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## DOES ETHIOPIA NEED AN INDUSTRIAL POLICY?

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## Editorial

It is now almost a decade since the Ethiopian government devised a broad development policy centered in the agriculture sector of the economy. Agriculture Development Led Industrialization (ADLI) hopes to increase agricultural productivity by concentrating on the dominant smallholder, which is expected to increase the income of the vast majority of the country's population. Higher income in this sector is hoped to increase the demand for industrial consumer goods that will then generate sufficient market to attract investment in the industrial sector leading to a demand driven rapid industrialization process.

Though it may be argued that the time span since this strategy was conceived and implemented is not long enough to reach definitive conclusions about the efficacy of this strategy in generating industrialization, the available evidence is certainly not encouraging. The degree to which the strategy has achieved its objective of increasing productivity in the agricultural sector, enough to increase demand for industrial sector goods, is still hotly debated. The lack-luster average performance of the agricultural sector over the past few years, partly owing to negative weather outturn, is emboldening the critics of the strategy. The expected link between higher levels of agricultural productivity and higher peasant incomes, crucial for the demand driven industrialization that the strategy envisioned, is further challenged by the observed decline of agricultural prices in periods of good harvest (as in 1996/97 and this year) mostly caused by the low level of demand for agricultural goods in the urban areas, which in turn is a product of the low level of income of the urban population as a result of high levels of unemployment and, in general, extremely low levels of economic activity in urban centers. This is empirically confirmed by the miserably low level of the value added contributed by the industrial sector to gross national output, probably the lowest in Africa and the world at large.

It is this vicious cycle of the need to increase agricultural income to generate demand for industrial products on the one hand and the need to increase urban incomes to generate demand for agricultural products so that peasants could get good prices for their products to enable them to increase their incomes on the other, that has partly led to calls for revisiting the strategy to look at industrialization not just as a derivative of the development in agriculture but an important area of policy concern in its own right.

Clearly, whichever way one looks at it, the question is not whether there is a need for industrialization. That is clearly acknowledged even by ADLI. The debate is more about how to go about it, or more precisely in this case, which sector should be given priority. Even after securing agreement about the need for rapid industrialization by giving, say equal weight to all sectors, there still remains the more thorny question of how to effect industrialization in practice. This involves the question of the relative roles of governments and markets in engendering rapid industrialization. Specifically, the question is what is the role of the state in the industrialization process? Is there a

need for an industrial policy to effect rapid industrialization in countries such as Ethiopia or is it better to leave the process to market forces to avoid unnecessary distortions which could possibly end up stunting the industrialization process?

These are by no means theoretical issues only. They are practical policy questions that have generated heated debate among academicians, policymakers and development practitioners based on presumed understandings of development experiences in a wide variety of countries and regions of the world.

The Ethiopian Economic Association and its research and publication wing, the Ethiopian Economic Policy Research Institute, put this issue directly to stakeholders in its round table discussion organized under the theme "Does Ethiopia need an industrial policy?" And this issue of *Economic Focus* is largely devoted to debating this particular subject. What was interesting about this round table was that there were no disagreements at all in answering the question. Panelists from the government, academic economists, the business community and UNIDO all agreed that there is certainly a need for industrial policy. With the exception of the presentation by the UNIDO representative, who unfortunately was not able to submit his paper for this publication, all the other papers are included in this issue of *Economic Focus*.

It is widely known that the argument against industrial policy emanates from the belief that industrial policy is trade inhibiting and that trade in general and international trade in particular is good for economic growth and development. Since industrial policy by definition requires targeting winning industries and supporting such industries through subsidies or protecting them through tariffs, the policy will necessarily limit the benefits of trade that could accrue to developing countries. It is further argued that such policy of protectionism has been tried in developing countries in the past and did not work while countries that have opened their economies to international trade have benefited tremendously from relatively open trade and globalization.

Since the latter argument is largely empirical, quite a bit of research has been conducted in the past couple of decades by proponents of free trade to show the benefits of globalization and free trade not only to developing countries but to all countries involved in the globalizing process. Until recently, this view of the benefits of globalization was largely accepted and the debate against it was largely based on reducing the "collateral damage" of the globalization process particularly in terms of distribution of the benefits and environmental concerns.

This view, however, has been recently challenged by some economists and we thought it would be good to share some of this recent research with our readers because of its relevance to the debate about the need for industrial policy in our country. We have also added a short article arguing the need for industrialization in order to improve the livelihood of Ethiopian peasants and another article attempting at a new theorization of the development challenges of Africa from a cultural and improved governance perspectives. Enjoy your reading. ■

# DOES ETHIOPIA NEED AN INDUSTRIAL POLICY?

**Brook Debebe**

Vice-Minister, Ministry of Trade and Industry

Mr. Chairman, Distinguished Members of the Ethiopian Economic Association, Invited guests, Ladies & Gentlemen:

It is an occasion of rare privilege & honor to address this assembly of Ethiopian Economists and other invited participants from different institutions. I believe this gathering of Ethiopian professionals and academics is among the forces who can shape the future development of the country.

Before I go into the subject matter "Does Ethiopia Need an Industrial Policy", let me make a few general remarks about the Ethiopian Manufacturing sector, some reform measures taken and the need to industrialize.

The Ethiopian manufacturing sector has been characterized by low level of development even by the standard of least developed countries. Its contribution to GDP is about 6%, 5.3% to employment and less than 15% to foreign exchange earnings. The sector, on the one hand, is still dominated by light manufacturing and agro-processing industries, while on the other hand, the basic metals, chemicals and engineering industries, which are sometimes called the industrializing industries, are at an infancy stage. The other characteristics of Ethiopia's industrialization was its focus on import substitution and not export promotion. The sector is highly import de-

pendent, about 54 percent, implying that over its past history the manufacturing sector has not managed to create sufficient linkages with other sectors.

The economic reform program undertaken includes the devaluation of the Birr which is supposed to make domestic industries competitive. However, as a result of the lowering of import duties, the sector's dependency on imported inputs, and a host of other factors, the manufacturing sector is losing its domestic market. Edible oil factories, shoe factories, grain mills, garment factories, plastic factories and even tea packing firms are being closed. Most owners and surprisingly some economists argue that the trend can be reversed by lowering tariff on imported inputs and increasing tariff on imported finished products. However, the issue at hand cannot be addressed from tariff point of view alone. Since it is a complex issue, it requires a comprehensive approach. There is a need to look into factor productivity, skills management know how, transaction costs which include government taxes, infrastructure, etc.

Ladies and Gentlemen:

Most COMESA member countries have joined the COMESA free trade area. Ethiopia has not yet joined it. Except china, almost all countries, that matter, have joined the WTO and Ethiopia has

only an observer status. It is in this context that we raise the issue we are raising "Whether there is a need for manufacturing sector policy or not". The Ethiopian Government has issued the Agricultural Development-led Industrialization, the Economic Reform Program, the Export Promotion Strategy, the Micro and Small Enterprise Development Strategy and the Five-Year EPRDF Peace and Development Program. In all these strategies and programs, it is expressed that developing the manufacturing sector is important. I am not going to details to explain these programs since most of you are aware of them. These programs, with the exception of Micro & Small Enterprises Development Strategy, are not elaborated enough to show the commitment of the government in detail.

To date the government has concentrated mainly on the agricultural sector. From the economic sectors, most of government resources went to agriculture and not to the manufacturing sector. However, apart from the above mentioned strategies and programs the government has taken the following actions in the manufacturing sectors.

1. Federal and regional micro and small enterprises development agencies are established and capacity development programs are under way.

2. To address the training needs and support programs to the leather sector, Leather Technology Institute is established and the establishment of a tannery pilot plant and garment workshop is under way.

3. A duty drawback scheme was established and now it is reinforced by the introduction of a voucher system and bonded manufacturing warehouses.

4. A law that governs capital equipment leasing companies was passed. However, the result is not encouraging.

5. A proclamation that governs business mortgage loan is also promulgated and this has enabled banks to mortgage machineries end equipment.

6. Some support programs in areas of effluent treatment, quality management, waste management, capacity building, etc. are being provided to the manufacturing sector in collaboration with bilateral and multilateral donors.

These are some examples on what has already been done. There are programs to be carried out in the coming four years. Already preparations to undertake studies on competitiveness and legal impediments to private sector development are under way. Capacity development programs for the public and private sector are being negotiated with the World Bank.

Ladies and Gentlemen:

I have mentioned few of the ongoing and future programs to indicate the importance the government has attached to the sector. The contribution of the sector to GDP, foreign exchange earning, employment generation has to increase by a significant percentage. To do this, a comprehensive approach will be required and this has to be reflected by policy declaration.

Thus to the question raised, that is: "Does Ethiopia require an industrial policy?", the answer is "yes".

A manufacturing sector policy document sets direction and rate of growth of the sector. It indicates the role of the stakeholders, the private sector, the government and donors. Above all, it states the level of government intervention with the accompanying resource allocation and institutional arrangements. Otherwise the document becomes an intention, a wish. I know some African countries which have elaborate industrial policy but have failed to register growth, leave alone develop the sector. There are other such as the East and South Asian countries which followed export-led growth and countries such as Chile and Turkey which followed import substitution strategy that led to industrial development. The difference between the African and the above-mentioned countries is in the commitment of the governments as reflected in resource allocation and institutional arrangement.

Industrial development is a complex process and that makes the preparation of a policy document equally complex. The possibility of the following traditional manufacturing sector growth which advocates resources based and labor intensive technologies can no longer be taken for granted. Some argue that it is not appropriate to follow the beaten path but to take the most up-to-date technology. Another factor that can be considered is the sectors relation with other economic and social sectors. Thus, when we talk of manufacturing sector policy it should not be looked in isolation.

I have briefly touched upon the status of the manufacturing sector in Ethiopia. The position of the government regarding the sector and the need for sectoral policy. I am sure your discus-

sion will contribute how the policy formulation should be approached and other relevant issues.

I once again thank the Economic Association for organizing this seminar, the panelists and your participants.

Thank you. ■

### Quotable Quotes

**It is in the interests of those who govern and those who are governed to extend the political importance of the industrialists, since, on the one hand, they are always inclined to support the existing government and, on the other, they work ceaselessly to limit the power and to decrease taxation.**

**Claude Henri, Comte de Saint-Simon  
Industry, 1817**



**Government is more than the sum of all the interests; it is the paramount interest, the public interest. It must be the efficient, effective agent of a responsible citizenry, not the shelter of the incompetent and the corrupt.**

**Adlai E. Stevenson Jr.  
speech in Bloomington  
Illinois, 1948**

# DOES ETHIOPIA NEED AN INDUSTRIAL POLICY?

**Teshome Kebede**

Acting President, Ethiopian Private Industries Association

## HOW DO WE PERCEIVE INDUSTRIAL POLICY (IP)?

Because of the diversity of the implication, extent and scope of Industrial Policy (IP), I feel it is important to clarify EPIA's perception of an IP to make the premise of our understanding clear at the outset.

- Broadly speaking, we perceive IP as a definition of a predetermined national direction to industrialization. We see it as a set of enabling components of what is planned to be achieved in building the national industry. IP should indicate how it can be done, which are the key elements and instruments to do it, who is expected to do what in that direction, what may not be done in the interest of its objectives, and so on.

- It is, therefore, a mechanism that enables us to look at the distant future in nation-building in the process of which the business environment is stabilized enough to become sustainable and reliable.

- In this sense, it can be taken as a driving force of development which enables government to invest in the future of the country by nurturing the growth of Small and Medium Enterprises to acquire competitiveness, create employment, generate wealth and eventually ensure the sustenance of the economic and social growth of the country.

- By this perception of IP, we see it as an institutional arrangement responsible to oversee a coherent and coordinated industrial development in the country with norms, rules and regulations ushering stakeholders into a strategically coordinated teamwork.

- As such, we understand it to be an instrument by which the government identifies and launches its interventions in specific sectors of the economy geared to foster and enhance the quality of industrialization in the country.

- In this sense, we find IP to be a mechanism by which the country's industrial distribution is mapped to focus on areas that hold the greatest opportunities while at the same time not neglecting those that have lesser comparative advantages in industry.

- It is, therefore, a means by which national resources and endeavors are made to optimally serve the same common goal of sustainable development coherently and consistently without overlaps and contradictions.

- It is also a mechanism by which government supports industries to stand out of consequential difficulties and be competitive in the market place.

- In a way, we see it as a commitment in which government sets out its national vision of industrialization carved out from

continuous consultation with the stakeholders, initiates and motivates (not dictates) its different arms of nation-building to actively participate in it and coordinates such efforts towards a harmonious contribution to the same end.

- And therefore, in this regard, we see it as a healthy intervention of the state enriched by a continuous and democratic dialog with all the stakeholders to build the necessary capacity and achieve a sustainable industrial development in the country.

Accordingly, we take terms like "industrial promotion initiative", "industrial development strategy/plan", "industrial growth plan", etc. and all those action plans designed to concentrate the national attention and resources towards promoting the development of industry synonymous to IP.

## WHO HAS USED IP IN INDUSTRIAL DEVELOPMENT?

The use of IP is often associated with the countries that pursued central planning as an outlook for their national development. However, we have ample proofs for almost all the industrialized countries around the world having used one form of IP or another.

In the USA, the antitrust legislation was enacted as early as 1870's to protect farmers and

small businesses from anti-competitive tactics of the then emerging corporate giants. Section 1 of the Sherman Act of 1890 made monopolization illegal and the actor guilty of a misdemeanor. Section 2 of the same act had nothing objectively different from protecting small businesses from being choked by conglomerates of the time with a view to nurturing them in the benefit of long-term national interests that every body appreciates today. Similarly, there were the Clayton Act and the Federal Trade Commission Act of 1914, the Wheeler-Lea Act of 1938, the Celler-Kefauver Act of 1950 and the rest of them to this day that we need not list out here.

