integration of growth theory with the theory of industrial organization, with work of Mansfield (), Stiglitz (1978, published 198), and Dasgupta and Stiglitz (1980a, 1980b). A second revival occurred with the work of Roemer (). Much of this work, though, was focused on innovation in advanced industrial countries. The process of learning and adaptation facing developing countries remained relatively undeveloped (See, e.g. Sah and Stiglitz, 1985).

Arrow, Kenneth J. (1962a), "The Economic Implications of Learning by Doing". *Review of Economic Studies* 29: 155-73.

Arrow, Kenneth J. (1962b), Economic welfare and the allocation of resources for innovation. In: R.R. Nelson, Editor, *The Rate and Direction of Inventive Activity*, Princeton University Press, Princeton (1962), pp. 609-625.

Uzawa, Hirofumi (1965) "Optimum Technical Change in An Aggregative Model of Economic Growth" *International Economic Review* Vol. 6, No. 1 (Jan., 1965), pp. 18-31

Shell, Karl (ed) (1967) *Essays on the Theory of Optimal Economic Growth*, MIT Press.

Nordhaus, William D, (1969) "An Economic Theory of Technological Change," *American Economic Review*, vol. 59(2), pages 18-28, May.

Atkinson, Anthony B & Joseph E Stiglitz (1969) "A New View of Technological Change," *Economic Journal*, vol. 79(315), pages 573-78, September.

Mansfield, Edwin (1980), "Basic Research and Productivity Increase in Manufacturing," *American Economic Review*, vol. 70(5), pages 863-73, December.

Joseph E. Stiglitz, (1987) "Technological Change, Sunk Costs, and Competition," *Brookings Papers on Economic Activity*, vol. 18(1987-3), pages 883-947.

Partha Dasgupta & Joseph Stiglitz (1980a) "Uncertainty, Industrial Structure, and the Speed of R&D," *Bell Journal of Economics*, vol. 11(1), pages 1-28, Spring.

Dasgupta, Partha & Stiglitz, Joseph (1980b). "Industrial Structure and the Nature of Innovative Activity," *Economic Journal*, vol. 90(358), pages 266-93, June.

The nexus of issues around learning, technology transfer, the infant industry and infant economy arguments, externalities associated with “discovery” of what can be produced competitively in a particular context⁴² were all part of the rationale for state intervention designed to promote growth (as opposed to, for instance, state interventions to prevent adverse consequences of unfettered financial markets.) Perhaps the neglect of learning reflects the fact that state sponsored efforts to do so have been often related to or manifested in “industrial policies”, a term that has acquired a bad name, partly because industrial policies have become associated or equated with the “loser” policy of picking winners and of private rents without social rewards.

There are many dimensions to what is called ‘industrial policy’ and it has taken markedly different forms in different countries. What we mean by learning, industrial and technology (LIT) policies are not those focused on picking winners or providing indiscriminate, unconditional or everlasting rents. LIT policies are about dealing with issues of learning, of infant industries and economies, of promoting exports and the private sector. They apply not only to manufacturing but also other sectors like agriculture and modern services like information technology or finance.

Arguably, virtually all countries that had achieved substantial development had used some variant of LIT policies, not just Japan and some other East Asian countries as widely believed.⁴³ In the US such state interventions led to the development of the telegraph, the Internet and such successful companies as Federal Express (which started with financing from a government sponsored program of loans for small businesses).

Indeed, the green revolution in South Asia could also be said to be a prime example of LIT policy. (This highlights the broader meaning of “industrial policies.” While we prefer the terminology LIT policies, many of the authors of the papers use the older term.)

In Africa too, there were examples of accomplishments with LIT policies. Ethiopia has enjoyed considerable success in promoting exports of leather goods, flowers and sesame via instruments of industrial policy. The success in promoting leather is particularly noteworthy because it involved using policies that are normally highly criticized: The Government banned exports of raw hides and skins⁴⁴ and took additional

Romer, Paul (1990) "Endogenous Technological Change" *Journal of Political Economy*, Vol. 98, No. 5, Part 2, October, pp. S71-S102.

Sah, Raaj Kumar & Joseph E Stiglitz (1985), "Human Fallibility and Economic Organization," *American Economic Review*, vol. 75(2), pages 292-97, May.

⁴² The importance of “discovery” had been emphasized in particular in the works of Karla Hoff (1997) “Bayesian Learning in an Infant Industry Model,” *Journal of International Economics*, 43, 409-436 and of Dani Rodrik and Ricardo Hausmann (2003) “Economic Development as Self-Discovery” *Journal of Development Economics* 72(2) 603-633

⁴³ See, for example, Ha-Joon Chang, *Kicking Away the Ladder: Development Strategy in Historical Perspective* (Anthem; 2002)

measures to encourage a supply response through a package of support, including access to term credit at reasonable interest rates, infrastructure, and the establishment of a leather institute to promote acquisition of technological capability and skills. The government was now seeking to reinforce early successes by promoting further value addition by moving up the chain from processed leather to footwear exports. Similar comprehensive packages of support had spurred rapid growth in the non-traditional exports of flowers. As a result of industrial policies, the share of “high-technology exports” in manufactured exports, though still tiny, had gone up from zero to 3 percent between 2000 and 2007⁴⁵. Kenya too has had successful industrial policies, both in horticulture and tea.⁴⁶

Other African examples of LIT policies are discussed in other chapters of this volume. The South African governments efforts’ at LIT policies are the subject of Nimrod Zalk’s paper in this volume; (whilst a note in Appendix xx discusses the efforts of a private firm, South African breweries --sometimes working with the government-- to adapt to and encourage production of local raw materials in countries it had invested in). Sen and Te Velde discuss state-business relations, an important aspect of East Asia’s successful industrial policies, in several African countries. (There is a simple rationale for this coordination: with market imperfections, prices do an imperfect job at “market coordination.”⁴⁷ Other contributions in this volume that emphasize consultative mechanisms for exchange of information and coordination between the state and the private sector include the contributions of Oyeyinke and Sampath, Bailey, Lenihan and Singh, Ohno and Ohno, and Hanatani and Watanabe).

