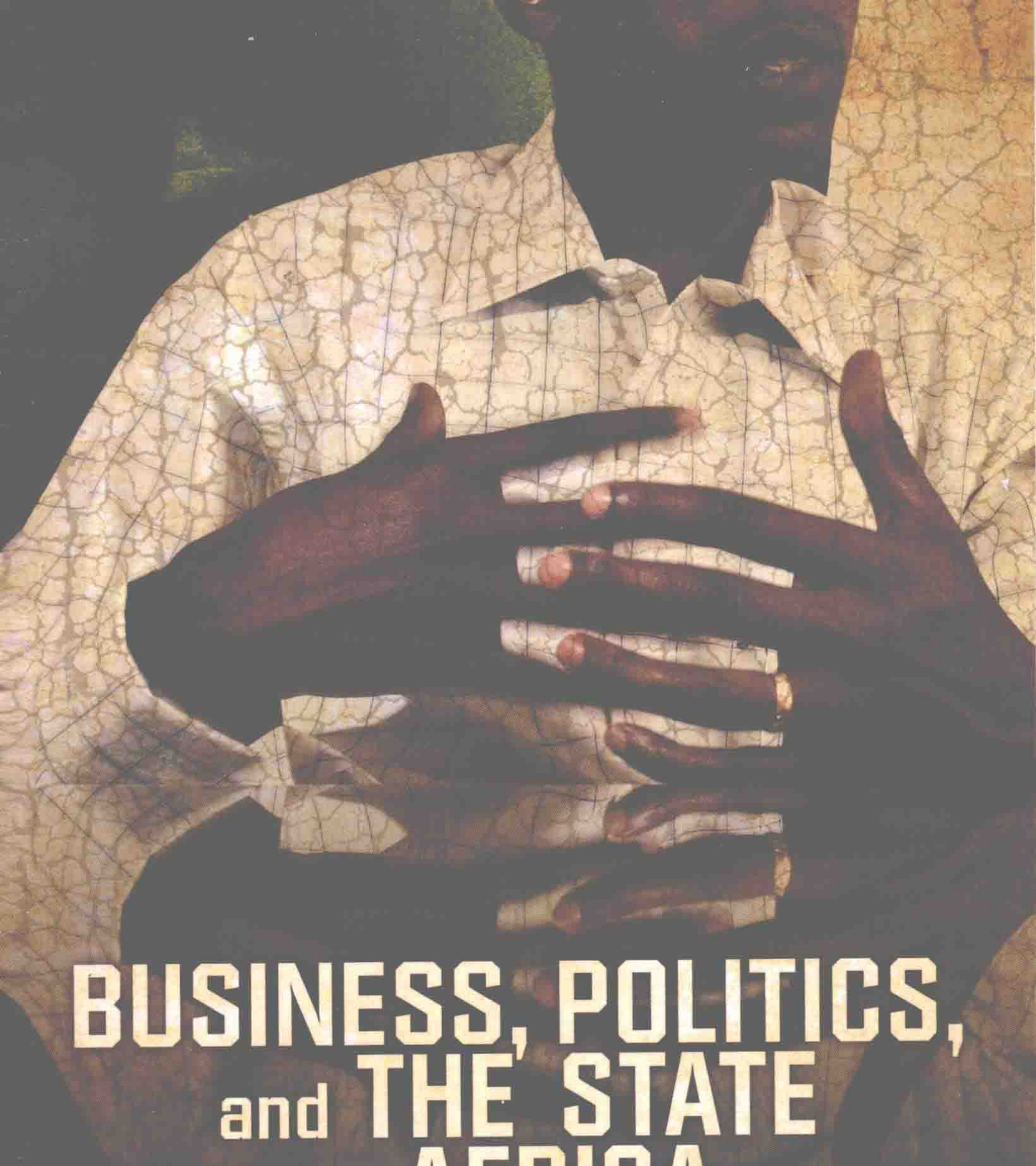

BUSINESS, POLITICS, and THE STATE in AFRICA

CHALLENGING THE ORTHODOXIES ON GROWTH AND TRANSFORMATION

TIM KELSALL

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with *David Booth, Diana Cammack, Brian Cooksey, Mesfin Gebremichael, Fred Golooba-Mutebi, Sarah Vaughan*