The bottom line remains, they were all meant to direct the relationship of businesses to some predetermined path of development, maintaining "perfect" competitive conditions, in a way that the government thought good for the overall growth of the country. This is true whether or not these objectives were clearly codified or implied. If there is any difference between what is called IP and the US approach is that IP has prevention as an instrument of achieving its objectives while the latter assumes punitive measures.

The American history of industrialization is characterized by a very unique background that no other country shares and therefore makes it a good example only for itself. That is, it is the only country on earth formed by a large number of people converging from different parts of the world with more or less similar reasons to be there and similar ultimate interests to achieve. However, there is still one element we can learn from it in this respect. The American development planners intervened in the free-market enterprise of their nation-building at the early days of their industrialization immediately after the civil war when resources were not so abundant

and efforts were uncoordinated.

The miracle of Japanese industrialization is accounted for by the government's interventions in specific sectors of the economy geared towards rationalizing the pattern of investment in a way that could respond dynamically to the needs of building its industrial infrastructure which had been battered during the war.

The purpose of the intervention was also to foster and accelerate the nationalistic sentiments that were flickered by the subordination of the war as an instrument to fuel fast industrial development in Japan.

The EU is still known for promoting IP as a strategic instrument of not only adjusting the industries of the individual member countries but also a comprehensive umbrella to govern the Union's economic interaction in the global economic order.

The small dragons of South East Asia have strong interventionist measures behind their dramatic industrialization that everybody appreciates today. South Korea had a clearly defined and codified protectionist policy for its domestic industries up to the 1980's systematically administered by a high-profile, high-level authority headed by no less than the president of the country.

In general, the answer to the question who has used IP as a tool in industrial development may best be replied by another question "who has not done so"? It is an uncontestable fact that all industrialized countries have or at least had one sort or another of a predetermined path to which they guided their industrial development and that is what lies behind their present day achievement. The paradox, however, is that most economic consultants coming from these countries do not seem to prescribe the same prescription they so successfully used for the developing

countries, the latecomers like ourselves for fear of, I presume, the intervention being overplayed.

### DOES ETHIOPIA NEED AN IP?

The history of the use of IP suggests that all of its beneficiaries used it as an instrument of their industrialization during the early stages of their development when resources were inadequate to allocate at will. They used IP as a strategic approach to their industrial development, as a vision for the future to rally all the stakeholders behind an effective common objective. They shielded their development against the perils of internal and external competition when their industries were at their infant stage and lacked the technical and technological backing to enable them to effectively compete in the short-run. They did so when the domestic market was limited and not yet attractive to FDI, their industries were small with little possibilities to penetrate export markets and therefore required the nurture and support of government in a coherent and coordinated manner rather than being left to swim or sink. In general, it can be concluded that IP has been instrumental in industrial development as a crisis policy.

As one of the few countries in the last raw of industrialization on the planet, when else do we need a crisis policy than now to steer us out of the doldrums we are in?

- Yes. We need IP as an instrument of crisis management since our problems are many and the resources, including the time and opportunities to do so, are limited and thus we need to set our vision and prioritize our needs.
- Yes. Because we are involved in re-engineering the development path of the country that has necessitated the proliferation of new rules, regulations,



directives and guidelines of legislative significance in regions, zones and Kebeles that need to be consolidated by such a central ideal to avoid their conflicting with each other as they now do.

• Yes. Because the industrial sectors in the country are areas that are less attractive for investment at the moment and thus domestic investors and FDI need to be encouraged, nurtured and directed.

• Yes. Because the little industrial development is concentrated in a few cities and regions of the country and therefore national policy incentives must be directed to correct this disparity.

• Yes. Because experience of other countries suggests development without a firm and solid industrial foundation is impossible while at the same time global competition has made it extremely difficult to attain such a sound industrial take-off in the absence of a well-thought-out industrial promotion.

• Yes. Since it appears we need to reconsider and rationalize the right course of our national development endeavors with industry at the center of it and not an all-time-subsistent peasant agriculture as it is the case at the moment, if, indeed, true development is to be achieved.

• Yes. Because we need to put the necessary development guide, the building blocks, regulatory framework and the support needed for the future of industry in place.

Other than these, the country has already appreciated the necessity and use of a well-thought-out policy framework to guide its initiatives in other sectors where the desired development is not forthcoming.

The Population Policy was enacted to contain the unchecked population growth of the country within its means. The controversial new Education Policy must have been intended to bring about a rapid human resources

development for the country's growth. Similarly, the Foreign Relations Policy, the Economic Policy, and other similar policy statements currently exist. They are all identified as the best means to systematically guide the country's socio-economic life by charting out the intended future direction in their respective areas so that all the stakeholders and partners know the anticipated directions and benefit the overall national development drive from the ensuing coordination.

In conclusion, one may propose, Ethiopia, as one of the least industrialized countries on earth, has attained this status without a known industrial policy; what worse scenario can it bring about than this if we now devise well-discussed, well-thought-out and comprehensive IP a trial even by the rule of thumb not to say of the success stories of other countries like those I tried to mention earlier? ■



Arkansas Democrat Gazette, Oct. 2001

# THE NEED FOR AN INDUSTRIAL POLICY IN ETHIOPIA

**Kibre Moges**

Senior Researcher, EEA/Ethiopian Economic Policy Research Institute

Despite the fact that a conscious drive towards establishing industrial enterprises was initiated way back in the first quarter of the last century, still Ethiopia remains one of the least industrialized economies in the world, dominated by a backward traditional agriculture sector. But can Ethiopia afford to continue like this? The answer is obviously no, what may not be so obvious is, however, how should it industrialize?

Industrialization is a complex phenomenon as it is a revolution that sets in motion a chain of reinforcing activities in all sectors of an economy and beyond. It is a social process which introduces a profound change in the social and economic life of society. It impinges directly on people's lives, the way they live and think, the way they work, etc., through changes in technology, environment, and culture. So industrialization is the transformation of society's mode of life and as such, it is synonymous to development. Industrialization, for a country, is not an option, but a must.

The implication of this is that an industrial policy must address all measures that effect the transformation of economic sectors in a much comprehensive way, namely: linkages between economic sectors and within a sector, capacity and scale of operation of industries, technological status, geographical distribution, natural resource base, ownership

structure, etc.

It is with this background that the need or otherwise of an industrial policy can better be appreciated. The argument against industrial policy holds the view that market forces will best address these complex issues efficiently, thereby transforming an economy to an industrialized one. Central to this neo-liberal thinking is the belief that free-market prices provide the best indicators/signals for decision about efficient resource allocation. Alongside the importance of markets, the virtue of international trade based on comparative (cost) advantage is also underlined. Each country will concentrate on producing goods in which it has a relative (comparative) advantage.

What follows from this is that, as markets are the best arbitrators of efficient resource allocation, the role of the state in a developing country should be to implement macroeconomic policies so as to allow markets (domestic & international) to operate freely. Such policy measures include deregulating markets, liberalizing trade and financial markets, maintaining realistic exchange rates, etc. Apart from this, its economic role should be limited to areas where markets fail to function efficiently, such as infrastructures. The rest is automatically assured; individual economic agents guided by market signals, will industrialize the economy. As such, there is no

need for a specific industrial policy.

The alternative (Structuralist) approach, questions the efficacy of market forces alone to lead backward economies to industrialization, hence argues for an articulated industrial policy. The traditional/classical comparative cost advantage is essentially concerned with static efficiency in the allocation of resources, while the chief concern of backward economies is industrialization/ development in the longer term. There is some degree of inconsistency or conflict between market determined static comparative cost advantage and accelerated growth in the longer term. The special features of the economic and social structure of less developed economies and international conditions make a significant portion of neo-classical approach inapplicable and even misleading.

A clear example of this, proponents of the structuralist view is the dismal outcome of decades of structural adjustment programs in many developing countries (particularly in Africa) on the one hand, and the successful performance of newly industrialized economies (notably South East Asians) based on deliberately/consciously designed industrialization policies on the other.

For a developing economy, therefore, what is more important is not just static efficiency in re-

source allocation, but dynamic comparative advantage, which will also address the long-term industrialization prospect of the country. What should determine resource allocation should not be what a country is good at providing today but also what it can be able to produce tomorrow. Moreover, to rely on market forces, which are largely imperfect (partly non-existent and partly fragmented-not integrated) would not be the best option for rapid industrialization. The state, based on countries' industrialization experiences and own internal objective reality should be involved in the process of industrialization. Hence, the need for a home-tailored industrial policy.

Perhaps, after such a long experience with SAP and its outcome (now that implementing SAP as designed and dictated by International Financial Institutions, has failed to reduce poverty, let alone usher in industrialization, there is a talk to change its format, if not its content, to PRSP) the involvement of the state in the industrialization process may not be controversial. What could be so, however, is the modality of state involvement.

There are a number of key areas where the state could play a promotional role without necessarily hampering the operation and development of free markets. Some of the major ones include the following.

**i. Link with the world economy.** As the free play of market forces (globalization) tends to lead to further polarization, the state must intervene to mediate the relations between the national and the world economy.

**ii. Infant Industry Promotion.** Infant industries can be pressurized to make improvements in their productivity and overall efficiency levels only over time. This is because learning and acquisition of technological capability take a considerable period of

time. Until then, however, industries should be given some form of protection from highly competing technologically advanced foreign firms, especially when it is determined that the industry in question can achieve international competitiveness in a few years. The state has a vital role in managing the required protection.

The modality, however, may not necessarily be the traditional across the board, indefinite and unlimited protection, which has taken place in the past in many developing countries with balance of payments problems. Rather, protection should be applied selectively, at limited level and for a fixed period of time.

Protection should be selectively targeted. It is not necessary that all industries be equally and simultaneously protected. Secondly, if a given performance or target is to be achieved then there must be a time limit, hence, protection should be temporary. Thirdly, the level of protection too, must be limited. It should not be excessive to eliminate competition from abroad altogether, or too low to avoid exposing the industry concerned to the danger of foreign assault. It is essential to avoid monopoly tendencies. While industries are externally protected, internal competition should be encouraged.

Lastly, protection should not be a blank check, but a reward for a targeted achievement. The achievement could be in the form of higher export, improvement in productivity, higher production level, etc. In other words, protection should be accompanied by a regular pressure to drive industries towards higher productivity and efficiency levels, which would make them competitive internally as well as externally. In a way, the ultimate objective of protection is not only to create competitive industries, but also

to create a mature domestic market. If for structural reasons infant industries cannot altogether compete even in the domestic market, let alone export, then the market, in effect, is a siege of monopoly market.

**iii. Priority setting.** Establishing new industries involves great risk. Hence, producers have to be provided with extra incentives for entry in priority industries. The state has the role of providing the required incentive if such industry falls in the priority list.

**iv. Coordinating complementary & substitutable investments.** The importance of coordinating complementary investments in the presence of capital market imperfection and significant scale economies (in some industries) requires the intervention of the state. The state should also coordinate competing industries to avoid wasteful competition.

**v. Ownership and structural change of industries.** Certain key industries involve high risks or may require large capital investments, which may not be attractive for the private sector. So, in such industries (e.g. steel, petrochemicals, large engineering, etc.), which are essential for creating an integrated industrial sector, the state should inevitably invest.

**vi. Structure of the industrial sector.** To ensure that adequate investment is flowing to priority sectors or sub-sectors, such as capital goods industries, and keep the balance between large- and small-scale industries, or to create input-output linkages between industries, the state should have a key role through providing incentives, such as making credit available on priority basis, tax holidays, etc.

**vii. Technology transfer.** Developing local technological capability has prime importance in industrialization. Under the market principle, as developed countries

have comparative advantage in industrial technologies—as a result of long experience, ample financial resource and human capacities (skill)—less-developed economies would be better-off (in light of limited resources) to import existing technologies, but not to 're-invent the wheels'. Less developed countries can, therefore, acquire technological capability by integration into the world economy, relying on foreign investment and/or licensing. However, importing technology does not necessarily offer a shortcut to industrialization; rather it is the outcome of research and development by firms or research institutions and of on-the-job learning. Therefore, government must provide support for research and training. Also, to reduce the cost of imported technology, the state should intervene in identifying technologies that are not available at home, so called 'unpackaging technology'. The state should also be involved both through direct support for applied research and through fiscal incentives for such expenditures by the private sector, to

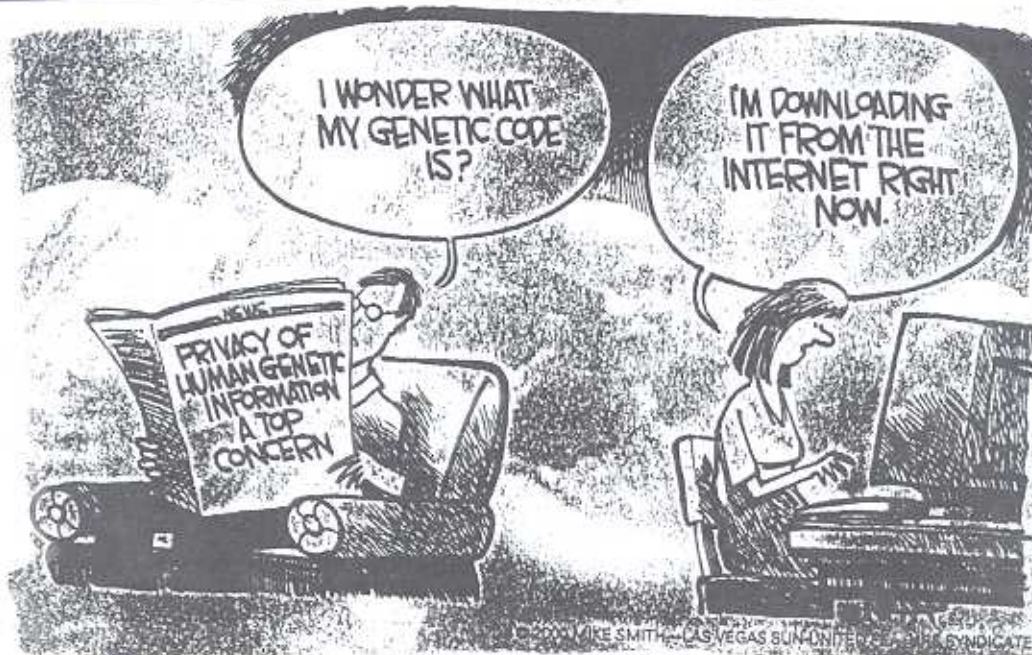
enhance local technological capacity.