What lessons can be learnt from these experiences in Africa and East Asia? Under what circumstances or for what types of states, should what sort of LIT policies be put on the menu of policy options? What sort of “health warning” should they carry? How can one reduce the risks of picking losers rather than winners? Is it better to focus on broad based policies—promoting all exports through exchange rate policies—rather than particular sectors, let alone particular firms? Several aspects of Africa’s distinctive situation, noted earlier, give particular salience to these issues. Is it possible, for instance, for Africa to reverse de-industrialization and increase employment opportunities in the industrial or formal sectors without some form of LIT policy? Indeed, can Africa narrow the agricultural productivity gap with the other regions without a LIT policy for

⁴⁴ It was noted that restrictions on exports of raw materials can be used to offset the disincentive effect on processing in developing countries on account of tariff escalation in developed countries, though it can’t, of course, substitute for doing away with such tariff escalation.

⁴⁵ These are defined thus in the data source: “High-technology exports are products with high R&D intensity, such as in aerospace, computers, pharmaceuticals, scientific instruments, and electrical machinery” World Bank, World Development Indicators database, April 2009.

⁴⁶ Industrial promotion combined with agricultural extension worked very well in Kenya, in this interpretation, as did the partnership between the public and private sectors. Smallholders were persuaded to grow tea, a long-term investment, by a combination of extension services and roads (public sector actions) whilst the private sector took up tea processing and marketing activities. This started in the 1960s and blossomed in the 1970s.

⁴⁷ this market failure provides the rationale for the indicative planning that was much discussed in earlier decades.

agriculture? These are the sorts of questions on which several of the papers in this collection aim to shed light.

Broadly speaking, the conclusion of these studies is that *Africa can benefit from appropriately designed LIT policies*. These contributions, whilst calling for care and caution, illuminate ways in which the high rewards of LIT policies can be reaped and the risks reduced in countries that have the requisite governance capabilities or the ability to acquire them. (The critical issue of governance is discussed in the next section.) Whilst, the degree of success achieved in the best performing, full-fledged East Asian developmental states like Korea or Taiwan may be difficult to replicate, there had been notable successes in quasi-developmental or “developmentalist states” like those in South and Southeast Asia, including the post-1980 “miracles” of China, India and Vietnam. The question is, how can some African countries join this list of successes?

Market failures as a rationale for LIT policies

Among the keys to success are understanding the rationale for industrial policies, on the one hand, and the downside risks of industrial policy on the other. There are several “market failures” which explain why there is a role for government. It is widely recognized that when markets are incomplete, when information is imperfect, and/or when there are externalities, markets may not work well. All of these factors are relevant for an economy in the process of “learning.” First, as we have already noted, knowledge itself is a public good; restricting the use of knowledge introduces an inefficiency. The potential conflict between dynamic and static efficiency is illustrated by patents. Patents restrict the use of knowledge; even worse, they can give rise to monopoly power. We accept (even “encourage”) these static inefficiencies because it is believed (partially wrongly) that they can give rise to “dynamic gains” by inducing firms to invest more in research. Neo-liberal policies focused on the inefficiencies associated with, say, tariffs, without ever asking the question whether there might be dynamic gains.

Even with patents, there is incomplete appropriability of the “learning” that occurs when a firm develops or introduces a new product in a country. There is thus an externality—an important externality that is at the center of development—and whenever there are such externalities, markets will not be efficient. But much of the learning that is associated with development is not patentable. A worker who is trained in the techniques of modern manufacturing can use this learning in another firm. A farm that discovers that the soil of the country is well suited for a particular crop for which there is a good market can easily be imitated. Indeed, matters can be even worse: if his “experiment” is successful, he will be imitated, to the point that profits may be driven down to zero; thus, he may face a no-win situation—if he is successful, entry will drive down profits; if he fails, he bears the loss. (See Hausmann and Rodrik⁴⁸ and Hoff⁴⁹ for the development of these ideas.)

⁴⁸ Ricardo Hausmann and Dani Rodrik (2003) “Economic Development as Self-Discovery” *Journal of Development Economics* 72(2) 603-633

The same is true for a bank that is trying to identify who is a good entrepreneur. If someone proves himself to be good, he will be poached away by rival lenders—or the threat of doing so will drive down the interest rates charged. But the bank may be limited (by risks of moral hazard—high interest rates can induce excessive risk taking⁵⁰) in the interest rates it can charge, so that it can't capture from good entrepreneurs enough returns to offset the losses from bad loans.⁵¹

The “infant capitalist” argument was of special significance for Africa where the organized/formal private sector is not only sparse but also heavily dominated by ethnic minorities of relatively recent vintage and/or by foreign investors. On this view, there is much to be said for the creation or strengthening of a class of indigenous African entrepreneurs. In this context, Malaysia's experience may well be of relevance. (A lack of understanding of the depths of market imperfections may play an important role in some of the failures of industrial policies in Africa. It was this absence of support rather than culture or capture that accounted for some of the failures of industrial policy.)

