(DRAFT)

African Development Prospects and Possibilities

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There are many interwoven dimensions to development, and on some counts Africa's performance has been better than on others. Particularly notable are the improvements in education and health (though the aids epidemic has reversed some of the gains). Perhaps, the most disappointing has been the growth record reflected in per capita incomes and poverty: per capita income is roughly the same as in 1970. Hence, Africa's prospects hinge on the answer to the overarching question of why has the growth performance of Africa been so disappointing and what are the possibilities and polices for Africa to achieve sustained, rapid growth and associated structural transformations?[1]

The question is not, of course, as simple as posed above because of the diversity of African countries and experiences that included the fastest growing economy in the world during 1960-2000: Botswana; the success story of Mauritius and countries that have experienced goodish growth (5+ percent) over longish periods of a decade or so, such as Mozambique, Ethiopia, Tanzania, Uganda and Ghana. These successes, those elsewhere, notably in East Asia and the revival of average growth in Africa since the late 1990s (before the 2008 crisis), suggest that there are lessons to be learnt for policy design.. There are a myriad of country-specific factors that affect economic performance. In particular, failed/fragile states are not contexts that are amenable to the sort of analysis we undertake. Our concern is with the policy options and prospects for the many African states committed to development.

To put things in perspective, we recall that as Africa emerged from colonialism, Asia was the region in turmoil with wars, revolutions, uprisings. A widely held view contrasted Africa's promise with Asia's pitfalls. [2] Also, Africa averaged reasonable growth in the 1960s and 70s. Its ending partly reflected adverse exogenous shocks: oil prices, global interest rates, and commodity prices. But they also exposed policy weaknesses: highly overvalued exchange rates, macroeconomic instability, irrational and extreme protection, un-or-counter productive rent seeking, bloated bureaucracies/public sectors, and dysfunctional financial sectors became all too common. Frequently,

[1] To address this, the Initiative for Policy Dialogue (IPD) at Columbia University established a task force on Africa. One outcome is Akbar Noman, Kwesi Botchwey, Joseph Stiglitz and Howard Stein (eds) *Good Growth and Governance in Africa: Rethinking Development Strategies* (forthcoming)

[2] The pessimism was shared by Nobel laureate Gunnar Myrdal (1968) *Asian Drama* (New York: Twentieth Century Fund)

extensive interventions were undertaken without regard for the capacity to design and implement them effectively.

The response was a set of reforms, often imposed as conditionalities, focused on liberalization and privatization that came to be known by the short-hand of the "Washington Consensus" (WC). To the extent that the Africa version of the WC served to highlight the aforementioned deficiencies and tilt the balance towards the market, it served a useful purpose. But it went too far in the other direction. Neither economic theory nor history provides a case for unfettered markets, even in advanced industrial countries. The results of many of the reforms in Africa were disappointing e.g. 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.

Exogenous versus Endogenous Growth

Six hypotheses have played a central role in the debate on Africa's performance and prospects. They pertain to (a) geography; (b) terms of trade; (c) the global "policy" environment e.g. the rules governing trade and aid; (d) inadequate *implementation* of the WC reforms; (e) governance; (f) Africa's failure is *because* it followed the WC policies

The first three hypotheses focus on *exogenous* determinants; the next two focus on aspects of African political-economy that in principle, are under its own control. The final puts some of the blame for Africa's failure outside the region—on those who imposed the WC policies—though ultimately countries are responsible for the policies they adopt. The fourth and sixth agree that policy matters but they differ on what constitutes appropriate policy. Both the advocates of WC and its critics agree that governance matters. But what aspects of governance are critical with what policy implications?