**viii. Foreign investment monitoring & control.** While recognizing the benefits which TNCs offer in terms of technology transfer and access to foreign markets, state control on the behavior of TNC's are necessary if the costs of foreign investment are to be minimized. The state should monitor and control the pricing practices of foreign enterprises. The state should also directly negotiate with foreign companies to obtain much favorable terms in revenue through taxation, royalties and share ownership than the free market can provide. Moreover, the state must have a role as the organizer of domestic firms into implicit cartels in their negotiations with foreign firms or governments.

**ix. State-private collaboration.** Successful industrialization requires a very close collaboration and understanding between all stakeholders, particularly, between the state and private business.

In short, industrialization is not a matter of either/or. It is not a choice between import substitution or export promotion, but a creative mix of both as these are not contradicting or conflicting measures but rather reinforcing ones; neither is it protection versus free-market, but a conscious and measured use of both until markets mature and develop. It is also not a matter of choice between state and private but a collaborative joint move for a faster industrialization of the economy, with the private sector as the prime mover.

But for successful industrialization there is an internal prerequisite that should be met in most African countries, including Ethiopia, namely, a development-oriented and devoted government. There is also an external constraint. The nature of newly emerging globalization or WTO regulations need to be critically assessed for their impact on industrialization in developing countries. ■



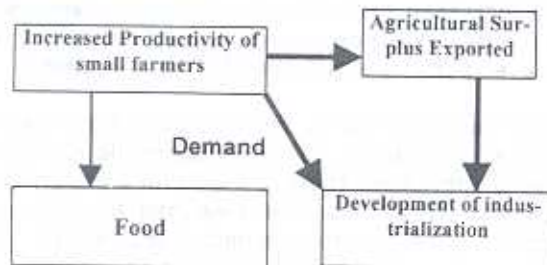
Newsweek, July 10, 2000

# THE CRISIS OF THE LAND ECONOMY: A Challenge for ADLI and One Reason for a Need for Industrial Development Policy in Ethiopia

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It has now become common for some 4 million Ethiopians to depend for their livelihood on availability of food aid. Ethiopia has now become an international food beggar. The government of Ethiopia is making efforts to solve this problem. The development strategy designed by the government to achieve food self sufficiency is known as the Agricultural-Led Industrialization (ADLI). The Agricultural Development-led Industrialization strategy can easily be simplified by the following scheme.



It is clear from the scheme that if ADLI is to be successful, the following should be met:

- That the productivities of smallholder agriculture should increase faster and surplus products should be produced
- The surplus agricultural output should get adequate domestic and external markets (at prices high enough to allow modest returns to farmers)

To achieve all this, agriculture should be competitive internationally. Given that this is also impossible, due to problems associated with land issues, ADLI will not be able to solve poverty and vulnerability of most farmers. To look into the problem, the following crude and unrealistic assumptions are made about the rural economy:

- Farmers acquire all non-food requirements such as cloth, tax, education, and other commodities from non-crop production activities;
- They acquire all the calorie requirements from farming activities (crop and non-crop);
- They require no seed (though it is assumed at

10% of productivity);

- There is no post-harvest loss (though it can go up to 10%);
- Livestock do not require additional land;
- The farm population is not growing and hence land is not fragmented;
- All the land households have is equally productive;
- Households farm all their land.

The other working assumption is that a household is said self-sufficient in food if it owns adequate land to produce 2100 calorie per member. Based on these assumptions and considering only yield per hectare (productivity land) as dependent variable which the government tries to influence using the various policy measures, the per capita land requirement and the implications of this to the general output growth is indicated below.

Land productivity is a variable that has to be specifically measured for each crop. However, a generalized measure of productivity can be applied for the present purpose. Various studies in Amhara region, Tigray, Oromia and Southern Peoples region by Sustainable Agriculture and Environmental Rehabilitation Program (SAERP) (implemented by UNECA) shows that average productivity of land could vary from 6.5 qt to 10qt.<sup>1</sup> However, it is assumed that productivity will increase in the coming years due to extension services and other policy measures of the government. Increase in productivity will affect the per capita land requirement of households directly as shown in the following formulae.

*Land requirement to produce annual food<sup>2</sup> requirements in terms of cereals, pluses and oil seeds = ((Total food requirement in terms of wheat equivalent)/C)/average yield Qt/ha. Where c is the conversion factor and is equal to 1.02*  

$$= (((2100 \text{ Cal/person/day} \times 365 \text{ day/year}) / 337000 \text{ Cal/qt of wheat}) / 1.02) / \text{land productivity}$$

<sup>1</sup> UNECA & Regional governments, Household Level Socio-economic Survey of the Amhara Region, 1996-97.

<sup>2</sup> For the formulae, see UNECA, ANRS, Household Survey, 1996.

= 2.229883 / land productivity

When the productivity of land increases, per capita land requirement to produce the annual food requirement decreases. The results of this function are tabulated in Table 2.

Table 1. Holdings

Size of Holding	Under 0.1	0.1-0.5	0.51-1.0	1.01-2.0
Cumulative HHS %	5.79	33.46	60.88	85.56
land size at class mark	0.1	0.3	0.75	1.5
% of Households	5.79	27.67	27.42	24.68

Table 1 continued

Size of Holding	2.01-5.05	5.01-10	More than 10	Total
Cumulative HHS %	98.91	99.95	100	100
land size at class mark	3.5	7.5	10	
% of Households	13.35	1.04	0.05	100

Table 2. Household Land Requirement at Different levels of Productivity

Estimated land productivity	7	8	10	11
Land requirement per household at estimated productivity	1.59	1.39	1.11	1.01
% of land deficit households at different levels of productivity	>85%	up to 85%	>60%	>60%

Table 2 continued.

Estimated land productivity	12	15	20
Land requirement per household at estimated productivity	0.93	0.74	0.56
% of land deficit households at different levels of productivity	>60%	60.88	at least 34%

In 1994, 33.46 % of farmers had land below the size of 0.5 hectare. Sixty one percent owned land less than 1 hectare. Productivity of land is expected to increase gradually and, in five to ten years, it is assumed to reach 20 qt/ha. However, 33.44% of the population, who own land below 0.56 ha, will not be able to produce the required calorie from their holding. At existing levels of productivity, in low potential areas up to 85 % are not able to produce adequate calorie from the land. Hence, large-scale malnutrition and food insecurity problems are explained not only by weather factor, but also with the resource endowment factor. If the productivity of land is 15 qt /ha, as indicated in the interim poverty reduction strategy, up to 61 % of the population don't have the capacity to produce required resource to achieve food security.

Since most of the assumptions are unrealistic, they have to be relaxed. For example, land will continue to be fragmented as the rural population increases. Out of the 23.2 million men in rural Ethiopia by 1994, 13.6 were under 19 years of age. It is more likely that these young men will be established as households taking land from their families. Some studies in food secure woredas have shown that unless the land is fragmented among family members, landless farmers will triple in the coming decades. Survey by MoLSA has shown that 16% of rural households are declared lan-

less. That means in a decade landless households can increase up to 48%.

It should be noted that households usually cultivate only a portion of their land. Some studies have shown that up to 30 %<sup>3</sup> of households-owned land is classified as marginal with low capacity for increasing productivity economically. Income opportunities outside agriculture are limited (only 5% rural households reporting)<sup>4</sup>. Post-harvest loss is estimated at 10 % and seed requirement 10 %, which could further increase land requirement per family. For various reasons, households cultivate a portion of their land holding. All these factors will require more land for households. Hence, even if productivity increases the possibility of producing surplus from 60% of the households is very small.

The good news is that 40 % of the households have the potential capacity for production of surplus output. If land productivity is rapidly increasing, as envisaged in the table, national self-sufficiency in food is an achievable goal. However, achievement of a higher-level productivity and food self-sufficiency requires a coordinated policy action (institutional, markets and services). What is most likely to happen with increased production is that many farmers will remain dependent on market for food and hence need to develop the non-agricultural business rapidly.

These facts will require responsible policymakers to examine the present policy on economic growth and poverty alleviation. There is a limit for a supply-based approach. While it is acknowledged that extension supports shall be strengthened, it should not constitute a major policy for reduction of poverty and food security. In addition to the current extension policy which emphasis at increasing the productivity of land, efforts to increase labor productivity shall be discussed. This involves, *inter alia*, policy measures in the following areas:

- Revising the land policy in stages;
- Considering other strategies for poverty alleviation that aim at getting more people out from agriculture and attracting capital to agriculture;
- An industrial policy that aims at diversification of the rural economy is badly required;
- Diversification and urban development is closely related<sup>5</sup> hence it would be very crucial to develop a detailed urban development strategy for the country. ■

<sup>3</sup> ANRS, Food Security Co-ordination Office, 1999.

<sup>4</sup> MoLSA, 1997.

<sup>5</sup> Yohannes Mekonnen, *The Relations of Urban Development and Rural Industrialization: Case Study on Rural Regions of Ethiopia: 2000* (paper published in the first Journal of the Amhara Economic Association).

# CORRUPTION FROM PUBLIC POLICY CHOICE PERSPECTIVE

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## 1. INTRODUCTION

Corruption and anti-corruption policies have come to dominate recent policy discussions among policy makers and the public at large. Despite the existence of this practice since the cradle of human society, the recent attention it has attracted seems to suggest that the problem has now reached such an unsustainable level that it could no longer be ignored. Interesting enough, the problem of reported corruption in the world reached its peak in the 1990s lending support for the argument that the growth of corruption in magnitude and scope is the main reason for the recent attention.

Corruption harms nations by misdirecting economic resources from productive use, weakening the provision of public services, and hampering the growth and development endeavor of nations. This is particularly damaging in poor countries and the poor in these countries because the chance for the poor to escape poverty would be diminished in corrupt systems than otherwise. Sustainable and shared economic growth could potentially provide plausible solution to the problems of poverty. Addressing the problem of corruption is therefore addressing issues of economic growth and poverty. Moreover, the debate on corruption has far-reaching implications and involve a wider domain of public policy choice and the very nature and role of government in national economies. This paper addresses the issue of corruption from a public policy choice perspective

and draws implications for putting in place preventive measures in the context of poor countries.

## 2. DEFINING THE EVIL AND THE DEVIL

What do we mean by corruption? Corruption, as a socially evil behavior, does not have a precise definition and could be observed from various perspectives. A broad and yet simple definition of corruption would be the abuse of public power for private benefits (Tanzi 1998; World Bank 2000). It involves breach of public power and responsibility for the purpose of benefiting oneself or a select group of others. It should be noted, nonetheless, that the beneficiaries might encompass wider groups since the abuser of public responsibility might do so to benefit entities based on political, ethnic, regional, and other denominations. The behavior of power abuse could come from the neglect of public responsibility that is bestowed in the office of public servants.

The problem of corruption is widespread and common in almost all countries irrespective of their stage of development, policy or ideological orientation, or the role of the state in the national economy. Apparently, the incidence of high level and often times political corruption seems to have increased over time reaching unsustainable bounds. Perhaps, the endeavors in developed countries to address the problem seems to rekindle interest in other countries to address what has been considered as an untouchable social evil.

It is now common to give at least nominal concern about the problem of corruption even in developing countries and the issue is no longer a taboo in these communities. Moreover, the problem has now come to public attention partly for ease of reporting worldwide corruption incidents through the mass media (see [www.transparency.org](http://www.transparency.org)).

The issue of corruption in poor countries involves wide areas and it is considered as one of the main obstacles towards rapid and sustainable economic growth and development (Mauro 1995). Addressing the problem of corruption in these countries, besides reducing misallocation and misappropriation of economic resources, would generate suitable conditions for widely shared and hence sustainable economic growth. The recent emphasis by international financial institutions, at least at cosmetic level, to incorporate anti-corruption policies as part of the policy package for financial assistance has been instrumental to put the issue in the agenda of financial assistance seeking governments. Despite the importance of self-initiated anti-corruption measures, the external pressure has played an important role in several developing countries.

In the process, the technology of corruption has grown in sophistication and public officials have continued abusing their authorities to shift public resources to benefit themselves and their allies in a complex web of economic and political mechanisms. Anti-corruption measures and agencies

could not be successful unless they are well versed with the technology of corruption and develop a learning process more advanced, credible and effective than usually orchestrated by corrupt agents in the system.