In each of these cases, private returns are not commensurate with social returns. The interactions of market failures provide further impetus for these government efforts at industrial policy. There has long been a discussion of government interventions to promote industries based on the “infant industry” argument.⁵² A criticism of that argument is that a firm, knowing that it will be more productive in the future as a result of “learning” today, could borrow—financing today's losses with tomorrow's profits. But this argument fails if there are capital market imperfections—as there are, inevitably, given information imperfections.⁵³ But matters are even worse because of coordination failures and other externalities. Some of the learning of one firm spills over to others. Greenwald and Stiglitz argue that all economic policy should be shaped by how policies affect the ability of economies to learn. For instance, if some sector (like the industrial export sector) has greater capacity to learn, say, technology from abroad, and some of the benefits of that learning spill over to the rest of the economy, then the government may wish to “distort” the economy towards the industrial sector. They refer to this as the infant economy argument for protection. Without industrial policies (including tariffs and subsidies) Korea might have stayed a rice producer, in accordance with its static comparative advantage. But that would have limited growth potential. By encouraging

⁴⁹ Karla Hoff (1997) “Bayesian Learning in an Infant Industry Model,” *Journal of International Economics*, 43, 409-436

⁵⁰ See Joseph E. Stiglitz & Andrew Weiss (1981), “Credit Rationing in Markets with Imperfect Information,” *American Economic Review*, vol. 71(3), pages 393-410, June.

⁵¹ See M. Shahe Emran & Joseph E. Stiglitz (2005), “On selective indirect tax reform in developing countries,” *Journal of Public Economics*, vol. 89(4), pages 599-623, April.

⁵² See Chang *Kicking Away the Ladder*. Op.cit.

⁵³ See Stiglitz and Weiss (1981), op.cit. For a related argument, also see Dasgupta and Stiglitz 1988. “Learning-by-Doing, Market Structure and Industrial and Trade Policies,” *Oxford Economic Papers*, vol. 40(2), pages 246-68, June..

industrialization, growth was enhanced. The static inefficiencies were more than offset by the dynamic gains (just as they are with well designed patents.)⁵⁴

One of the important ways, in which, LIT policy works, is that it can be a powerful instrument for socializing the risks of private investment. Such risk amelioration—important because of the imperfections of markets for key risks, even in advanced industrial countries-- played an important part in Asia and is particularly salient in early stages of development when a nascent class of proto-capitalists has to be nurtured or created. This risk-socialization function may be even more important in Africa; Africa is said to be inherently, a particularly high-risk environment because of its vulnerability to exogenous shocks of weather and commodity prices. Is there a case for paying systematic attention to socializing risks? If so, what are the implications? Does that bolster the case for stylized East Asian type interventions of the trade, industry and finance variety? Again, the answer provided in this collection of essays is broadly “yes” but not in all cases; they have to be carefully tailored to specific country contexts and the existence or creation of relevant governance capabilities.

The critique of industrial policies

The neo-liberal or Washington consensus reforms have been particularly hostile to the sort of activist trade and other interventions that are the stuff of LIT policies and that were so widely used in East and South Asia. Whilst there is much to be said for doing away with irrational, highly distorted structures of protection that serve little purpose other than engendering rents to some privileged elites, LIT policies can be very effective, including in promoting technological change and encouraging shifts in production structures in agriculture.

To be sure, while LIT policies have been at the centre of sustained growth and successful development, there have been many failures and varieties of LIT policies. But failure is by no means unique or even distinctive to such policies. Bad design and poor implementation can trump policy in any area. There have also been, for example, many failed programs of stabilization, agricultural research and extension, and financial reforms. That does not mean we give up on macroeconomic stability or improvements in agricultural productivity and in finance. The point is to learn lessons of both successes and failures in elaborating policy options and to examine how the risk-reward ratio can be improved.

The danger of “capture” by special interests exists, of course, not just in developing countries but also countries like the US where the subsidy to biofuels could be seen as an example of “capture”. The trick is to combine carrots with sticks and to cut one’s losses early rather than allowing permanent subsidies to inefficiencies. Being clear about the purposes and pitfalls of LIT policies is crucial.

⁵⁴ See Bruce Greenwald & Joseph E. Stiglitz, 2006. "Helping Infant Economies Grow: Foundations of Trade Policies for Developing Countries," *American Economic Review*, vol. 96(2), pages 141-146, May.

Thus, a recurring theme of the critics of trade policies aimed at promoting development is that they created rents. Some of the trade distortions failed to promote dynamic industries. Trade reforms in Africa often took away such distortions, but replaced them with nothing. The result was not an elimination of rents but their diversion to other less useful or “growth-unfriendly” forms such as kickbacks on government contracts.