To what extent does geography explain low *income* as distinct from low *growth*? Geography may well be an important explanation of why some countries are poorer than others. There are many dimensions to geography and in Africa much attention has been devoted to being land-locked, notwithstanding the fact there is no significant difference in the growth of land-locked and coastal African countries over 1961-2004. For most countries, transport costs are not so important that there are not measures to reduce their economic impact. Their costs may lead to lower incomes. At worst, being landlocked means higher requirement for such investments for any given growth and/or wages and land rents being lower than they otherwise would be. There is though, no a priori reason that being landlocked should lower growth, especially once the "adjustments" designed to overcome the barriers are made.[3] Indeed, changes in technology that reduce transport costs will differentially benefit geographically disadvantaged countries, so they might be expected to have faster than average growth. Geography is not destiny. The relevant

[3] See the Africa Task Force report *op.cit*

question is, given their geography, what policies and institutions can best promote growth.

The prices of Africa's exports have been highly variable and correlated. Go and Page address the issue of to what extent can the recent growth spurt be attributed to **terms of trade**, arguing that whilst export prices helped, " growth acceleration … is due not only to favorable terms of trade and greater aid, but also to better policy ... Nonetheless, the sustainability of that growth is fragile, because economic fundamentals, such as savings, investment, productivity, and export diversification remain stagnant."[4]

The third important external factor for Africa is the quality and quantity of **aid**.. Initiatives like the Paris and Accra declarations and theCommission for Africa contain promising proposals for enhancing aid effectiveness but implementation remains inadequate. . Part of Africa's poor performance is a result of low and stagnating agricultural productivity **--**with important implications for growth and poverty since so many of the poor depend on agriculture. This is being addressed by a number of initiatives pertaining to an African green revolution and recognition of the need to reverse underinvestment in agriculture, notably in irrigation. But agriculture's problems are being exacerbated by climate change. An adequate response will require considerable financial and technological assistance.

Africa's prospects also depend on trade negotiations: the current Doha round might adversely affect Africa[5], while effective enforcement of recent WTO rulings on cotton would bring significant benefits. A successful conclusion to a truly development-oriented round of trade negotiations would be of enormous benefit, but prospects of such an agreement appear dim. A sustained recovery from the current global financial crisis clearly also has an important bearing on Africa's prospects.

Policy: Washington Consensus or not?

Underlying the Washington Consensus controversy in Africa is a difference in views about what is critical to economic success. One view sees the essence of development as a transformation of the economy and society[6], and emphasizes improvements in productivity and how these can best be brought about. The other view focuses on economic efficiency, narrowly defined: ensuring that the economy operates on the production possibilities curve. Those who focused on the first view note that

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[4] Delfin Go and John Page (eds) (2008), *Africa a t a Turning Point?* (World Bank), pp2-3. A more detailed appraisal of this analysis is found in the Africa Task Force volume mentioned above.

[5] Appraisals of the impact of the Doha Round generally show losses for Africa, other than South Africa. See Sandra Polaski, *Winners and Losers: Impact of the Doha Round on Developing Countries,* Carnegie Endowment, 2006.

[6] J. E. Stiglitz, "Towards a New Paradigm for Development: Strategies, Policies and Processes," 9th Raul Prebisch Lecture, October 19, 1998, UNCTAD. Chapter 2 in *The Rebel Within*, Ha-Joon Chang (ed.), London: Wimbledon Publishing , 2001..

what separates developed and developing countries is not only a gap in resources, but a gap in knowledge, and some economic structures are more conducive to reducing that gap.[7] WC reforms encouraging a focus on activities that reflected static comparative advantages were from this point of view counterproductive.

The result was lack of economic diversification and stagnation. The share of manufacturing has been generally declining since 1980 (as has employment in the formal sector). Relatedly there has been little success in exporting manufactures or in attracting foreign direct investment 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. Whilst it is difficult to measure learning and technology acquisition directly, these trends suggest there has been little of that.[8]

Africa's economic revival before the 2008 crisis reflects favorable exogenous factors; but also "better" policies (e.g. avoiding markedly overvalued exchange rates and large macroeconomic imbalances). However, that leaves several relevant policy questions. These revolve around the scope for improving a) policies, informed by the lessons of success (especially in promoting economic structures conducive to "developmental transformation" and "learning"); and b) governance. We argue that the whilst WC policies may have diminished distortions, they also may have undermined the ability to have sustained growth; and that, correspondingly, the governance agenda was not successful in strengthening governance capacities that enhance long term growth.