### 3. CORRUPTION AND THE STATE

The issue of corruption is closely linked with the state and officials whose responsibilities are to execute government rules and regulations. Despite the widespread existence of corrupt practices in the private sector, the issue that is addressed here would mainly focus on corruption in the public sector and by public agents and officials. The fact that governments use extensive rules and regulations create monopoly power at the disposal of public officials who exercise authority at discretion. This is the power at different hierarchies of authority that has been abused by corrupt behavior to transfer public resources for personal benefits. Hence, addressing the evils of corruption essentially requires redefining the role of the government in the national economy and the discretionary power of public officials in the decision-making processes. The policy choice hence involves conflict of interest between public power centralizing forces and that of streamlining the government by eroding discretionary power. This intricate relation suggests that anti-corruption measures could hardly be effective unless we are committed to reform the overall nature of government in the national economy.

Corruption in the public sector could be observed from two main perspectives: *state capture* and *administrative corruption*. State capture refers to the actions of individuals, groups, or firms to influence the formation of laws, regulations, decrees and other government policies to their own advantage as a result of illicit and non-transparent provision of private benefits to public officials.

These actions are directed to extraction of rents from the state for a narrow range of individuals, groups or sectors by distorting the basic legal and regulatory framework with considerable economic cost to the society at large. Administrative corruption, on the other hand, refers to deliberate imposition of distortions in the prescribed implementation of existing laws, rules and regulations to provide advantages to either state or non-state actors as a result of the illicit and non-transparent provision of private gains to public officials (World Bank 2000). This categorization has analytical importance and yet the two processes are closely intertwined to each other. When regulations are designed in such a way to benefit a certain group, violation would be unavoidable.

Governments exercise various forms of interventions in the economic, political and social life of their citizens. These interventions have been justified in certain circumstances where market forces are not strong enough to assume their conventional responsibilities. However, government intervention is essentially conducted through the establishment of rules and regulations at different strata of public office hierarchies. These rules and regulations create discretionary power in the hands of governments and the bureaucracy that implements these provisions. The prevalence of corrupt behavior and practices in most countries is partly attributable to an undue expansion of government intervention in economic and social life of their societies. These interventions generated power at the discretion of public officials at the expense of the rest of the economy that could be subjected to abuse.

What are these public choices that contributed towards increased power in the hands of public officials? First, there is taxation and hence resources collected by the public sector relative to national economy. Second, backed by

revenue collection and borrowing, the government secures the power of public spending. Third, rules and regulations have increased which require frequent, at times unnecessary, contact with the private sector and foreign agents. These features are not necessarily causes for corrupt behavior. However, their existence and the power that accompany them create a favorable condition for the emergence of corrupt behavior. It actually becomes a choice dilemma for public officials between abusing public responsibility and absorbing the subsequent cost. It should be noted that the behavior of corruption concerns the emerging institution and social norms than just individual behavior of public officials. Even if personality influences the timing of committing the evil, the opportunistic behavior gradually but unavoidably sets the tone and temptation in motion. Despite the importance of penalizing and purging those addicted corrupt officials, anti-corruption measures could not be successful unless their values are institutionalized.

### 4. ATTACKING CORRUPTION

Once the problem of corruption reaches an unsustainable level and the system is infested with it from errand personnel to officials at the pinnacle of political power, how should it be addressed? Political economy factors generally shape the nature and effectiveness of anti-corruption measures. This explains why in some countries not in others reform policy measures, including anti-corruption measures, have a higher chance of implementation. Definitely, the behavior of corruption and its institution could not be stamped out easily and within a short period of time. And yet, it requires commitment on the part of anti-corruption agencies, the government and the general public. It is therefore necessary to put in place reform policies that would squarely address the problem. However, when corruption is practiced at a grand



scale under the purview of political cover up, the outcome would be devastating and hard to eradicate. Even if bureaucratic corruption is a problem as disruptive as any other social problem, political corruption is the worst in degenerating a system into vicious circle of corruption and its expansion.

Anti-corruption measures, once again, have taken center-stage in the political agenda of governments to clean themselves from such corrupt behavior and practices. Despite the importance of such a bold approach, this way of addressing the problem might be politically tainted and could still be abused to serve corrupt practices. It is important to note that politicians would hijack the anti-corruption agenda to selectively attack political rivals instead of cleaning the government from such practices. It is therefore necessary to direct anti-corruption measures in multi-pronged and case-specific manner and apply them to all public officials without exception. A corruption-tainted system also gives rise to opportunistic behavior and aspiring corrupt agents would seek political affiliation and shield to execute their intentions. That seems to explain why corrupt officials usually belong to and are backed by incumbent government. To be effective and credible, anti-corruption agencies should be as politically independent as possible.

This approach to address the problems of corruption puts governments in a difficult choice dilemma that involves reducing discretionary power, rent formation and streamlining the public sector on the one hand and maintaining grip on political interest and support groups, using public resources to secure political survival, and rewarding opportunist behavior and political loyalty on the other. Essentially, reducing high-level and political corruption necessarily involves reforming the patron-client relationship and the role of the government in the na-

tional economy.

If a political system is genuinely committed to reduce and ultimately eradicate corruption, what are the ways to go about it? The problems of corruption, just like any other disease, would better be prevented than cured. Once subjected to it, a system would find it hard to regain momentum from lingering debilitating effects for quite a long period of time. It is therefore important to search for preventive measures so that public officials would refrain from contracting the very disease that is effective and attractive enough to become a way of life for corrupt agents. Moreover, the technology of corruption is such that it grows in sophistication and would raise the cost of detection. For both reasons, it becomes practical to search for measures that both preempt corrupt practices in the public sector and make detection of violation relatively objective and effective. The fact that corruption involves diverse characteristics suggests that anti-corruption measures should necessarily be multi-pronged in approach and practical to serve as effective ways of cleaning a corruption-ridden system.

It is beyond the scope of this paper to outline exhaustively the possible measures that could be taken to address the problem. In what follows, I would outline possible measures in line with the Ethiopian context.

First, reducing corrupt practice necessitates reforming the public sector and putting in place practical measures that discourage the engagement of public officials in corruption. This could take different forms. Streamlining the public sector and undertaking elaborate awareness measures to publicize the reforms to the general public. At this stage, the public should be informed in clear and precise manner the need for reforming the existing measures and the rationale for the new measures.

Second, strengthening the legal system and protecting its independence from political intervention. All offenders of public responsibility and power, without exception, should be accountable for their actions. After all, it is their deliberate choice, out of the existing set of possibilities, to engage in corrupt practices. The existence and operation of an effective legal system would provide beforehand the violators of public power sufficient information about the cost of their behavior and protect them from naïve illusion of escaping the legal system.

Third, corruption in the public sector could not be eliminated by shifting public power across government agencies without informing the public about the rationale of taking such measures. When such measures are necessary, they have to be done in line with standard procedures. Otherwise, arbitrariness encourages distortion in responsibility and hence accountability of decisions. When important decisions are made by 'memo-laws', tracing accountability would be difficult and encourages corrupt behavior.

Fourth, in poor countries like Ethiopia, public officials depend for income mainly from their employment in the public sector. Salaries and at times fringe benefits constitute their income. Under such circumstance, their personal spending behavior should closely follow the flow of their salaries and benefits. It is therefore important that public officials declare clearly and exhaustively their family wealth position. Fifth, a causal observation of public spending in developing countries suggests that most of these lines of expenditure are closely related to expenditure outlets that are private in nature.

Radical opponents of the visible hands of the government recommend that corruption could be eliminated only by eliminating those bargain chips that governments provide to the public and hence develop client-patron rela-

tionship. A clear and yet extreme view of this issue perhaps would be eliminating government to uproot corruption. This view, despite its appeals, does not fetch practical and rational leverage to serve as guide to policy decision. A more pragmatic and yet challenging issue is to determine how a government can clean itself from corruption. After all, the process involves eroding the discretionary power of public officials that they cherish to hold and exercise. This would be feasible only if scrupulous and credible leadership is exercised from the political system and the general public actively participate in the process.

There are different views on this subject. One approach would be streamlining the bureaucracy of government so that a transparent system would accommodate less and less corrupt behavior. The trust of this argument is that with the gradual elimination of excessive discretionary power from the hands of public officials, it would be possible to reduce the power that has been abused for personal advantages. This also reduces the incentive on the part of the private sector to incur extra cost to receive what is legitimate. Perhaps another approach is to make the penalty on corrupt and convicted officials as severe as possible so that it sends the right message to aspiring officials. The second approach could be abused especially when the legal system is not independent from political influence and itself is subjected to the same problem of corrupt behavior.

The legal system in most countries is under the influence of political parties and due process of law is at its infant stage. Apparently, the legal system in most countries is corrupt by itself let alone to serve as an instrument to clean the malfunctioning of other public entities. Even in a sound legal system, the nature of corruption is such that measures are taken to stop corrupt behavior and usually have little effect to undo the damage that was caused by widespread

corrupt practices. It should also be noted that those who are engaged in corruption are getting sophisticated so as to minimize the probability of being caught and freezing or confiscation of their properties. The nature of things in such cases is such that the agents would take measures beforehand to eliminate possible evidence against them. This makes an already difficult issue even more tantalizing to the legal system.

In this kind of circumstances, it is imperative to search for solutions whose outcome does not necessarily hinge on the existence and effective operation of the legal system. In this spectrum of public policy choice problem, streamlining government structure, reducing discretionary power in the hands of public officials, incorporating sound practices that would discourage public officials from committing abuse of power for personal benefits and finally allowing the legal system to operate independently of the political system would be medium term measures to address the problem. In the long-term context, however, structural reforms are necessary so that laws and regulations are not systematically exposed to corrupt practices and transparent rules and regulations would be put in place that are not easily amenable to illicit interpretation and frequent imposition of official discretionary decisions.

In the subsequent discussion, I will focus on some of the aspects of the subject matter in the context of developing countries. Some of the issues involve: Why does a government in a poor country take anti-corruption measures? What are the benefits and the pressure sources for the change in the stance on corruption? How could anti-corruption measures be sustained until the status quo in the system is effectively replaced?

One of the reasons that gave the foundation for corrupt practices and the emergence of corrupt behavior is the rampant intervention-

ist stance of the government in economic and social affairs. Intervention takes both direct ownership of economic resources and indirect control over resources in the hands of the private sector. A government that owns economic resources exercises its economic power by allocating the benefits of these resources asymmetrically across the population, regions or sectors. Unless transparent and abiding rules are put in place, political affiliations would influence access to public resources and benefits the overall outcome of which is distortion of resource allocation. The government can also exert its influence on the private sector by indirectly controlling through laws, rules and regulations. Both of these would create opportunities for the government to command economic resources in the system. The government would in turn manage these resources and hence exercise its power through elected or non-elected public officials and hierarchy of bureaucracy. All of these agents derive, though at different degree, power that their position generates and use it to execute their public responsibilities or abuse it to benefit themselves or their supporters.

Pressure for anti-corruption measures could emerge from domestic or external sources. However, the typical characteristics of corruption to stifle economic growth and development efforts seems to put governments in a situation where hard choices should be made between continuing the practice and cleaning the system to pave way for economic growth. This conflict of interest would ultimately influence the pursuit and effective implementation of anti-corruption measures. It is this process and hierarchy of power relation that needs to be reformed. Since it is a process, it requires a gradual and yet credible approach and because of the fact that hierarchy is involved, it assumes a great deal of leadership quality. It is frustratingly difficult to control corruption when public

officials at the pinnacle of political power are deeply tainted in corruption.

5. CONCLUDING REMARKS

Corruption is an irritating social and economic problem. It is a phenomenon that has attracted considerable attention among policy makers and the general public. It has disgraced personalities at different hierarchies of political and economic power. Anti-corruption measures are also popular themes in current political and policy discourses. And yet, the problem has proved itself difficult to uproot unless both the general public and governments are firmly committed enough to make its perpetrators clean themselves from such practices. A clear elabo-

ration of the risk and the cost that is involved and the effectiveness of the legal system to unearth corrupt practices are necessary elements to restrain potential aspirations.

Credibility in the anti-corruption movement is an important factor in the process and political intervention should be prevented to sustain the credibility factor. Moreover, anti-corruption agencies should be given the authority to examine public officials whenever enough supportive evidence is presented to it. It is extremely important to protect such agencies from political interventions and professionals in the agency should have no political affiliations so that they act in an independent manner possible. Finally, anti-corruption

institutions should encourage their agents to learn efficiently and effectively an increasingly sophisticated and innovative technology of corruption so that they could be proactive in preventing corruption instead of exerting their entire effort just for uncovering those already committed corrupt practices.