The consequences of abjuring of any form or degree of LIT policy proved disastrous: they were reflected in the de-industrialization of Africa, manifested in the falling share of manufacturing in GDP that has been widespread over the past two decades or so. Concomitantly, formal sector employment has fallen as a share of total employment, often quite sharply in the face of rapid population and labor force growth (see the contribution of Aziz Khan). Moreover, rents are not exclusive to industrial policy or interventionism. Neo-liberal reforms -- and especially privatizations and concessions-- also give rise to rents. The issue was not whether or not there were rents but how those rents are used or what activities do they encourage; and what institutional arrangements minimized agency costs. Markets are not “technology-friendly” (for one thing technology is a public good) and rents are essential for the acquisition or development of technology.

A more nuanced policy would have asked: How does one prevent the associated rents from becoming a permanent subsidy to inefficient, uncompetitive enterprises, which become addicted to the rents rather than grow-up?

By the same token, questions are often raised about the ability of governments to do a better job than the private sector in picking winners; but this way of putting the argument misses the point: the reason for government involvement is because of the externalities and/or other market failures. The case for government intervention is to support investment projects with large spillovers, which the private sector would not take into account in their investment decisions. (Wade makes a distinction between the state acting as a “leader” and trying to pick winners and as a “follower” that seeks to encourage nascent activities that have shown promise.)

Some success cases

These questions inform the discussion “industrial policy” that is the center of attention of several of the papers in this volume Ohno and Ohno well as Hanatani and Watanabe aim to draw lessons from East Asia for Africa. They both emphasize the diversity of circumstances and LIT policies in East Asia and emphasize there is no one-size-fits-all LIT policy. A large part of the East Asian lesson is the method of policy formulation rather than specific measures. This style of policy making is characterized by pragmatism and flexibility. As Ohno and Ohno note in such an approach, “the problem of weak policy capacity is overcome through focused hand-on endeavor to achieve concrete results, which we call *dynamic capacity development*, rather than trying to improve

governance scores, generally vis-à-vis the global standard” (italics in original). This “dynamic capacity development” is akin to the “growth-enhancing governance” that we emphasize in the next section.

Bailey, Lenihan and Singh underline the variety of LIT policies by extending the analysis of LIT policy to Ireland and arguing that that too has useful lessons for Africa. They remark that “Commonly adopted definitions of industrial policy are too narrow where the prime focus..... has been on subsidizing firms and (on) interventions with respect to particular sectors.....good practice industrial policy is in fact much more ‘holistic’ in its approach and focuses *simultaneously* on both demand and supply side factors.....on micro economics as well as macro economics” (italics in original).

The contribution of Sen and te Velde focuses on experience in several African countries with a vital element of LIT policy, State-Business Relations (SBR), and show not only the possibilities but also the successes with such policy. More precisely, they find that there are a number of cases of varying degrees of success with establishing the sort of SBR that were so central to LIT policy success in East Asia and that these had a favorable impact on private investment and growth. Nimrod Zalk’s case study of LIT policy in South Africa makes a case for such policy, paying attention to both the pitfalls and potential of LIT policy. The essays by Wade and by Oyeyinke and Sampath also serve to highlight the possibilities and potential for success of LIT policies in low-income or “latecomer” countries in general, which is of special relevance for Africa. Oyeyinke and Sampath emphasize ways to strengthen institutional capacity for LIT policy whilst Wade examines the ways that LIT policy can help with “catching up” in today’s globalized world by making a case for open-economy LIT policy. Stein examines the African experience with one important tool of industrial policies, export-processing zones, that have had such success in some countries but have had only limited success in Africa. He attributes that to the fact that such economic zones in Africa have not been part of a broader LIT policy as they have, where the zones have been particularly successful.

VI. 2. Governance

A central question repeatedly raised with respect to the applicability of industrial policies that were so successful in East Asia to Africa is “governance.” The lack or inadequacy of governance capabilities is held to be a major, if not the central, cause of the poor economic performance of Africa. By the same token, the problem of governance is said to preclude Africa from successfully emulating many of the interventions that proved so effective in other contexts, notably of the East Asian variety. Credible sunset clauses on rents are, it is argued, rare and difficult—beyond the governance capacity of most African countries.

This is one of the pivotal issues addressed in this volume; indeed it could be said to be at the heart of the constraints to and possibilities of economic growth and transformation in Africa. (Most of the papers in this volume touch, in one way or another,

on governance. It is the focus of the contributions of Mushtaq Khan, Thandika Mkandawire and Meles Zenawi. The nexus of governance and the state also feature significantly in the contributions of Fosu, Hanatani and Watanabe, Ohno and Ohno, Oyeyinka and Sampath, and of Sen and te Velde.)

While the “governance” discussion is important—it is clearly one of the critical issues facing the countries of the sub-continent (and, in one form or another, virtually all countries around the world) -- we argue that the “good governance” agenda as it has come to be defined and pursued in Africa has itself become a part of the problem. We propose a radically different approach-- what Mushtaq Khan’s paper refers to as “growth-enhancing” governance and which is closely allied with the call for a focus on “transformative” rather than “restraining” institutions in Thandika Mkandawire’s contribution. We consider this to be necessary for Africa to achieve, sustained, rapid, poverty-reducing growth.