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ABBREVIATIONS

APPP	Africa, Power and Politics Programme
CCM	Chama cha Mapinduzi (Tanzania)
CPP	Convention People's Party (Ghana)
DfID	Department for International Development (UK)
EFFORT	Endowment Fund for the Rehabilitation of Tigray
EHPEA	Ethiopian Horticulture Producers Export Association
EPRDF	Ethiopian Peoples' Revolutionary Democratic Front
EPZA	Export Processing Zones Authority (Tanzania)
FDI	foreign direct investment
GDP	gross domestic product
GEMA	Gikuyu, Embu and Meru Association (Kenya)
HIPC	Highly Indebted Poor Country
IMF	International Monetary Fund
IPTL	Independent Power Tanzania Ltd
ISI	import substitution industrialization
KADU	Kenya African Democratic Union
KANU	Kenya African National Union
KAU	Kikuyu Central Association (Kenya)
KIA	Kilimanjaro International Airport
KTDA	Kenya Tea Development Agency
MCP	Malawi Congress Party
MDAs	ministries, departments, and agencies
MDGs	Millennium Development Goals
MKUKUTA	National Strategy for Growth and Poverty Reduction (Tanzania)
MoTI	Ministry of Trade and Industry (Ghana)
NDC	National Democratic Congress (Ghana)/National Development Corporation (Tanzania)
NGO	non-governmental organization
NPP	New Patriotic Party (Ghana)
ODA	Overseas Development Agency
OECD	Organisation for Economic Co-operation and Development
PDCI	Parti démocratique de Côte d'Ivoire

PFMRP	Public Financial Management Reform Programme (Tanzania)
PNDC	Provisional National Defence Council (Ghana)
PP	Progress Party (Ghana)
PPP	public–private partnership
PSCAP	Public Sector Capacity Building Programme (Ethiopia)
PSDS	Private Sector Development Strategy (Ghana)
PSI	President's Special Initiative (Ghana)
R&D	research and development
RDB	Rwanda Development Board
RHODA	Rwanda Horticulture Development Authority
RIG	Rwanda Investment Group
RPA	Rwandan Patriotic Army
RPF	Rwandan Patriotic Front
SAA	Syndicat agricole africaine (Côte d'Ivoire)
SOE	state-owned enterprise
TAHA	Tanzania Horticultural Association
TANU	Tanganyika African National Union
TCME	Tanzanian Chamber of Minerals and Energy
TIC	Tanzania Investment Center
TICTS	Tanzania International Container Terminal Services
TPLF	Tigrayan People's Liberation Front
TRA	Tanzania Revenue Authority
UDF	United Democratic Front (Malawi)
UGCC	United Gold Coast Convention
UMNO	United Malays National Organization
VAT	value-added tax

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The book is a collaborative effort. The Introduction and Chapter 1 are mainly the work of Tim Kelsall, with significant contributions from David Booth, Brian Cooksey, and Diana Cammack. Chapters 2 and 4 are mainly the work of Brian Cooksey, and Sarah Vaughan and Mesfin Gebremichael, respectively, with significant contributions from Tim Kelsall. Chapter 3 is mainly the work of Tim Kelsall, and Chapter 5 of David Booth and Fred Golooba-Mutebi. Tim Kelsall wrote the Conclusion, although all of the authors contributed in effect.

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INTRODUCTION: GROWTH, GOVERNANCE, AND ECONOMIC TRANSFORMATION IN AFRICA

In recent years Africa[1] appears to have turned a corner economically. After decades of being the world's slowest-growing region, it is now outpacing Latin America, eastern Europe, and the Middle East, posting annual growth rates of over 5 percent (Economist 2011). The IMF forecasts that African countries will occupy seven of the world's top ten growth spots over the next five years (ibid.), and a recent report by global management consultants McKinsey spoke of African 'lions' to rival Asia's celebrated 'tiger' economies (McKinsey Global Institute 2010). The slew of positive reports about Africa's economic progress has generated considerable optimism, and led to claims that conventional good governance and structural adjustment policies are finally bearing fruit.