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በልሳነ ኢኮኖሚክስ ቅጽ 4 ቁጥር 1 ስለደመወዝ ገቢ ግብር ሂሳብ ስሌት አሠራር ለቀረበው አስተያየት የተዘጋጀ መልስ እና የግማሽ ደመወዝ ገቢ ግብር ሂሳብ ስሌት አሠራር በሚል አርእስት በወጣው ጽሑፍ ውስጥ አንዳንድ ስህተቶችና ግድፈቶች ስላሉ ከዚህ በታች በተመለከተው ውኔታ ታርጦ እንዲነበብ ከይቅርታ ጋር እናሳስባለን።

■ ይህ አገጽ የጽሑፍ ገጽ 20 ላይ ከመግቢያ 1 በፊት ተካትቶ ይነበብ

አገጽ የጽሑፍ

መ/ቤቶች በሚያስፈልጋቸው (በሚኖራቸው) የሰው ኃይል ሥራ መደብና ደረጃ መሠረት በጀት እያስያዙ ደመወዝ ይከፍላሉ። ሠራተኛው ከወር ደመወዙ በገቢ ግብር ሕግ በተመለከተው የገቢ እርከኖችና (income tax brackets) በተጓዳኝ የታዳጊ ግብር ምጣኔዎች (marginal tax rates) መሠረት ምን ያህል ግብር መክፈል እንዳለበት ይታወቃል። በመሆኑም ሠራተኛው (ተቀጣሪው) ከሥራ ቤቅ፣ አዲስ ቤቀጠር ወይም የተወሰነ ቀን ሠርቶ ሥራውን ቢለቅ በግብር ሕግ ሠንጠረዥ መሠረት የሠራተኛውን ቀናት በማጤን የደመወዝ ገቢ ግብሩን ሂሳብ መቀመጫ ይኖርብናል።

የውጭ ሀገር ትምህርት (ሥልጠና) ለሚላኩ ሠራተኞች እስኪመለሱ ድረስ መንግሥት ግማሽ ደመወዝ እንዲከፈላቸው አገዛዥ የሠራተኞቹ የሥራ መደብና ደረጃ በዚህ ጊዜ የማይለወጥ

በመሆኑ በጀቱም አይቀየርም። ስለዚህ የደመወዝ ሂሳብ፣ የጥቅል፣ የተጣራው እና የተቀናኛ (የግብሩና የውረታውን) እኩል ለሁለት በማካፈል መሠራት ይኖርበታል።

ገጽ 21 አንቀጽ 3 . . . ሳይንሳዊ ግንዛቤ እንዲኖረው የሚለው ሳይንሳዊ ግንዛቤ እንዲኖረን ተብሎ ይነበብ።

ገጽ 21 አንቀጽ 3 . . . «አገናዝቦ በትክክል መሥራት» የሚለው «አገናዝቦ በትክክል መሥራት» ተብሎ ይነበብ።

ገጽ 21 አንቀጽ 3 . . . ይኸው ሃሳብ (idea) የሚለው ይኸው እሙን (axiom) ተብሎ ይነበብ።

ገጽ 24 ምስል (ሀ) ... ውጤት መሆኑን የሚገልጽ የግለሰብ የገቢ ግብር ኩርባ (individual employment income tax curve) ሥፊት<sup>12</sup> ።... በሚል ይነበብ።

ገጽ 25 አንቀጽ 4 ላይ "0.15-42"<sup>14</sup> የሚለው "0.15Y-42"<sup>14</sup> ተብሎ ይነበብ።

ገጽ 26 ሠንጠረዥ (10) ግማሽ የተጣራ 835.80+2 የሚለው 835.80+2=417.90 ተብሎ ይነበብ።

ገጽ 26 አንቀጽ 3 ላይ... ሠንጠረዥ መረዳት ይቻላል በሚለው ምትክ ሠንጠረዥ (11) መረዳት ይቻላል በሚለው ይነበብ።

ገጽ 27 ዋቢ ምርጫዎች (References) የሚለው ዋቢ መረጃዎች (References) ተብሎ ይነበብ። (ወደ ገጽ 35 ዘርዋል።)

# GOVERNANCE, CONSISTENCY AND DEVELOPMENT IN SUB-SAHARAN AFRICA: IDENTIFYING THE DEVELOPMENT PROBLEM\*

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'As economics pushes on beyond 'statics', it becomes less like a science, and more like history'.<sup>1</sup>

## THE PURPOSE

The purpose of this article is first, to identify and explain the development problem persisting in countries in Sub-Saharan Africa. It is the belief of the author that without this, it is not possible to design meaningful development programs, to secure development impacts, nor to develop the 'African' development theory that is needed to help Africa develop and prosper. Second, after discussing governance issues and establishing reasons for inconsistent formal behavior, examples will be given why it is not possible to secure sustainable development impacts through projects and policy reforms in circumstances where the development problem is not resolved satisfactorily.

## INEFFECTIVE STATES AND PUBLIC ADMINISTRATIONS IN SUB-SAHARAN AFRICA

The underlying assumption of the

\* The article is based on Heikki Haili's forthcoming book, 'Partnerships in Aid Dependent Poor Countries in Sub-Saharan Africa: Insights into Aid Effectiveness-First Steps Towards a Theory of Development', Chapter 5.

\*\* The opinions expressed in this article are exclusively those of the author and do not represent the views of either the Embassy of Finland, Addis Ababa, or the Ministry for Foreign Affairs in Helsinki.

<sup>1</sup> John Hicks (1979), 'Causality in Economics', p. xi. Basil Blackwell. London.

article is the old World Bank dictum that without effective states development is not possible in Sub-Saharan Africa. The Bank has put it as follows: 'an effective state is the cornerstone of successful economies, and without it, economic and social development is impossible'.<sup>2</sup> The importance of effective states as economic and political actors is particularly pronounced in poor countries in Sub-Saharan Africa simply because the states are weak. As it has been reported elsewhere the states in Sub-Saharan Africa should have two basic roles in development, i.e. directive and facilitative roles, to be successful in their development efforts.<sup>3</sup> So far they have not been able to perform satisfactorily on this point.

The ineffectiveness of states is reflected for example in the way Public Administrations work in African countries. In one of the most recent publications in Ethiopia, African governance experts lament on the chaotic state of Public Bureaucracies in the continent. The challenge is seen as follows: the major challenge for Africa's academics and public policy makers is to emulate the 'Asian Economic Miracle' in

<sup>2</sup> World Bank (1997), 'World Development Report: The State in A Changing World,' Oxford University Press.

<sup>3</sup> Heikki Haili (2001), 'Some Notes on Development in Aid Dependent Countries in Sub-Saharan Africa: The Role of State and Budget Deficits Revisited,' Economic Focus, Bulletin of the Ethiopian Economic Association, Vol. 4 No. 1, Aug-Sep 2001.

terms of reconfiguring and restructuring Public Administrations in order to provide an enabling environment for sustainable economic growth which could result in reduced poverty levels in the continent.<sup>4</sup>

The volume contains four articles that describe experiences from Equatorial Guinea, Democratic Republic of Congo, Zambia, and Ethiopia. The experiences could be considered as representative for the whole continent. The authors list the following problems of governance. The problems have been described in the order of countries mentioned above. First, there has been a detrimental impact of a prolonged political interference on operations of the country's Public Administration. Also, in the country in question there has been an excessive politicization of the Public Administration without attempts to establish a coherent correlation between planning, management, budgeting and policy implementation. The Public Administration could be seen as a political arm of the government. Second, King Leopold of Belgium and rulers after him together with the administrative elite have treated the country's Public Administration as their 'private property' from which lucrative benefits can be obtained. The author hits the target by conclud-

<sup>4</sup> DPMN Bulletin (2000), 'Editorial: Changing African Public Administrations: New Challenges', Vol. VII, No. 3, Addis Ababa.

ing that the various Civil Service Reform initiatives carried out under the framework of Structural Adjustment Programs designed by the World Bank and the International Monetary Fund may have not succeeded in effecting positive administrative transformation on account of not having recognized the enduring impact of the Leopoldan Legacy in the Democratic Republic of Congo. Third, in Zambia the seriousness of the commitment of the government and its elite is questioned to the major goals of the country's Public Service Reform Program. The ideological stance adopted by the socialist inclined political class has effectively short-circuited any meaningful attempts to shake-up and reinvigorate the Public Administration. Furthermore, the Reform program has been used as a facade to attract donor funding that sustain the conspicuous consumption of senior bureaucrats. Fourth, the author on Ethiopia gives a standard view on the Ethiopian Public Administration, and seems to be obsessed by the World Bank's technical or managerial approach to reform to solve the governance problem without realizing the dangers of the fallacy of maintaining rigidly dichotomized divisions between different categories within societies in the current African context. The author concludes his contribution that it is imperative that the country's leadership accords the Civil Service Reform Program the highest level of political support. However, it might be questioned whether this commitment would secure effective results given the quality of current political interference in Ethiopia as witnessed by some observers.<sup>5</sup> As it will become clear later, commitment is not enough. What is needed is

a vision for an effective Public Administration and its implementation. Both of them are in short supply currently not only in Ethiopia but also elsewhere in Africa with a few exceptions.

Interestingly, in one of the recent articles on Ethiopia's Civil Service Reform, it was noted that while planning the reform package, reasons behind the weaknesses of the civil service seems not to be properly articulated and diagnosed. Furthermore, the author states that the reform measures were introduced without giving due attention to the country's administrative history, existing political reality, administrative capacity and economic structure. He continues that reform prescriptions were mere transplantation, and the impositions made were executed without understanding the context. He then continues by quoting E. Warrington that in the Public Administrations 'habits of thought and patterns of behavior' are likely to persist as long as the circumstances that give rise to them exist. The author concludes by saying that it is fallacious to assume that reformed organizational structures, career paths, reward systems or any other technical reforms are sufficient enough to guarantee an effective civil service without addressing critical issues like governance etc.<sup>6</sup>

The author makes a couple of important observations. First, before any successes could be expected from Civil Service Reforms, the basic or underlying problems should be properly analyzed. As it is argued below, this has not been the case so far in Sub-Saharan African countries. Second, improper analysis of a

problem has led to a situation whereby crucial factors have been overlooked for example the existing political reality. Third, reforms have been seen as transplantations from outside without giving due considerations to local conditions. In this, Mamadou Dia's ideas have been followed. As it becomes evident later, the key issue is not one of reconciliation of different administrative cultures but creation of consistent formal behavior in organizations and other systems within societies. Fourth, if consistency in behavior is not created 'habits of thought and patterns of behavior' will persist making public administrations non-performing or non-functional. Fifth, the author is correct in saying that addressing critical issues like governance should precede any Civil Service Reform to be successful. However, the author fails to give an adequate account of what are the critical issues. This will be done later in this paper.

As a way of introduction, one could say that the key eye opener to governance problems in Sub-Saharan Africa is the realization that states are 'prisoners' of their own cultural heritage as the author on Democratic Republic of Congo so clearly indicates though he did not elaborate the issue. Consistent with this, it is fallacious to assume that the World Bank's technical or managerial approach to reforms would solve the problems of governance, ineffective states or governments in Africa without first solving the development problem. The issue is not only about availability of finance, the size of the Public Service, or about basic skills as such. These are apparent misconceptions. The important thing is that institutions in different organizations or in other systems would produce consistent formal behavior. The argument is that this is not possible without solving the development problem first. Consequently, the reason why reforms are difficult

<sup>5</sup> One of the latest accounts of the quality of political interference and its developmental implications in Ethiopia could be found in Tekalign Gedamu (2001), 'Troubling Times for Ethiopia's Banks: A Personal View'. Address Given at a Meeting Sponsored by the Addis Ababa Chamber of Commerce, 18 September 2001, Hilton Hotel, Addis Ababa.

<sup>6</sup> See Paulos Chanie (1999), 'Initial Observations on Problems and Prospects of the Civil Service Reforms in Ethiopia' (a Draft), p.21. Prepared for the Ninth Annual Conference on the Ethiopian Economy. Organised by the Ethiopian Economic Association and the Department of Economics, Addis Ababa University.

to implement successfully is that Public Services are almost impossible to separate from the rest of the society in the sense of existing value systems. The so-called enclave approach to Civil Service Reform is not able to produce sustainable results. However, where this could be done at least partial successes could be expected. Perhaps, examples of at least partially performing Public Services could be found in Botswana, Ghana, in the Republic of South Africa, and in some other African countries.

### DUAL VERSUS BLURRED ECONOMIES

In development literature poor countries have been traditionally called 'dual economies' due to the dual nature of their economic structures. A dual economy is one in which there is a traditional or pre-capitalistic sector on the one hand, and a capitalistic or modern sector on the other. The former consists mostly of peasant farmers using simple methods of cultivation.<sup>7</sup> The description of a dual economy has been made in a good neo-classical tradition consistent with a dichotomized image of the poor countries in Africa. This description is not, however, to the point, and thus not very helpful. Poor countries in Sub-Saharan Africa are rather 'blurred economies' with blurred divisions and visions. As it has been reported, an overriding problem of conventional political science-based approaches to the politics of adjustment has been their fidelity to transposing certain of the key categories of neo-classical economics to the political arena. These categories have been used to designate watertight social institutions and group of actors. Furthermore, the implication is that in the neo-classical tradition there are rigidly dichotomized divisions between states and markets, public and private, state

and civil society, and formal and informal.<sup>8</sup> However, in Sub-Saharan Africa these divisions are not clear. Poor countries are rather 'blurred economies' with blurred division and visions as the examples about Public Administrations in the four countries clearly indicate.

Blurred divisions and visions have fundamental implications for all aspects of the African societies and how they work including the state and its organizations, markets, and different systems in general. A lot of examples could be found to illustrate these blurred divisions in Sub-Saharan Africa. Three are given here. In the next paragraph it will be explained what has given rise to these blurred divisions. -Traditionally, law and order for example is maintained through a normative system, which is part of the social structure. In other words, the 'system of law and order' is not independent of 'personal' relations in the sense that they dominate the working of the system and the outcomes it produces. The next example relates to the cyclical time concept. According to this concept, the belief in ancestors plays even today an important role in the development of personal moral awareness, and the distinction between private and public morality is made tenuous because ancestral spirits control the world of living.<sup>9</sup> One of the most telling examples of how blurred divisions work in practice is the old tradition whereby the distinction between 'public' and 'private' finances is blurred. This

blurred division easily leads to pilfering of state resources and diversification of state bureaucracy into 'private' activity as was explained above in the case of Democratic Republic of Congo. Behind these blurred divisions, leading to blurred visions through inconsistencies in formal behavior, we find basic characteristics of poor countries in Sub-Saharan Africa, e.g. the 'personal' map of behavior, authoritarian societies, and the cyclical time concept. These are elaborated in the next section where it is explained why states are weak in Sub-Saharan Africa. But before that is done, a few additional observations are in order.