Corruption and lack of competence of state institutions is widely believed to account for poor economic performance and in a vicious circle to prevent African governments from intervening effectively in the ways in which East Asian and other successful countries did. The “good governance” package confuses ends with means and in as much as it is about means to development, it can be misleading and diversionary. There is no gainsaying that appropriately designed anti-corruption efforts, democracy, the rule of law, clear and credible property rights and related elements of “good governance” are desirable in themselves. But such words often hide as much as they enlighten. As legal scholars have pointed out, there is more to the issue of property rights than the simplistic formula “defining clear and credible property rights” might suggest.⁵⁵ Often these “prescriptions” have been used to promote a particular view of what institutions are the most important for development and how they should be designed; a view that is embedded in neo-liberalism and its excessive faith in markets.⁵⁶

The first of the two contributions by Mushtaq Khan traces the roots of the “good governance” agenda and relates it to the wider literature on institutions and development. He finds a conflict between the conventional “good governance” agenda, which he calls “market-enhancing governance” and what should be the agenda from a developmental perspective: what he refers to as “growth-enhancing governance”. He attributes the former as emanating from a particular methodology and view of history – a view, which is in fact profoundly ahistorical and which conforms to the neo-liberal take on the relative

⁵⁵ The property rights agenda has been at the center of the work of Hernando DeSoto. For a critique of these views, see David Kennedy (2003) ‘Laws and Developments’, pp 17–26 in A. Perry and J. Hatchard (eds) *Law and Development: Facing Complexity in the 21st Century*. London: Cavendish. or Haldar and Stiglitz { }

⁵⁶ This is not to deny the vital importance of institutions; indeed it may well be that “institutions rule” as Rodrik *et al.* famously remarked. As Mkandawire reminds us development economics from its inception in the early post-war years has emphasized the role of institutions. Dani Rodrik & Arvind Subramanian & Francesco Trebbi (2004), “Institutions Rule: The Primacy of Institutions Over Geography and Integration in Economic Development,” *Journal of Economic Growth*, vol. 9(2), pages 131-165, 06.

roles of the market and the state, e.g. by focusing on institutions that are deemed to be hindrances to markets performing in the way they are presumed to in neo-liberalism (e.g. property rights) to the neglect of other forms of government interventions to improve on or substitute for markets (e.g. by solving coordination problems). The standard argument for the importance of good governance is based on a statistical relationship between a measure of governance and a measure of performance. Mushtaq Khan points out that if you take developed countries out of the econometric study of the relationship between growth and governance, as measured by the standard indicators, there is no meaningful statistical relationship between governance and growth. More particularly, countries can be divided into high growth economies and low growth economies; and within each category, there is no relationship between growth and governance.

The “good governance” agenda was probably more driven, however, by neoliberal beliefs than econometric findings: the latter simply buttressed what the advocates of this agenda “knew” to be true. The governance agenda focuses on property rights, rule of law, anti-corruption as means of reducing transaction costs and as “preconditions” of development rather than ends in themselves. This governance agenda starts with the question, why markets fail? The answer it gives is because of weak property rights, bad interventions and high transaction costs. Given the seeming obviousness of the desirability of, say, having good property right, the question arises why have so many countries failed to do what would seem to be in their interests; the answer given is because of corruption and rent-seeking. And to solve this problem it is suggested that you need sweeping reforms and democracy to ensure accountable governments.

These are all highly desirable ends in themselves and may well facilitate and in turn be an outcome of development and but they are neither necessary nor sufficient for development. For developing countries, this may be welcome news, because this “good governance” agenda may not be feasible, especially in countries at an early stage of development. No country has ever implemented the current “good governance” agenda before embarking on development – not the now developed countries nor the rapidly “catching up” countries of Asia, a point emphasized by several of the contributions to this volume. These may be too expensive and/or run into constraints stemming from the structural problems of underdevelopment.

So what should developing countries be doing? The answer is that successful development requires governance reforms focused not on this particular “good governance” agenda but on “growth-enhancing” governance. This may even entail that the protection and creation of property rights for the productive groups in society happens at the expense of the undermining of the rights of unproductive groups as happened so commonly in settler colonies where not just the property rights but often the lives of “pre-capitalist” indigenous groups were eliminated. It will certainly entail ex-post flexibility and dealing with constraints as they arise. This more pragmatic approach would focus on a small number of measures at each stage directed at the governance capabilities required for dealing with the critical market failures holding back growth in a specific context.

Thandika Makandawire's essay argues that in the African discourse, the importance of institutions had long been recognized but the particular form that "institutional reform" took (like the governance agenda discussed in Khan's paper) was counterproductive. It was only after the "good policy" agenda of "getting prices right" had failed that the multilateral institutions and donors" turned to the "institutional" agenda. This disappointment was attributed to the failure of "governance". The "new paradigm" defined institutions and approached institutional reforms in an excessively narrow way. It focused, for instance, on property rights. There emerged a "one-size-fits-all" approach to institutions or what Makandawire calls "institutional mono-cropping". This "mono-cropping" itself became part of the problem: the institutions focused upon were not the appropriate ones; they had not been integral to the development of the rich countries and were not so for Africa. The emphasis had been almost exclusively on "restraining" institutions to the neglect of the "transformative" institutions that development requires.

At the same time there were increasing expectations of governments and a mismatch between institutions and tasks: Governments deemed to be unable to intervene properly in markets are deemed to be capable of effectively implementing a highly demanding set of institutional reforms. Moreover, impractical and inappropriate institutional "import substitution" neglects making use of and building on institutions that exist in a society; contrary to one of the lessons of East Asia for Africa.