A growing number of heterodox thinkers, however, have begun to question this interpretation. They point to the dependence of African growth on global commodity prices, investment in extractive sectors, and foreign aid, querying whether it can be sustained. African economies have yet to witness a structural transformation of the kind East Asia experienced in the latter half of the twentieth century, nor have they moved into producing higher-value commodities for export (United Nations Economic Commission for Africa 2011). In order to do so, heterodox thinkers argue, they will need to adopt more ambitious industrial policies.

Industrial policy, however, is currently out of favor in most of Africa. The explanation can be found in the conventional wisdom on African governance. In this view Africa's regimes are 'neo-patrimonial', their legitimacy tied to the distribution of economic favors to clients or cronies, meaning that industrial policies will inevitably fall prey to unproductive 'rent-seeking'. With 'government failure' such a chronic problem, economic development is best left to market forces. Unsurprisingly, heterodox thinkers disagree, arguing that market failure is a more serious problem than government failure; but in doing so they tend to understate the magnitude of governance problems in Africa.

This book is written as an intervention in this debate. For reasons that will become clear, we side with the heterodox position that Africa needs more ambitious industrial policies if it is to develop, but we accept the conventional wisdom that in many African states neo-patrimonialism is a problem. We do not think it is an insurmountable problem, however, and our main contribution is to stipulate the conditions under which neo-patrimonial governance, or else something rather different to liberal 'good governance', can be combined with sound industrial policies and strong developmental performance. We do this by revisiting the history of post-independence economic performance in a selection of Asian and African countries, and then we extend our analysis through case studies of four contemporary African states. By the end of the book, we will have a better idea of the kinds of institutional arrangements that permitted some African regimes to pursue successful industrial policies in the past, together with a deeper understanding of the relationship between governance and economic performance in Africa today.

The debate about African growth

Between 1960 and 2000, Africa was the slowest-growing region in the world. Many African countries grew respectably in the 1960s and early 1970s, but their growth was derailed after 1974, turned negative in the 1980s, and rebounded only weakly in the 1990s (Rodrik 2003: Fig. 1). Eighteen African countries recorded negative annual real per capita growth rates between 1973 and 2000, sixteen countries recorded growth rates of less than 1 percent, and six countries had growth of between 1 and 2 percent per annum. The pattern of growth was also highly volatile, with only the tiny countries of Botswana, Equatorial Guinea, and Cape Verde experiencing growth that was sustainable and steady (United Nations Economic Commission for Africa 2011: 78–80). The impact on livelihoods was severe. At the turn of the millennium social services were in chronic disrepair, nearly half the African population fell below a $1.50 a day poverty line (Ndulu and O'Connell n.d.: 2),[2] and large parts of the continent were vulnerable to lethal epidemics, famine, and war. In 2000, the *Economist* magazine ran a cover story labeling Africa 'The hopeless continent' (Economist 2000).

The next decade saw a remarkable change of fortunes. Several economies, and especially oil exporters like Angola and Equatorial

Guinea, began recording double-digit growth rates. Other, non-oil exporters like Tanzania, Uganda, Rwanda, Ethiopia, and Malawi began to grow at 6 percent a year or more. The region overall averaged per capita growth of 2.7 percent between 2000 and 2008 (World Bank 2009a).[3] In this context commentators began to point to some of the advantages of investing in Africa: a collective GDP of $1.6 trillion, combined consumer spending of $860 billion, 316 million new mobile phone subscribers, 60 percent of the world's uncultivated arable land, fifty-two cities with a population of more than a million, a bigger middle class than India, and twenty companies with a revenue of more than $3 billion (McKinsey Global Institute 2010). Others talked not just of 'lion' but of 'cheetah' economies (Radelet 2010).