Naturally, countries in Sub-Saharan Africa differ, at least to a certain extent, for different reasons in terms of their underlying characteristics. In some countries, the legacies of old colonial powers are still visible in the public service. Different European legacies constitute in a large measure the general framework, with formal institutions, for the political systems of modern Africa. In some countries there are special legislation or political superstructures that compound the blurred divisions even more. A good example of this is Kenya. In Kenya, there is special legislation that has made it possible for politicians to be in business in a massive way.<sup>10</sup> Thus political and economic interests are blended. As a result

<sup>10</sup> Especially harmful for the functioning of the Civil Service was the report of the Ndegwa Commission that recommended that civil servants could participate in private business. It has been reported that growing corruption with a breakdown of fiscal controls combined with the Ndegwa Commission's (1971) recommendations meant that it became increasingly difficult to distinguish politicians/government ministers/civil servants from Kenyan indigenous businessmen. In this environment, the performance of ministries ranged from dismal to total failure. See David Himbara (1994), 'Kenyan Capitalists, the State, and Development', p. 122-130. Lynne Rienner Publishers, Boulder and London.

<sup>7</sup> See for example I. Livingstone et al. (1980), 'Economics for Eastern Africa', p. 43. Heinemann.

<sup>8</sup> These observations are from Yusuf Bangura et al. (1992), 'Adjustment, Authoritarianism and Democracy: An Introduction to Some Conceptual and Empirical Issues' in Peter Gibbon et al., eds., (1992), 'Authoritarianism, Democracy and Adjustment: The Politics of Economic Reform in Africa'. Seminar Proceedings No. 26, the Scandinavian Institute of African Studies, Uppsala.

<sup>9</sup> See on these points for example Eric O. Ayisi (1980), 'An Introduction to the Study of African Culture', p. 110. Heinemann.

'rent-seeking groups' are in an ideal position to use their accumulated economic resources and political links with the state to manipulate the economy, business, and the operation of the markets at will to their own advantage.<sup>11</sup>

As this situation in Kenya has continued approximately for 30 years, it has caused a near collapse of the moral code in the country. Furthermore, Kenya's political structures are based on ethnicity and patronage. The political system fails to secure accountability, basic rights of the citizens, human rights and security. In Kenya there is a clear breakdown in the rule of law with a rising number of criminal offenses, mob justice and illegal land occupations etc. All this has resulted in economic decline and increased poverty. Existing political culture is not conducive to improvements. In this situation, outside assistance cannot do much to help solve governance problems. For starters, a real commitment would be needed. However, it is difficult to foresee a real commitment to reform because it would mean that the Kenyan government would work against its own short-term political and economic interests.

#### CULTURAL FACTORS LEADING TO BLURRED ECONOMIES AND WEAK STATES

Culture is about behavior and behavior patterns that are based on a system of symbols or maps of behavior. Two distinct cultural systems can be distinguished, e.g. a 'personal' and 'impersonal' cultures that give rise to 'personal' and 'impersonal' maps of behavior.<sup>12</sup> In every culture

these maps are prevalent to different degrees. This is the reason why cultures differ and the concomitant behavior in these cultures.

Cultures differ in respect of three factors.<sup>13</sup> First, cultural specificity derives first and foremost from the 'personal' map because it is more or less context specific while the 'impersonal' map is more universal. The 'personal' map of behavior is more dominant in developing countries and in Sub-Saharan Africa. Second, cultures differ also in the relative weight given to the two maps in different areas of human activity. Depending how these 'blend' and 'balance' will result in different behavior and actions by individuals as members of communities or by other decision-making entities like organizations. Third, the nature and intensity of the tension between the 'personal' and 'impersonal' maps will be different in different cultures. For example, in a culture where there are practically no meaningful formal rules of behavior or the enforcement of those rules is erratic or deficient, the tension between the two maps is also non-existent or weak. This has implications for releasing the potential for development.

Risking oversimplification, one could say that states are weak due to three interlinked cultural reasons that give rise to blurred divisions and visions in Sub-Saharan Africa.<sup>14</sup> First, they are weak because states in Africa are based on principles of a 'chieftain' society. Major charac-

Resistance' by Frederique Appfel et al., eds. (1990). Clarendon Press, Oxford.

<sup>13</sup> In defining cultural characteristics, Banuri's classification has been used. See Tariq Banuri (1990), op. cit., p. 82.

<sup>14</sup> Due to space limitations, the description of the basic characteristics of Sub-Saharan African societies given in the article does not give credit to the complex nature of these societies. However, it is believed that the illustrations given are enough to make the chain of argument hold to derive the fact that formal behaviour is inconsistent in Sub-Saharan Africa.

teristics of such a society are the following: authoritarian relations between people are dominant; a chief has a supreme authority in judicial, political and social matters; and people are unflinchingly loyal to him. When these principles are translated into an operational code of conduct of post-colonial period, states more often than not assume a role that serves the interests of the ruling elite rather than the public at large. This assumed role usually leads to attitudes that accept political interference within different spheres of societies. Second, the very nature of a chieftain society is compounded by the fact that most governments in Africa are kept 'hostage' by the peasant mode of production and its inherent value systems.<sup>15</sup> These value systems reflect and are consistent with the 'personal' map of behavior. A 'personal' map is a culture in which every person sees himself as having only personal relationships with other people, with the natural environment, and with knowledge. Let us illustrate these different dimensions one by one. In a 'personal' culture a person sees

<sup>15</sup> The idea is originally from Göran Hyden (1983). See his profound work, 'No Shortcut to Progress: African Development Management in Perspective'. Heinemann. See also Yusuf Bangura (1992), 'Authoritarian Rule and Democracy in Africa: A Theoretical Discourse' in Peter Gibbon et al., (1992), op. cit., p. 43-44. Bangura interprets Hyden by saying that the contemporary African state is projected as a pathetically poor moderniser as it has failed to 'capture' the small-scale producers buried in 'relations of affection'. He continues by claiming that the values of communal life are manipulated by the dominant groups to sustain the support for their struggles over political offices and economic resources. In a way, both of these authors are right. Both 'groups' keep each other 'hostage'. However, Bangura fails to recognise the power of values in dictating behaviour in communities where the 'personal' map is predominant, and where the 'impersonal' map is not relevant or non-existent. This is the very reason why traditional values condition the way societies have been structured, how they function, and what are the economic, social and political priorities in Sub-Saharan Africa.

<sup>11</sup> This theme has been further discussed in general terms in Yusuf Bangura et al. (1992), op. cit., p. 16.

<sup>12</sup> The terms 'personal' and 'impersonal' maps of behaviour and examples explaining them are from Tariq Banuri (1990), 'Modernisation and its Discontents: A Cultural Perspective on the Theories of Development' in Dominant Knowledge: Development, Culture, and

himself simply as the nexus of a web of relationships. Thus, in this kind of a culture the idea of an individual is difficult to perceive. The behavior of a person is controlled by the group he or she belongs to, its inherited value systems, and by the authority of elders or chiefs. In a 'personal' culture, the environment would be seen in its relational context. For example a home is not just a place you are living in at the moment but also an integral part of your past as well as your future. This means that in a relational context everything is unique and irreplaceable. In a 'personal' culture valid knowledge derives from identification with the object of knowledge; through a personal relation between the observer and the observed.

Perhaps in less abstract terms, an example from exchange theory tells that in a world where the 'personal' map is predominant people enter into exchanges to sustain human relationships. Thus people might go to the market place to 'make them better off' in the sense of fostering personal relationships. The actual exchange would be of secondary priority.<sup>16</sup> Consistent with this line of thinking, economic transactions refer more to the quality and kind of the real articles than to abstract values.<sup>17</sup> Also, based on author's own experience from Abidjan, in a 'personal' culture a social process seems to be more important than the concrete end result of a work process as such. This became evident while trying to fix a flat tyre in a garage some years ago. The flat tyre was never properly repaired in spite of the availability of modern equipment. Other examples are also easy to find to indicate the nature of a 'personal' map of behavior in concrete situations.

Third, the cyclical time concept deserves to be mentioned separately though it could be seen as an integral part of a 'personal' culture. This time concept emphasizes among other things the importance of ancestral spirits in behavior and decision-making. Cyclical time could be contrasted with linear or mathematical time that is predominant in 'impersonal' cultures. Linearity makes for example long-term planning and considerations of effectiveness meaningful.<sup>18</sup>

To make the argument explicit, a 'personal' culture could be further contrasted with examples from the 'impersonal' one. In that culture, people perceive themselves as having 'impersonal' relationships with other people, with the natural environment, and with knowledge. Behavioral modes are more or less consistent with formal rules and regulations or with the other parts of the formal institutional framework where formal systems dominate behavior. Let's take an example from traffic. Flowing traffic is based on a system, and that is based on a vision how traffic should flow. Following an 'impersonal' map of behavior, violators of traffic rules are at least in principle punished. That possibility has a strong incentive on directing behavior that makes traffic a smoothly and orderly flowing system. In a 'personal' driving culture the opposite is true. In that culture there is room for 'creative driving' as the author's French colleague once put it. Violators of traffic rules are not usually punished, and the traffic does not flow smoothly as indicated clearly by chaotic traffic for example in Addis Ababa. In this kind of a culture corrupt behavior is acceptable. Usually in real life, it is not possible to find a pure mode of behavior of either kind. As it was explained before, behavioral maps 'blend and bal-

ance' in different cultures. The way they do will dictate the behavior of persons in different situations or the functioning of systems like organizations, governments, etc. In cultures where the 'personal' map is predominant, as is the case in cultures of poor countries in sub-Saharan Africa, formal behavior as a rule is not consistent that will give rise to confusion and anti-development tendencies.<sup>19</sup> This is a basic reason why divisions and visions are blurred and states are weak in Sub-Saharan Africa. This will be elaborated in more detail below.

#### INCONSISTENCY OF FORMAL BEHAVIOR—IDENTIFYING THE DEVELOPMENT PROBLEM

In any culture there are informal and formal institutions or institutional frameworks. Customs, beliefs, attitudes etc. are examples of informal institutions. Formal institutions consist of laws, official rules and regulations. Thus, institutions define the 'rules of the game' which induce a certain type of behavior.<sup>20</sup> Exactly what kind of behavior depends on the tension between the 'personal' and 'impersonal' maps of behavior as was explained before. Therefore, culture, as reflected by the tension, defines how individuals perform in any group, organization or system. It is believed that an old Finnish wisdom still holds true which says that in a 'bad' environment even a 'good' man will be spoilt. The implications of this old wisdom are profound for effectiveness of states and for understanding the devel-

<sup>16</sup> See Tariq Banuri (1990), op. cit. p. 87-92 for more examples.

<sup>17</sup> An interesting account of 'personal economies' could be found in Richard Thurnwald (1969), 'Economics in Primitive Communities', Oxford University Press.

<sup>18</sup> See more on this point Heikki Haili (1991), 'Philosophy and Enterprising in Africa' (in Finnish). Ministry of Foreign Affairs of Finland. Kehitys 2/1991.

<sup>19</sup> Behaviour of an individual or an organisation is called formal in the context of a system that has formal rules, regulations or is governed by laws, or some other assemblage or combination of things or parts forming a complex or unitary whole etc. that has shared rules of behaviour or 'impersonal' logic of its own.

<sup>20</sup> In defining institutions Douglass North's definitions were followed. See Douglass North (1990), 'Institutions, Institutional Change and Economic Performance'. Cambridge University Press.



opment processes in Sub-Saharan Africa.

Before establishing the development problem facing Sub-Saharan Africa, let us briefly visit one of the most authoritative expositions on institutions and governance for the African continent.<sup>21</sup> The basic theme of the author is that the crisis of capacity building is more of a crisis of institutional capacity than a crisis of technical and financial capacity, e.g. availability of skills, technology and funds. - With this, it is easy to agree. As argued in this article the development problem cannot be solved without appropriate institutional capacity. - The author then continues by saying that this crisis is essentially due to a structural disconnect between informal, indigenous institutions born of traditional African culture and formal institutions mostly transplanted from outside. - If by a disconnect is meant 'to sever or interrupt the connection of or between' the author's argument is not very helpful, because it does not offer an explanation in a sense of theoretical discourse. Thus, a more scientific explanation is needed.

The author concludes his basic theme by saying that it is through adaptation that formal and informal institutions can converge and build on each other's strength to reduce transaction costs and to maximize institutional performance. This process of convergence is at the heart of the reconciliation paradigm proposed in the report.<sup>22</sup> The argument is a convincing one. However, a mere convergence does not create the needed tension between different behavioral maps that would give rise to development.

The interesting question is why the author presents his conver-

gence 'theory' of institutional capacity building when it is evident that the approach cannot explain or establish the development problem. It can only offer partial solutions to governance problems in Sub-Saharan Africa.<sup>23</sup> -The first two parts of the answer to the question are obvious ones. The third one is less so but a logical consequence of the first two. First, the convergence 'theory' of institutional reconciliation describes the current practice of institution building in Sub-Saharan Africa. However, as it was observed earlier, it does not explain it in the sense of offering sustainable solutions. Nevertheless, it is a safe choice and fits well to a conservative bank. Second, the adopted approach allows the author to adhere to the technical or managerial approach to Civil Service Reforms that is typical to the World Bank. Third, the reconciliation paradigm is not based on any cultural analysis. In other words, it is void of any theoretical considerations that would be necessary for a valid explanation of institutional and economic development. The paradigm is only a description of current development practices found in different countries as exemplified by the report. Contrary to this, any serious attempt to explain institutional and economic development should be based on cultural analysis of institutions as has been explained in this paper.