Thandika Makandawire and Mushtaq Khan's essays complement each other. They both worry that, the pursuit of overly-ambitious and complex governance agendas risks making the pursuit of the best an enemy of the good. That what are desirable ends in their own right get confused with what is needed to accelerate growth and "catch-up". What is clear is that it is time to go beyond rhetoric and lecturing countries not to be corrupt, to the analysis of policies and institutions. Khan and Makandawire draw attention to and shed light on such questions as: what policies mitigate the developmental impact of corruption? Are there systematic ways of changing the way rents are accrued and shared in a manner that promotes or at least, does not hinder growth? Are there ways of designing, for instance, systems of checks and balances, of monitoring, which reduce the scope for corruption? What governance capabilities need to be prioritized when and to what end?

The Developmental State

The experiences in East Asia and elsewhere show it is clearly possible to have a state able to promote development—the developmental state. These experiences show that states can intervene with reasonable efficacy and can, for instance, influence the use of rents in the right direction. Countries such as Indonesia, Malaysia and Thailand did not have as developmental a state with as much scope as Korea or Taiwan but did succeed in accomplishing rapid development. They intervened with a wide range of instruments. More complex was the "developmentalism" of South Asia: India, Pakistan and Bangladesh at various points had achieved substantial success with "developmentalist" interventions, including notably in the spread of the "green revolution".

The full-fledged developmental states of Korea and Taiwan did not emerge out of nowhere in a complete form. As several of the essays in this volume emphasize, the construction of the developmental state is a deliberate, messy and complex affair. For example, Korea in the 1950s could be termed as a highly incompetent, dysfunctional and corrupt polity. Also China could be thought of as having made a transition from an ideological, revolutionary state to a developmental one. And so could Vietnam. Being developmental or not is not a binary choice but there is a continuum and states can aim to move up the chain rather than face the stark and impossible choice of being either developmental and able to intervene or non-developmental and confined to the neo-liberal role of provision of infrastructure – both physical and institutional (property rights, enforcement of contracts, maintaining law and order and so on.).

The African Development State

Makandawire and Khan's essays partly echo and also serve to lay the groundwork for Meles Zenawi's contribution and his call for the pursuit of a developmental state paradigm in Africa. That is in contrast to the neo-liberal paradigm with its limited or "night watchman" state. If Africa is to "catch-up", it will need to go beyond this limited vision of the State. Whilst it is too early to declare success for Ethiopia's "developmentalist" strategy, there are positive signs as illustrated by the examples of heretofore encouraging results of export growth and diversification (leather goods, flowers, sesame) aided by industrial policies; and by the fact that GDP growth exceeded 7 percent per annum during 2000-2007.

Ethiopia is not alone. African leaders and scholars have emphasized both the feasibility and desirability of a developmentalist state in Africa. In an earlier piece published elsewhere, Makandawire comments "most arguments raised on the impossibility of developmental states in Africa are not firmly founded either in African historical experience or in the trajectories of the more successful 'developmental states' elsewhere. Africa has had examples of countries whose ideological inclination was clearly 'developmentalist' and that pursued policies that produced fairly high rates of growth and significant social gains and accumulation of human capital in the post-colonial era".⁵⁷ Botswana success is perhaps the most notable. A developmentalist state cannot, of course be imposed from outside; it has to emerge from the political economy of a country. Even in Ethiopia the project of building one has had to contend with divisions amongst the political party in power.

The right questions to focus on are what sort of state is able to intervene and in what manner? What are the critical requirements of governance and how to go about acquiring them? What are the requirements and prospects of moving towards a developmental state? How can the risks of government failure be mitigated – failures that might make matters worse than market failures? How can countries ensure that they do not repeat the errors of failed etatism of the past? Whilst mistakes are unavoidable, it is important to

⁵⁷ Thandika Mkandawire, "Thinking about developmental states in Africa", *Cambridge Journal of Economics*; May 2002; 25,3; pp. 309-310.

emphasize the East Asian lesson of abandoning failures quickly; of constantly reviewing and modifying policies, as emphasized by several contributions to this volume, including those of Ohno and Ohno and of Hanatani and Watanabe, and of Bailey, Lenihan and Singh who remark that the “key is to adapt and tailor policies holistically to (the) stage of development”. At the very least, the options for an African government wishing to take the route to the developmental state paradigm and undertake the necessary governance reforms should be elaborated and put on the table.

The promise and possibilities in Africa are indicated by Sen and te Velde who conclude that “our research shows that the creation and sustenance of effective state-business relations ... may have a stronger impact on economic growth in Sub-Saharan Africa than the conventional measures of governance reform such as improvements in the rule of law and stronger anti-corruption measures that have been stressed in the literature and the policy debate.” This is very much in line with the case for a State that is “growth-enhancing” and “transformative”.

VII. Pro-Poor Growth and Human Capital

Pro-Poor Growth and Human Capital

A developmental state is concerned not just with promoting growth for its own sake, but because it can enhance the well-being of its citizens, especially the poor. The issue of pro-poor growth received more attention in the discussions of the Task Force than they do in this volume. These issues are to be further elaborated upon in the subsequent volume. For Africa, increases in agricultural productivity have to be a central element of poverty reduction. Employment is another key issue, particularly in urban areas. In this volume, the paper by Azizur Rahman Khan notes that employment generation is perhaps the most important characteristic of pro-poor growth. Analysis of labor markets in Africa is hindered by paucity and indifferent quality of data. Nonetheless certain broad trends are fairly clear. Self-employment in family and subsistence activities hides unemployment and low productivity in these activities means that the incidence of the working poor is very high in the region. The proportion of the employed who earn less than PPP\$1 a day is 55 percent in Africa, compared with 34 percent in the region with the next highest proportion, South Asia, and a range of 3-12 percent in other developing regions.