This economic revival has provided support for the idea that the conventional donor approach on the continent is working. Referred to throughout this book as the 'neoliberal orthodoxy', 'conventional wisdom', or 'standard policy advice', that approach rests on the idea that African governments should limit themselves to providing macroeconomic stability, property rights security, light-touch regulation and investment facilitation, and a level playing field for economic competition (World Bank 2004). Donors have been pushing this advice for more than two decades, and there is now a broad unanimity in African governments about the importance, for example, of sound macroeconomic management. In most states, the budget deficits that fueled inflation, eroded competitiveness, and led to unmanageable debt are a thing of the past. Inflation averaged 22 percent in African economies in the 1990s, but in the 2000s this fell to 8 percent. Budget deficits shrank from 4.6 percent of GDP to 1.8 percent (McKinsey Global Institute 2010: 12).[4]

Many African countries have also taken measures to make investment easier by improving regulatory frameworks. Almost all African countries now have investment promotion centers that are supposed to cut through bureaucratic red tape by offering a one-stop shop for investors. Most have also taken significant steps to liberalize internal and external trade, and to privatize large swathes of previously moribund, state-owned industry. Nigeria, to give just one example, privatized more than 116 state-owned enterprises between 1999 and 2006 (ibid.: 12). Many countries have also made reforms in the areas of credit regulation (84 percent), labor market regulation (82 percent), business regulation (64 percent), and trade policy (50 percent) (ibid.: 13).

The World Bank's *Doing Business* annual reports and league table, which use business interviews to rank countries on criteria related to the ease of doing business, capture this progress. They are based on the belief that: 'Where business regulation is burdensome and competition limited, success depends more on whom you know than on what you can do. But where regulations are relatively easy to comply with and accessible to all who need to use them, anyone with talent and a good idea should be able to start and grow a business in the formal sector' (World Bank and International Finance Corporation 2011: 1). The reports provide a powerful index of the nature of the 'business climate' in both developed and developing countries, and thus an incentive to governments to undertake 'best-practice' economic reforms. Over the past five years, thirty-nine African countries have made progress up the table (Mitchell 2011), a result in part of donor-driven private sector development programs.

Not everyone is impressed by these statistics, however. Despite manifest progress in African growth figures over the past decade, an increasingly influential group of heterodox political economists argue that the changes are superficial and liable to be short lived. A key reason is the role of international commodity prices in driving African economic recovery. Oil and gas have been at the forefront of Africa's current growth spurt (Southall 2009: 16), with the price of oil rising from $20 a barrel in 1999 to $145 in 2008 (McKinsey Global Institute 2010: 2). Other commodities have also benefited: the price of coffee tripled between 2000 and 2010, and cocoa and cotton have more than doubled (World Bank 2011b: 8). These rises have been fueled primarily by increased market demand in other developing countries, especially in Asia. Between 1995 and 2008 China, for example, increased its share of African oil exports from 1 percent to 13 percent (McKinsey Global Institute 2010: 45), and trade between China and Africa overall leapt from less than $10 billion a year in 2000 to over $50 billion by the end of 2006 (Alden 2007: 8).

Emerging economies in Asia and Latin America have also been at the forefront of foreign direct investment (FDI) in Africa, supplementing increased investment from Africa's traditional trading partners. Heterodox economists point out, however, that much of this investment has been focused in 'capital-intensive extractive sectors that have few forward and backward linkages with the rest of the economy' (United Nations Economic Commission for Africa 2011: 3). Over the period 2002–07, for example, the resources sector expanded by 24 percent, twice the rate of agriculture and more than two and a half times that of manufacturing (McKinsey Global Institute 2010: 2). In fact, manufacturing growth was near the bottom of twelve growth sectors, with only public administration growing more slowly (ibid.: 2). These factors find reflection in the balance of Africa's external trade. Sixteen countries still rely heavily on just a single commodity, and the share of manufactures in African exports has barely increased, rising from 30 percent to just 33 percent in fifteen years (World Bank 2011b: 14). Over the past thirty years, the structure of African economies has remained virtually unchanged. South Africa and Mauritius aside, no country has an internationally competitive manufacturing sector, or an internationally competitive services sector (Amoako 2011: 24).[5] Fundamentally, Africa remains an exporter of raw materials and an importer of consumer and capital goods (Southall 2009: 27). To make matters worse, although FDI has been growing, it is still the lowest of any region, and the rate of private investment generally is about half that of Asia's (World Bank 2011a: 4).