Based on the above, the development problem facing Sub-Saharan Africa could be enumerated as follows: due to blurred divisions and visions formal behavior of different systems is not consistent. Inconsistency means, assuming constant the other factors influencing the performance

of systems, that formal institutions are not able to produce effective outcomes, e.g. outcomes that would secure high quality performance as dictated by formal institutions. The reason is that the tension between the 'personal' and 'impersonal' maps of behavior is dominated by the 'personal' culture. For this reason the 'tension' is not meaningful for development. The 'personal' map of behavior is not consistent with the requirements of formal institutions.

The conditions that induce consistent formal behavior are a necessary condition for explaining the development problem in Sub-Saharan Africa. It is not, however, a sufficient condition. Establishing inconsistency in formal behavior in different African systems, as has been done in this article, is a starting point for a more comprehensive analysis to explain why the continent lags behind the other continents in performance and development. That explanation would be a major challenge, and thus is not attempted here.<sup>24</sup>

#### IMPLICATIONS OF INCONSISTENT BEHAVIOR FOR PROJECT IMPLEMENTATION AND POLICY REFORMS

In most cases in Sub-Saharan Africa, the tension between the 'personal' and 'impersonal' maps of behavior, if it exists, is not meaningful for the development at a national level or in sub-categories of development (e.g. poverty reduction etc.). On the contrary, the tension more often than not creates anti-development tendencies. In extreme cases, this would mean that whole civilizations could vanish as has happened in the course of history. On a more practical note, one could say that 'anti-development tendencies' explain why project implementation and a creation of a 'supply

<sup>23</sup> These partial solutions become evident for instance in the examples given in pages 86-114 of the report mentioned in footnote 23. The author studies for example 'a performance-based enclave for tax and customs management in Ghana'. Obviously, the 'enclave approach' harboured cannot be a holistic solution for revenue management.

<sup>24</sup> However, the explanation has been attempted in Heikki Halli's forthcoming book. See footnote one.

<sup>21</sup> Mamodou Dia (1996), 'Africa's Management in the 1990s and Beyond: Reconciling Indigenous and Transplanted Institutions', The World Bank.

<sup>22</sup> Mamadou Dia (1996), op.cit. p. vii.

response' to reforms, or even implementation of reforms, is so difficult in Africa. This is illustrated below.

According to one study on donor-recipient relationship, capacity building, and effectiveness of aid, it was concluded that the effectiveness of aid also depends on the recipient's environment, which in most cases leaves much to be desired. The problems include low capacity and capability as well as a turbulent economic and organizational environment. The concomitant result was the dominance of the donor in decision-making, and a failure to build local capacity. As a consequence, it was found that it is increasingly difficult for the donor to leave the scene because of the one-sidedness of the interaction of donor policies. Under such circumstances the quest for self-reliance is tantamount to chasing a mirage.<sup>25</sup>

Given the explanation of the development problem in Sub-Saharan Africa in this paper, it is easy to understand why so many projects have failed in Africa. As long as the donor is at the scene, its policies, systems and organizations secure consistent behavior through the established formal institutions and practiced 'impersonal' culture that can interpret formal institutions in a way that produces the necessary tension for intended results. However, two points should be kept in mind. First, a project, as an aid modality, is not able to 'blend and balance' a local informal institutional framework with a more 'impersonal' institutional framework to secure results. Consequently, there is a need for a development modality that could instigate societal transformation through shifting the balance between the behavioral

maps to favor the 'impersonal' map of behavior and formal institutions. Second, it should go without saying that it is not possible to build local capacity through projects, or to transform 'personalized' cultures to more effective organizational structures, that could create a pro-development tension between behavioral maps that is a precondition for a take-off.

The results of adjustment and structural reforms have been more disappointing than expected in Sub-Saharan Africa during the past twenty years or so. Particularly, reform programs have had a minor or insignificant impact on investments, savings rates, and long-term growth per capita in reforming countries.<sup>26</sup> Currently, this view, the official view of the World Bank notwithstanding, is widely shared.<sup>27</sup> Not only there has been disappointment in the investment performance and growth but also in the structural transformation of economies. The transformation has been slow or non-existent, and many countries have experienced de-industrialization.<sup>28</sup> De-industrialization could be interpreted as a fundamental anti-development tendency that prevails in Africa. The tendency has

resulted in a slow and partly 'biased' diversification of production.

### CONCLUSION

An analytical account of the problems constraining development in Sub-Saharan Africa has been given above. Due to the nature of the problems, the analysis has not always been as scientific as one might desire. Even some would think that the account given is not a true picture of the African reality. Successes or at least partial successes of reforming formal systems have been secured by converging informal and formal institutions as explained by Mamadou Dia. This might be so. However, the vision underlying this treatise is that convergence of different institutional heritages falls far short of addressing adequately the development problem persisting the continent, e.g. a lack of consistency in formal behavior. The adopted view is not development pessimism, nor an act of support to modernization theories but simple development realism based on analysis and experience. It should be emphasized that there is nothing superior about the 'impersonal' map of behavior over the 'personal' map. The 'personal' map of behavior gives a culture its content and the 'impersonal' map its order. Both are needed to make African societies worth living in. ■

<sup>25</sup> See Gelase Mutahaba and Rweikiza Baguma (1990), 'Foreign Assistance and Local Capacity Building in Tanzania' in Eshetu Chole et al., eds. (1990), 'The Crisis of Development Strategies in Eastern Africa'. OSSREA Book Series.

<sup>26</sup> See for example Ibrahim A. Elbadawi et al. (1995), 'Growth and Development in Sub-Saharan Africa: Evidence of Key Factors', p. 25. African Economic Research Consortium. See also the World Bank (1994), 'Adjustment in Africa: Reforms, Results, and the Road Ahead', p. 3, and the World Bank (1996), 'Special Program of Assistance, Phase Four' Revised Draft.

<sup>27</sup> See on this point Benno Ndulu (1997), 'International Governance and Implications for Development Policy in Sub-Saharan Africa: A Review of Experience and Perspectives for the Future' in Roy Culpeper et al., eds. (1997), 'Global Development: Fifty Years After Bretton Woods. The North-South Institute.

<sup>28</sup> See Francis Stewart (1992), 'Are Short-term Policies Consistent with Long-Term Development Needs in Africa' in Giovanni Andrea Cornia and Gerald K. Helleiner, eds. (1994), 'From Adjustment to Development in Africa', p. 98-128.

## ANNOUNCEMENT

**THE ETHIOPIAN ECONOMIC ASSOCIATION IS PLEASED TO ANNOUNCE THAT THE PROCEEDINGS OF THE 10TH ANNUAL CONFERENCE ON THE ETHIOPIAN ECONOMY WILL SOON BE AVAILABLE FOR ITS ESTEEMED READERS.**

## THE EMPEROR HAS NO GROWTH: DECLINING ECONOMIC GROWTH RATES IN THE ERA OF GLOBALISATION

Mark Weisbrot, Robert Naiman, and Joyce Kim\*

### INTRODUCTION

Has increasing globalization been good for growth? Have the policies advocated by the International Monetary Fund, the World Bank, and the US Treasury Department — often imposed by these institutions on low and middle-income countries — helped to stimulate economic growth? Almost all of the discussion of this subject has simply assumed this to be true. Even among those who have been critical of globalization and the most powerful institutions that promote it, the IMF and the World Bank, this belief goes largely unchallenged. However, as this paper will show, there is no support for this assumption in the official data. For the overwhelming majority of the world, especially in less developed countries, the last two decades of increasing globalization have seen a considerable slowing of economic growth.

If these facts were well known, the entire debate over globalization would change dramatically. The growth of output per person is not the only economic objective, nor is it necessarily the most important one in all circumstances. Nonetheless it is what allows a society to achieve a rising standard of living. For most people in the poorer countries of the world, economic growth offers the only hope that their children and grandchildren might escape from crushing poverty.

Of 176 countries for which the IMF published data in 1999, there were 54 — or 31% — which had a per capita GDP of less than two dollars per day. This means that the hundreds of millions of peo-

ple in these countries would all be very poor — by an absolute measure — even if each nation's income were evenly divided among its population. Increasing economic growth is therefore an urgent priority for these countries.

If globalization and other policies promoted by the IMF and the World Bank have not led to increased growth, it becomes extremely difficult to defend these policies. The costs of these changes — the destruction of industries and the dislocation of people, the harsh "austerity" medicine often demanded by these institutions and by international financial markets — become a burden to society without any clear countervailing benefit.

Globalization has encountered rapidly increasing opposition in recent years. Even its most prominent advocates have now acknowledged the legitimacy of their opponents' concerns. At the World Trade Organization's 1999 meeting in Seattle, then-President Clinton noted that the protestors "represent millions of people who are now asking questions about whether this enterprise in fact will take us all where we want to go. We ought to welcome their questions and be prepared to give an answer."

Labor unions in the United States and other developed countries have objected to the lowering of wages and working conditions, through competition from imports based on cheap (and sometimes violently repressed) labor. The increasing ability of domestic firms to move overseas to avoid union organization or wage in-

creases has also put downward pressure on wages at home.<sup>1</sup>

Environmentalists have criticized the rewriting of global trade and investment rules, and the process of globalization for contributing to a "leveling downward" of environmental standards. Religious groups have lamented the weakening of social safety nets and effects on the poor, and advocates for underdeveloped countries have argued that the indiscriminate opening of markets to international competition prevents the implementation of any viable economic development strategy. And even some of the profession's most prominent pro-"free trade" economists have made an about-face on the question of liberalizing markets for international lending — recognizing that this has gone too far in recent years, and was one of the main causes of the Asian financial crisis.<sup>2</sup>

Yet most of the debate over globalization has been greatly constrained by certain myths, some of which are rarely ques-

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<sup>1</sup> Kate Bronfenbrenner, "Final Report: The Effects of Plant Closing or Threat of Plant Closing on the Right of Workers to Organize," Cornell University Press, 1996.

<sup>2</sup> See, e.g., Jagdish Bhagwati, "The Capital Myth: The Difference Between Trade in Widgets and Dollars," *Foreign Affairs*, May/June 1998.

tioned. Globalization is seen as an inevitable, technologically driven process. It is portrayed as a natural phenomenon, like the weather, to which we must adapt if we are to survive and prosper. We are told that we live in "a global economy," and that national governments are helpless to determine their own economic policies in a world of global markets.

As noted above, it is assumed that the globalization of recent decades has led to higher economic growth and has therefore made most people better off—although it is acknowledged that the process has some "winners and losers." And the most powerful globalising institutions—the IMF and the World Bank—are assumed to be playing a stabilizing and constructive role, even if they sometimes make mistakes.

Some of these myths are completely false and are easily dispelled with a glance at the numbers; others require more background and information in order to make a fair evaluation. And some are based on a kernel of truth that has been exaggerated beyond recognition. This paper will take a closer look at some of the most important of these myths, in the interest of furthering a more honest debate about globalization and its institutions, especially the IMF and the World Bank.

Globalisation is no more natural or inevitable than the construction of skyscrapers. The globalization we have seen in recent decades has been driven by a laborious process of rule making. It is the establishment and enforcement of these rules that allows Timberland shoes, for example, to make their product in China at wages of 22 cents an hour, and then sell it at the local suburban mall. Advances in transportation and communications did not determine this result.

Our leaders have rewritten the rules of the game in a way that has driven down wages for the vast majority of American employees.

One may agree or disagree with this policy, but it should be understood as a conscious political choice.

The same thing could have been done to the salaries of doctors, for example. With much less effort and expense than it has taken to negotiate investment and trade agreements like NAFTA and the WTO, we could license and regulate the training of doctors in foreign medical schools. By allowing these doctors to practice medicine in the United States, we could lower the salaries of doctors and greatly reduce health care costs, without any loss of quality.

Interestingly, the savings to consumers from reducing American doctors' salaries to even those of Europe would be enormous: about \$70 billion a year.<sup>3</sup> This is about a hundred times more than the gains from tariff reduction in our most comprehensive trade liberalization agreements, such as the one that established the WTO five years ago.<sup>4</sup> Huge savings could also be achieved by introducing international competition to the practice of accountants, lawyers, economists, and other professionals. But it is unlikely to happen, because these professionals—unlike the majority of the US labor force—have enough political clout to protect themselves from international competition.

There is no doubt among economists that the process of rewriting rules has had a significant negative impact on the wages of American workers. The debate is about the size of the impact, be-

<sup>3</sup> It should be noted that the administrative waste in our health care system is significantly greater than this amount. See General Accounting Office (GAO), "Canadian Health Insurance: Lessons for the United States," Report to the Chairman, Committee on Government Operations, House of Representatives, 1991.