Whilst making employment in agriculture more productive and lucrative has to be an essential element of poverty-alleviating growth, it is unlikely that agriculture can provide reasonably high-productivity employment to perhaps even all the labor force already in the sector, let alone the additions to the labor force in the pipeline in the foreseeable future. This implies that reasonable progress in reducing poverty will require Africa to replicate what A.R. Khan labels as one of the most important lessons of East Asian development, viz. “rapid structural change leading to a transfer of labor from agriculture to industries and modern services by means of very high rates of growth of these sectors

brought about by support for these sectors on a very broad front”. Sustained, rapid growth and structural change then is particularly important for poverty reduction in Africa. We have focused on some fundamental policy requirements for such outcomes in Africa. A.R. Khan notes several others: the importance of public investment in providing infrastructure and human capital.

Critics of “pro-poor” growth worry that the focus on poverty will reduce the overall growth rate, and thus long term prospects for poverty reduction. This raises the question of whether for countries with particularly poor growth and essentially stagnant or falling per capita incomes, should one focus first, just on growth? Is that a challenging enough task without overburdening the agenda with also influencing the pattern of growth to ensure that it is pro-poor?

The experience of East Asia suggests that focusing in distribution may actually contribute to sustained growth. Indeed, one can ask, can some African countries afford to neglect the issue of making growth pro-poor? “Shared growth” is essential for political sustainability of reforms.

Indeed, in low-income African countries, rapid growth in the initial stages, unless based on natural resources, is necessarily pro-poor: it is not possible to have strong overall growth without healthy growth of agriculture and small-and-medium enterprises (SMEs), precisely where the jobs for the poor are. The distributional impact of growth in low-income Africa should be of central concern where it is fuelled by natural resources. In such countries, inequality cannot be justified as a necessary consequence of providing incentives. The striking thing is that, nonetheless, such countries are typically marked by high levels of inequality.

Another essential ingredient of making growth pro-poor is, of course, investment in the human capital of the poor. That health, education, fertility reduction and poverty alleviation are a seamless web has gained widespread recognition since this nexus was emphasized in the *World Development Report 1980*⁵⁸, the World Bank’s first such report on poverty. Since then these issues have received much attention in the literature. *The World Development Report 1998*, focusing on knowledge in development acknowledged that it was a great mistake to neglect post-primary education in Africa. Investment in human capital of the poor is vital both as an end as a mean.

The paper by Ansu and Tan looks at the issue of higher level skills for growth. In Africa there is the anomaly of a shortage of high-level skills, while the region is a significant exporter of these skills; moreover those who remain in their countries are often underutilized with high rates of unemployment for those with higher education and many of those employed being engaged in activities other than those for which they were trained. A two-track approach to be pursued simultaneously is proposed. One is for quick results utilizing those with higher education and another is a longer-term effort at a systematic transformation of the education system.

⁵⁸ World Bank (1980), *World Development Report 1980* (Oxford University Press, New York)

A World Bank team working on this issue, looking at the experience of several East Asian countries, found much of relevance for Africa in adopting a short-term, quick-results strategy linked to attracting DFI in non-extractive activities. Singapore provides an example. The Government invited India's Tata industries to invest in Singapore and offered to subsidize or pay for the much of the costs of training whilst Tata supplied the equipment and trainers. It also worked with the French and Japanese governments to establish an electronics training and a higher technology institute, respectively. Malaysia and Ireland were also examples of countries that had successfully pursued public-private partnerships and/or established and subsidized technical training for skills needed by the private sector. In Africa there are beginnings of this type of approach e.g. in Ghana, Mozambique and Nigeria. There are then the longer-term challenges of raising the quality of training and relating the supply of trained people to demand for them.

International Context

Africa's development, like that of so many other developing countries, is greatly affected by globalization: both flows of goods and services, capital, and labor, and ideas about how development should proceed. "Impact of Globalization and Liberalization on Africa" is the subject of a wide-ranging review by Jomo and von Arnim. The issues raised included the problems of declining terms of trade for primary exporters (the Singer-Prebisch thesis); market access; capital outflows, debt, aid and DFI. In their view globalization and liberalization had not nearly been as beneficial to Africa as they could have been; indeed it was not entirely clear that their impact on Africa had been positive. There are two sets of questions: one is how to make the international system more Africa-friendly (e.g. by improving the quality and quantity of aid) and the second is how Africa should respond to the changing global context. These issues are to be examined further in the future work of the task force (see below).

Deepak Nayyar examines the growing importance of China and India as aid and trade partners of Africa, and the implications for Africa of the rising importance of China and India in the world economy. On the trade front, there are both substantial challenges and opportunities; they are formidable competitors as well as large and growing markets.

VIII. Issues to be Explored and Concluding Comments

The Next Phase

Some issues that are not covered in this volume have been flagged as of particular importance for sustained and equitable growth for Africa, and will be covered in a subsequent volume (reflecting the work of the Africa Task Force in its last meeting, held in Pretoria). These include, notably those of i) finance; ii) agriculture; iii) climate change; and iv) aid.