Partly as a result, improved economic performance has not translated into commensurate reductions in unemployment and poverty, nor significant progress toward the Millennium Development Goals (MDGs). In the words of the United Nations Economic Commission for Africa, 'The continent is experiencing a jobless recovery' (United Nations Economic Commission for Africa 2011: 3; see also World Bank 2011a: 4). According to one of Africa's most distinguished economists, Africa needs to grow at about 7 percent a year for the next twenty or thirty years to make a serious dent in poverty, but 'growth induced by commodity price increases, static efficiency gains from better allocation of resources through economic liberalization, new discoveries of natural resources, or increases in foreign financial assistance – is simply not sustainable' (Amoako 2011: 24). Current policies, which focus on strengthening macroeconomic management, reducing official corruption, and providing a friendly business environment, have their uses, but according to Amoako, what Africa really needs is a structural transformation. Governments must work more proactively with the private sector to remove market failures and structural distortions, boost productivity growth, diversify production and exports, upgrade technology in all sectors, and increase global shares of, in particular, high technology exports (ibid.: 27).

The role of industrial policy in development

Heterodox thinkers believe that Africa can only sustain high growth and poverty reduction if it adopts a more ambitious form of industrial policy, sometimes referred to as 'learning, industrial, and technology' policy (LIT). According to Noman and Stiglitz,

> LIT policies focus on learning, especially by infant industries and economies; they focus on externalities and knowledge spillovers; they typically (especially in Asia) consist of promoting exports and the private sector. They apply not only to manufacturing, but also to other sectors, such as agriculture, and to modern services, such as information technology or finance. (Noman and Stiglitz 2011: 24)

The idea is that because growth and wealth rest ultimately on the productivity of labor, successful developers need to move out of low-productivity activities and into higher ones. Typically this begins with a productivity revolution in agriculture, proceeds with an increased role in the economy for industry and in particular manufacturing, and continues with movement into more sophisticated, high-tech or knowledge-intensive areas of production and services (Breisinger and Diao 2008; Whitfield 2011a). Although neoliberal economists have a faith that entrepreneurs in competitive markets will be led down this path as though by an invisible hand, heterodox authors identify a number of reasons why this may not be so.

The first set of reasons concern what are called 'knowledge externalities' or 'knowledge spillovers'. Consider a developing-country entrepreneur with an idea for a new type of investment. To determine its potential profitability, considerable market research may be necessary, and the costs incurred in setting up a new operation significant. However, if the said investment proves to be profitable, the initial investor may experience a flood of competitors, find his profit margins quickly eroded, and not even recoup his initial research costs. It is for these reasons that developing-country entrepreneurs tend to stick to tried and tested sectors, such as transport, haulage, or real estate, instead of moving into new sectors with potentially greater social benefits. In cases like this there is a case for government industrial policy to subsidize initial discovery costs, or to protect an initial investor from undue competition (Rodrik 2003, 2004; Whitfield 2011a).

Another sort of market failure is bound up with coordination or collective action problems. Consider an investor who knows that a horticultural operation in a developing country will be profitable, but only if he has access to freight services, input suppliers, etc. In the absence of these investments he cannot proceed; but in the absence of a horticultural sector, there are unlikely to be any suitable services or suppliers. In a case like this, there is a rationale for government to underwrite simultaneous investments across a sector, perhaps by providing credit guarantees (Rodrik 2004).

A final, and arguably most important, source of market failure is associated with learning costs. Even if there exists a potential comparative advantage in a new economic activity, novel technologies and industrial processes take time to learn and adapt. Entrepreneurs in developing countries will usually struggle to make profits initially, and many will fail. Extending capital to such ventures is therefore a risky business. In a context of perfect information, strong contract enforcement mechanisms, and functioning credit recovery systems, the market should be able to supply credit at an appropriate cost. But these phenomena are invariably absent in developing countries, meaning that private capital is likely to be undersupplied. Here is another example, then, of where subsidized credit, credit guarantees, or limited forms of market protection may be desirable (Khan 2011b: 58–61).

Economic development, in the heterodox view, is a dynamic process. As a country's endowments of physical and human capital evolve, so does its comparative advantage in different industries (Lin 2011b). Governments need to follow this advantage at each stage of their economic development by coordinating industrial policy and supporting the private sector: 'Economic development is a process, it involves the private sector entering new industries, learning new skills, building new infrastructure, establishing new financial systems and enjoying access to capital. But individual companies cannot coordinate these changes – and this is where the state steps in' (Lin 2011a: 16). In particular, 'first movers' who step into 'unknown territory' need special incentives such as tax breaks, co-financing arrangements, and help identifying markets: 'Without first movers there is no dynamic growth' (ibid.: 16). The state also plays a key role in supplying or facilitating the upgrades to 'hard' and 'soft' infrastructure that permit the realization of new comparative advantages (Lin 2011b).[6]

This is demonstrated by the history of today's developed states.