Governance and Growth: Towards an African Developmentalist State

Perhaps disappointment with WC policies contributed to a focus on governance as the critical problem. On this view, governance problems make the kinds of policies that led to success in East Asia unlikely to work in Africa. Indeed, they may be counterproductive. The alternative view notes that at the time that East Asia employed its interventions, its governance was far from perfect; more generally, governance itself should be viewed as "endogenous": it is affected by other variables, including the level of income. Poor countries are more likely to pay low wages to their officials making them more prone to corruption. And the high level of corruption prevents African governments from intervening effectively in the ways in which highly successful countries did. The result is a vicious circle—low income leads to poor governance which sustains low incomes.

[7] Greenwald and Stiglitz, "Helping Infant Economies Grow: Foundations of Trade Policies for developing Countries,", *American Economic Review: AEA Papers and Proceedings,*Vol. 96, No. 2, May 2006, pp. 141-146.

[8] Total factor productivity could be used in principle but in practice is fraught with serious data problems and sensitive to the specification of the production function. It is unlikely that reasonably reliable estimates can be made in most, if any African country.

One obvious prescription is to limit the role of government, particularly appealing to the WC perspective, in the extreme version of which there are only a limited set of institutions that are important; those necessary for the functioning of markets: enforcement of contracts and property rights.

Corruption is, of course, bad. Reducing corruption should facilitate and in turn be an outcome of development. But the *elimination* of corruption is neither necessary nor sufficient for development. Moreover, this “good governance” agenda may not be feasible, especially 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. The question is what kinds of “policies” reduce the scope for corruption, and their incidental effects on development.

There is a conflict between this “good governance” agenda, and what Mushtaq Khan argues should be the agenda from a developmental perspective: what he calls “growth-enhancing governance”[9]. Successful development requires reforms focused on such governance; and on what Mkandawire calls “transformative” institutions rather than “restraining” institutions. Restraining government actions may reduce the scope for corruption, but it may also reduce the scope for undertaking growth enhancing activities.

This alternative approach to governance reform focuses on a small number of measures at each stage directed at improving the governance capabilities required for dealing with the critical market failures holding back growth in a specific context. The pursuit of overly-ambitious and complex governance agendas risks making the pursuit of the best an enemy of the good.[10]

While governance is important, it is not everything, e.g. Sen and te Velde find that “effective state-business relations ….may have a stronger impact on economic growth in Sub-Saharan Africa than the conventional measures of governance[11].

And the issue is not rent seeking per se—in all societies there is rent seeking. The question is whether it can be put to good use. Nor is being developmental or not a binary choice: there is a continuum. The full-fledged developmental states of Korea and Taiwan did not emerge out of nowhere in a complete form --indeed, Korea in the 1950s was termed as a highly dysfunctional and corrupt polity. Countries such as Indonesia, Malaysia and Thailand did not have as developmental a state as Korea or Taiwan but did succeed with a wide range of interventions. . Japan, China and Vietnam— countries with different histories and circumstances—succeeded in different ways, and to varying

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[9] Mushtaq Khan and Thandika Mkandawire’s contributons to the Africa task force in the forthcoming volume, *op.cit*.

[10] See J. E. Stiglitz**,** “Development-Oriented Tax Policy” in R. Gordon, ed. Tax Policies for Developing Countries, OUP/IPD (forthcoming.)

[11] Sen and te Velde *in Good Growth and Governance in Africa* op.cit.

degrees. So too for the "developmentalism" of South Asia: India, Pakistan and Bangladesh had achieved considerable successes with interventions, including notably in the spread of the "green revolution". Latin America also provides many examples, especially Brazil and Chile.