Sustained and reasonably rapid growth is hardly possible without businesses having adequate access to credit at reasonable real interest rates. The absence of such access to

credit in Africa is in marked contrast to East Asia; and has been, arguably, one of the chief inhibitors of growth. In East Asia, governments took an active role in helping create effective financial sectors. At critical stages in the development of the region, the government played a crucial role in allocation of finance—one of the main tools of LIT policy was access to finance, provided, for instance, as a reward for success in exports. Governments often exercised financial restraint—limiting entry, controlling interest rates—though it did so carefully, ensuring positive real interest rates.⁵⁹

In Africa, dysfunctional, decrepit financial sectors that were common in the pre-reform period have been the subject of protracted reforms since 1980. A high degree of financial repression often with negative real interest rates was not uncommon. Nor was the abuse of development finance and other state-owned financial institutions by the politically powerful. Invariably, the reforms have been mainly about liberalization and privatization of the financial sector. The results have been disappointing, though not surprising to those not wedded to the neoclassical models which assume perfect information and perfect markets⁶⁰. Financial markets are especially prone to failure, particularly given the salience of information asymmetries and moral hazard in such markets.

The Washington Consensus reforms have often led to persistently high real interest rates (frequently in double digits), and huge spreads between deposit and lending rates, without a major improvement in access to credit and without significant increases in savings rates. The “reformed” financial sector was neither doing a good job of mobilizing savings nor of allocating them. Excess liquidity was common, high real interest rates to dampen demand for credit and high yields on government bonds reduced the banks’ desire to supply term credit. The rural areas, by and large, remained starved of banking services. This has led to a revival of interest in the role of the state in the provision of credit: Is there a role for development banks or directed credit that played such a vital role in accelerating growth not only in East Asia but also at different times in different countries of South Asia (e.g. Pakistan in the 1960s) and Latin America (e.g. Brazil in the 1950s and 1960s and again more recently)? How might the details of policy design guard against relapse into the bad, old ways of state involvement in the financial sector in much of Africa and elsewhere?

As noted above, agriculture is vital not only for growth but also for making it pro-poor. This is another area where the insights of the successful developmental states of East Asia may be of relevance to Africa: many of the East Asian countries began their successful developmental efforts with land reform.

Climate change is already having a large impact on many parts of Africa. Ultimately the sustainability of rapid growth and poverty reduction will depend on how this issue is addressed. And an adequate response in Africa will require considerable foreign assistance both financial and technological.

⁵⁹ See Stiglitz and Uy (1996) and World Bank (1993), *The East Asian Miracle, op cit.*

⁶⁰ See World Bank, *World Development Report 1998-99: Knowledge for Development*, October 1998.

Concluding Comments

At the time of the first meeting of the African task force in Manchester at the Brooks World Poverty Institute, the sense of the meeting was that whilst the recent rapid growth (prior to the crisis) is welcome, it partly reflects the familiar African cycle of growth rising and falling with changes in the external environment, particularly commodity exports and prices. That meeting, occurring, before the crisis, and concluded that there was little room for complacency: there were concerns about the sustainability of the higher growth path and that 5 percent was not nearly good enough, especially in light of continuing rapid population growth in the vicinity of 3 percent per annum. The last meeting of the Task Force prior to the publication of this book occurred after the global financial crisis⁶¹, and reaffirmed the Task Force's concern about sustainability: Africa had been badly hit, through no fault of its own. The growth of the Sub-continent's economy will be lower than that of its population in 2009. South Africa was especially badly hit, as GDP fell by some 2 percent⁶²

Africa has been afflicted with low growth expectations—and these expectations may have contributed to the sub-continent's low performance. The Task Force's emphasis on the need to break out of the “low growth expectations equilibrium” has received support from virtually every study of Africa's future. Africa should be aiming for growth in excess of 7 percent.⁶³ As we noted earlier, growth of this level will be necessary if the region is to achieve the Millennium Development Goals—aspirations which it is now not on target to meet.⁶⁴ In the light of the standards set by the successful developing countries in recent decades, including the African star, Botswana, such aspirations are not unreasonable. The recent improvement in growth in the years before the global financial crisis does not diminish the importance of the issue of getting serious, sustained growth going in Africa; and the impact of the global financial crisis has reemphasized the need to break out of its dependence on the export of natural resources.

It is our hope that this book, the experiences of the successful countries in other parts of the world, and the work of the African Task Force, will contribute to the debate on how this can best be done.

⁶¹ The meeting took place in Pretoria, on July 9-10, 2009. .

⁶² IMF (2009) World Economic Outlook, October 2009

⁶³ This is the sort of growth that the Growth/Spence Commission focuses on. The Commission for Africa organized by the UK Government speaks of growth targets of 7+ percent in the Region.

⁶⁴ UN Economic Commission for Africa and African Union Commission, Assessing Progress in Africa towards the Millennium Development Goals Report 2008, March 2008, <http://www.uneca.org/cfm/2008/docs/AssessingProgressinAfricaMDGs.pdf> “The continent's average annual growth rate of approximately 5.8 per cent still remains significantly lower than the 7 per cent annual growth rate required to reduce poverty by half by 2015.” “It shows that progress is being made in a number of areas such as primary enrolment, gender parity in primary education, malaria deaths, and representation of women in parliaments. If this rate of progress continues, the continent will be on course to meet a significant number of the MDGs by the target date. This will still be disappointing since the objective is to reach all the targets by 2015.”