Virtually all successful developers have at one time or another employed industrial policies that have helped first to raise productivity in agriculture, then to increase the share of manufacturing and services in GDP, and then to move into higher-value areas of manufacturing and services (Breisinger and Diao 2008; Noman and Stiglitz 2011; United Nations Economic Commission for Africa 2011; Whitfield 2011a).[7] In fifteenth-century Britain, for example, the government imposed tariffs on unprocessed wool products, with the aim of developing a textiles industry (Whitfield 2011a). Sweden in the eighteenth and nineteenth centuries developed a number of strategic industries such as iron and steel, railways, telegraph and telephone, and hydroelectric power through public–private partnerships. It also provided some protection for heavy industry (Chang 2010). Nineteenth-century France and Germany both used the power of the state to create and protect investments in the period during which they were catching up with Britain (Gerschenkron 1965). Until the early twentieth century, the US state was one of the most protectionist countries in the world, and its government invested heavily in railways, higher education, and research and development (R&D) (Chang 2010). Japan's post-World War II industrial policy, which saw the country transition from light manufactures to heavy industry to information technology, sought to steer the economy into the highest-value areas of the world economy, *and* identified the most efficient methods Japanese firms employed, before propagating them industry-wide (Johnson 1982). South Korea used an even more extreme form of market-defying industrial policy, while Taiwan used both state and party to create strategic industries and to push and prod the private sector into doing the same (Wade 1990). The most recent group of successful developers, Southeast Asian states, poured resources into agricultural R&D and rural development, lifting millions out of poverty in the process (Van Donge et al. 2012).[8]

Rents and economic development

We noted in the introduction to this chapter that industrial policy is currently out of vogue in Africa. To understand this we need to grasp the role played in industrial policy by 'economic rents'. In economic theory, 'rents' are windfall gains or excess incomes that accrue to agents who operate in imperfect markets. They are often, although not always, created by government intervention: for example, when the government awards a monopoly over trade or production of a certain good to a particular business, where it restricts import trade through a licensing or tariff scheme, or when it provides subsidized credit to an entrepreneur, it permits the holders of these privileges to earn rents. In neoclassical theory government intervention and the rents it creates have long been regarded as economically damaging. By granting an infant industry a monopoly over the production of some good, for example, the monopolist will tend to produce a smaller amount at a higher cost than could have been provided by a competitive market. The monopolist's rent is society's loss. In addition, the possibility of earning these lucrative rents stimulates a process of rent-seeking, as agents compete with each other to gain access to them (Khan 2000a; Krueger 1974). Sometimes rent-seeking takes the form of legitimate lobbying activities; but often it takes the form of bribery and corruption. In either case, because rent-seeking activity doesn't actually produce anything, it is socially wasteful. An economy that has a lot of rent-seeking will consequently operate inside its transformation curve, with growth and incomes less than they could have been (Khan 2000a; Krueger 1974).

In the neoliberal interpretation, industrial policies shoulder much of the blame for Africa's dismal economic performance up until the beginning of the last decade. The story is that African governments introduced a range of market distortions into their economies with the aim of promoting industrialization, and that these distortions undermined the economy. For example, granting monopoly licenses to industrial producers led to low production at high cost, and little innovation. Overvaluing exchange rates with a view to importing cheap technology lowered the real price paid to export crop producers, leading them to smuggle their goods or stop producing altogether. Artificially low prices for food, designed to keep down the cost of the urban wage, deterred food production by small farmers. These distortions combined eventually to produce a generalized economic crisis, as exports dried up, industrial inputs could not be imported, and only parallel markets could supply the cities with food (Bates 1981, 1988; World Bank 1981). We will see in the cases of Tanzania and Ghana in Chapters 2 and 3 that there was substantial empirical support for this interpretation (see also Williams 1994).[9]

Another part of the neoliberal analysis is the role of rents in preventing policy reform. The story is that even when it was clear to African