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? 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 abandon failures quickly and to constantly review and modify policies. A broader lesson of successful development is to get the balance right between the market and the state.

Learning, industrial, and technology policies

Africa is not short of countries that have (or are able to acquire) the needed governance to undertake a more active role in promoting development. One of the key areas central to the success of the developmental state is **learning, industrial and technology (LIT) policies**. The desirability of such policies can be approached from several perspectives.

The theoretical perspective focuses on the reasons that markets, by themselves, are not likely to produce sufficient growth enhancing investments, such as those associated with learning, knowledge accumulation, and research.[12] . Externalities in learning and discovery would support an infant economy/infant industry argument for government intervention.[13] So do capital market imperfections that impede development. But the issues of learning have received scant attention, in marked contrast to those of resource allocation. Indeed much of the focus has been on "industrial policies", a term that has acquired a bad name because it has become associated with "picking winners" and private rents without social rewards. But there are many dimensions and forms of such interventions.. What we mean by LIT policies are those focused on issues of learning, of infant industries and economies, of promoting exports and the private sector, not only in manufacturing but also agriculture and services like information technology or finance.

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[12] The importance of "discovery" had been emphasized by Hoff (1997) "Bayesian Learning in an Infant Industry Model," *Journal of International Economics*, 43, 409-436 and by Rodrik and Hausmann (2003) "Economic Development as Self-Discovery" *Journal of Development Economics* 72(2) 603-633. The problem of "discovery" of entrepreneurs is emphasized by Emran and Stiglitz, "Financial Liberalization, Financial Restraint, and Enterpeneurial Development," August, 2007 (at www.josephstiglitz.com)

[13] See, e.g. Greenwald and Stiglitz*, op. cit.*

The orthodoxy has been particularly hostile to LIT policies. Whilst there is much to be said for doing away with irrational, highly distorted structures of protection, LIT polices can be very effective. All countries that had achieved substantial development had used some variant of LIT policies, not just East Asian countries.[14] Indeed, the green revolution in South Asia could be said to be a prime example of LIT policy. In Africa too, there were examples of accomplishments with LIT policies e.g. leather and flower exports in Ethiopia, tea in Kenya, manufactured exports in Mauritius. There have also been many failures but failure is by no means unique or even distinctive to LIT policies. Bad design, poor implementation and "capture" can trump policy in any area. There have also been, for example, many failed programs pertaining to stabilization, agriculture, and finance. 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.

Some LIT policies have been criticized because they give rise to rent seeking. But - neo-liberal reforms, especially privatizations and concessions, also give rise to rents. The issue is not whether or not there are rents but how those rents are used or what activities they encourage; and the design of institutional arrangements to minimize agency costs. Markets are not "technology-friendly" (entrepreneurs seldom capture more than a fraction of the marginal contributions) and rents are essential for the acquisition or development of technology. 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 diversity of circumstances and LIT policies in East Asia testifies that there is no one-size-fits-all LIT policy: a large part of the East Asian lesson is the pragmatic and flexible method of policy formulation rather than specific measures. In Africa, the potential for LIT policies to get around the "resource curse"[15] and the associated excessive dependence on commodities can be particularly important. As can their impact on agriculture, which is vital not only for growth but also for making it pro-poor.

The past four decades have resulted in a revolution in developmental thinking. Rapid robust growth is possible, even in a region—Asia—in which prospects at the beginning of the period appeared bleak. Before the influence of neo-liberal policies, there had been similar successes in other parts of the world: Brazil had grown at close to 6% for three quarters of a century.

A brief examination of Africa's history shows that both external circumstances and policies matter. Africa has shown in the past that it could experience strong growth. The

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

[15] There is, of course, far more to ensuring that an endowment of resources become the blessing that they should be. See *Escaping the Resource Curse*, M. Humphreys, J. Sachs, and J.E. Stiglitz, eds., New York: Columbia University Press, 2007

sort of policy reforms we sketch above combined with a reasonably favorable external environment could provide a basis for promising prospects for Africa.