<sup>4</sup> If we were to add the efficiency gains from reducing non-tariff barriers, the benefits of the Uruguay Round would be higher—perhaps as high as one thirty-fifth of the potential savings from reducing the salaries of doctors.

cause it is difficult to measure and separate the various changes that have led to an unprecedented weakening of labor's bargaining power in the United States. Imports have doubled since the early 1970's, and the outflow of direct foreign investment has also risen sharply. These changes have lowered union membership and weakened labor generally. But so have other factors, such as the Federal Reserve keeping unemployment (until a few years ago) much higher than necessary. Aggressive and often illegal anti-union tactics by employers, such as the intimidation and firing of union sympathizers, or hiring of permanent replacement workers during a strike, have also taken their toll.<sup>5</sup>

It is difficult to separate the influence of all of these factors and measure their specific effects, partly because each means of undermining labor's bargaining power may enable others to happen. For example, the loss of millions of unionized jobs in auto, steel, and other industries to globalization, and the increased ease of employers' "running away" to poorer countries may have encouraged the aggressive anti-union tactics that escalated sharply beginning in the 1980s. Economists who have attempted to measure the effect of trade itself on wages—even those who are strongly in favor of globalization—have found it to be very significant. For example, William Cline of the Institute for International Economics estimated that 39% of the increase in wage inequality from 1973-93 has resulted from increased trade.<sup>6</sup> And this is just

<sup>5</sup> "...the overwhelming majority of employers use a broad range of aggressive legal and illegal anti-union tactics, including discharging workers for union activity...offering bribes, supporting anti-union committees, holding captive-audience meetings...most of these tactics are associated with significantly lower [union] win rates..." Kate Bronfenbrenner and Tom Juravich, in *Organizing to Win: New Research on Union Strategies*, Cornell University Press, 1998, p. 19-36.

<sup>6</sup> William Cline, *Trade and Income Distri-*

trade — it does not capture the effect of employers' increasing ability to use the threat of plant relocation in order to undermine labor's bargaining power.

For example, in a study commissioned by the labor secretariat of NAFTA, Kate Bronfenbrenner of Cornell University surveyed firms who faced union organizing drives since NAFTA was passed. She found that the majority of them threatened to shut down operations if the union won. 15% of the firms actually did close all or part of a plant when they had to bargain with a union. This was three times the rate of such incidents that occurred before NAFTA.<sup>7</sup>

In any case, the last quarter century of globalization has clearly failed to raise the wages and salaries of the majority of the US labor force. We can see this by looking at the real median wage, which is about the same today as it was 28 years ago. This one statistic tells a very big story, a fact that the more ardent advocates of globalization either don't understand, or pretend that they don't. *Median*: that means the 50<sup>th</sup> percentile, i.e., half of the entire labor force is at or below that wage. This includes office workers, supervisors, everyone working for a wage or salary — not just textile workers or people in industries that are hard hit by import competition or runaway shops. *Real*: that means adjusted for inflation, and quality changes. It is not acceptable to argue, as is often done, that the typical household now has a microwave and a VCR. That has already been taken into account in calculating the real wage.

This means that over the last 28 years, the typical wage or salary earner has not shared in the gains from economic growth. Now compare this result to the previous 27 years (1946-1973), in which foreign

trade and investment formed a much smaller part of the US economy, and was more restricted. During this time, the typical wage increased by about 80%. This is one reason why it is uncommon for anyone to defend the era of globalization on the basis of its contribution to living standards in the United States.

Politicians will often state that the global economy has contributed to the growth of jobs in the United States, although economists — even those who are most enthusiastic about increasing trade — do not. This claim is simply false, since the United States has been running a trade deficit for 26 of the last 28 years, during which time trade as a percentage of the economy has doubled.<sup>8</sup> A trade deficit means that the nation is importing more than it is exporting. Under such circumstances trade can only have a negative effect on employment.<sup>9</sup>

The overall effects of globalization on living standards in the United States seem to be better understood by the majority of the public than they are in elite and policy-making circles. A *Wall Street*

*Journal/NBC* poll found 58% of Americans believed that foreign trade reduced jobs and wages. When asked to describe their views on trade in a recent *Business Week/Harris* poll, only 10% chose "free trader." Fifty percent chose "fair trader," a label rarely used by anyone outside the labor or protest movement. And 37% chose "protectionist" — a word that is never granted a positive connotation in the press. Although there were mixed feelings about globalization in general, people most often chose "protecting the environment" and "preventing the loss of US jobs" as a major priority for trade agreements — putting them directly at odds with our policy makers and trade officials.

### GLOBALIZATION AND GROWTH IN LESS DEVELOPED COUNTRIES

Given the lack of support for current trade and commercial policy, among the statistics as well as the American people, defenders of the status quo have increasingly argued that it is a boon to the economies of the underdeveloped countries. The following statement from former US Treasury Secretary (then Deputy Secretary) Larry Summers, quoted without correction in the *New York Times*, is typical:

"When history books are written 200 years from now about the last two decades of the 20th century, I am convinced that the end of the cold war will be the second story. The first story will be about the appearance of emerging markets — about the fact that developing countries where more than three billion people live have moved toward the market and seen rapid growth in incomes."<sup>10</sup>

7 *ibid.*, 1996, page 234.

8 Bronfenbrenner, "Final Report: The Effects of Plant Closing or Threat of Plant Closing on the Right of Workers to Organize," *op cit.*

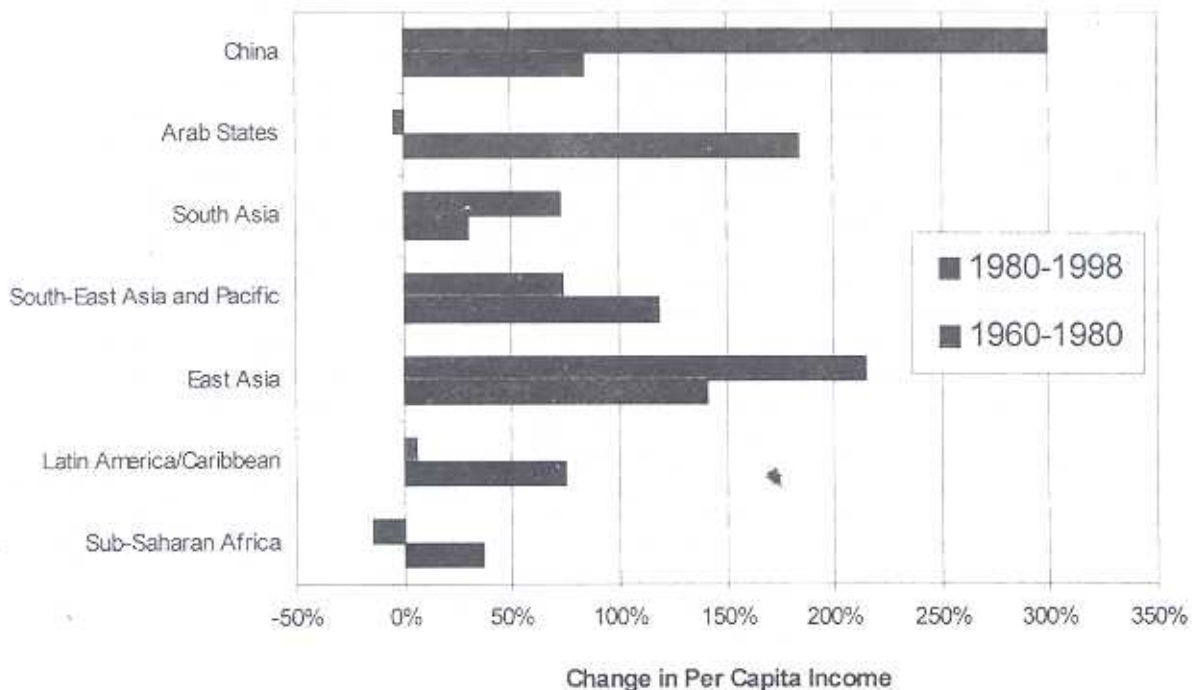
9 "Economic Report of the President," Council of Economic Advisers, February 2000.

10 Most economists would actually maintain that trade has no appreciable effect on the total number of jobs in the United States over the long run. This would be for either of two reasons: first, many if not most economists assume that the economy achieves full employment over the long run. Second — a much more plausible assumption — is that the Federal Reserve determines the rate of unemployment over the long run, through its control over short-term interest rates.

The second reason is basically true, although it must be noted that while the Fed determines the overall rate of unemployment and therefore the total number of jobs that the economy can produce, the amount of gross job loss can still be very much affected by trade. For example, manufacturing workers can lose their jobs to import competition, while new jobs are created in the service sector. The total number of jobs may end up being the same, but there is still much hardship, and generally lower wages, for those who lose their jobs in manufacturing.

10 Nicholas D. Kristof with Edward Wyatt, "Who Went Under in the World's Sea of Cash," *New York Times*, February 15,

Figure 1: Change in Per Capita Income in the Developing World: 1960-1980 vs. 1980-1998



Source: UNDP Human Development Reports 1998, 2000.

This argument appears to be readily accepted, in spite of the fact that the overwhelming evidence is to the contrary. It has become the most common defense of current policy, as well as the IMF and World Bank, in journalistic and policy-making circles. Often it is accepted even by critics of the IMF and the Bank, who are concerned about the effects of globalization on income distribution, but assume that globalization has indeed raised incomes throughout most of the world.

Figure 1 shows the rate of growth of GDP per capita for the various regions of the developing world. If we compare the results since 1980 with the previous two decades, the difference is striking. In every region except East Asia and South Asia, the later period shows remarkably slower growth.

In Latin America, for example, GDP per capita grew by 75% from 1960-

1980, whereas in the latter period it has only risen 6%. For sub-Saharan Africa, GDP per capita grew by 36% in the first period, while it has since fallen by 15%.

These are enormous differences by any standard of comparison, and represent the loss to an entire generation—for hundreds of millions of people—of any chance to improve its living standards. Even where growth was significant, as in Southeast Asia, it was still better in the earlier period. The exceptions to this trend were East Asia and South Asia, which grew faster from 1980 to 1998 than in the previous period. The East Asian result is due to the quadrupling of GDP, over the latter period, in China (which has 83 percent of the population of East Asia.) The South Asian result is due to faster growth in India (which has three-quarters of the population of South Asia.)

In short, there is no region of the world that the Bank or Fund can point to as having succeeded through adopting the policies that they promote – or in many cases, impose – upon borrowing countries. They are understandably reluctant to claim credit for China, which maintains a non-convertible currency, state control over its banking system, and other major violations of IMF/Bank prescriptions.<sup>11</sup> And in both India and

<sup>11</sup> Official spokespersons and supporters of IMF and World Bank policies generally point to an individual country over a relatively short period of time, when defending their record. For example, in a *New York Times* article (June 25, 2000, by Joseph Kahn, page 5) then-US Treasury Secretary Larry Summers cited Uganda and Poland as success stories for their economic model. But Uganda, despite seven years of growth, is still 30 percent below its per capita income of 1983. And Poland, as it turns out, is very unrepresentative of the IMF's work in the countries of Eastern Europe and the former Soviet Union – most of which are still far below

China, their opening to trade took place about a decade after the increase in growth began.<sup>12</sup>

### THE GROWTH SLOWDOWN

The growth slowdown of the last two decades was a worldwide phenomenon. Table 1 compares the rates of growth of output per person for 116 countries during 1960-1980 versus 1980-2000.

The countries for which data was available for both periods, the (arithmetical) average rate of growth of output per person for the period 1960-1980 was 83%. For 1980-2000 it was 33%.

There were 89 countries – 77% — that saw their per capita rate of growth fall significantly from the period 1960-1980 to the period 1980-2000. Only 14 countries — 13% — saw their per capita rate of growth rise significantly from 1960-1980 to 1980-2000.<sup>13</sup>

Eighteen countries — including several in Africa — would have more than twice as much income per person as they have today, if they had maintained the rate of growth in the last two decades that they had in the previous two decades.<sup>14</sup> The average Mexican would have nearly twice as much income today, and the average Brazilian much more than twice as much, if not for the slowdown of economic growth over the last two decades.

Many countries would have dramatically changed their position in the world economy if they had

their 1989 levels of income (see below).

<sup>12</sup> Rodrik, 2000, p. 2-3, 8.

<sup>13</sup> We considered a country's growth to have fallen significantly if its per capita growth was more than 5 percentage points lower in the second period. We considered a country's growth to have risen significantly if its growth was more than 5 percentage points higher in the second period. (We excluded countries here that had negative growth in both periods.)

<sup>14</sup> These are the countries where the entry in the column "Increase forgone in per capita GDP" is more than 100%.

maintained their previous rate of growth, compared with where other countries stand today. Greece would be richer than Belgium; Uruguay, Mexico, Gabon and Trinidad would be richer than South Korea; Brazil would be richer than Saudi Arabia; Ecuador would be richer than Costa Rica; Ivory Coast, Cameroon, Haiti, Lesotho, Togo, and Nigeria would be richer than China.<sup>15</sup>

The failure to acknowledge this dramatic decline in growth rates has left a gaping hole in the debate over the policies of the world's two most powerful financial institutions. It allows the Fund and the Bank to continue imposing a whole cluster of failed policies repeatedly, without their competence or the policies themselves being called into question. When prominent economists such as Jeffrey Sachs or former World Bank Chief Economist Joseph Stiglitz criticize the IMF's macroeconomic policies, or Harvard's Dani Rodrik questions the institutional overreaching on questions of openness, the Fund and the Bank pay no heed. The Fund simply repeats its assertions that it is helping developing countries to maintain macroeconomic stability, and to grow. Perhaps it (and the Bank) could do more to fight poverty and protect the environment, but they are "getting the fundamentals right" so that countries will have the option to improve living standards for everyone. But this is exactly what they have not done.

If the IMF and the Bank were simply research institutions, their errors would not be so damaging, since their analyses would compete in the marketplace of ideas and be judged by their success or failure. But in fact they control access to credit for countries with most of the population of the developing world (and transition

<sup>15</sup> This can be seen by comparing a country's entry in the column "1999 per capita GDP if adjusted for forgone growth" with the entries in the column "Per capita GDP (1999 U.S. Dollars)."

economies). The Fund acts as gatekeeper: most of the Bank's lending is contingent on Fund approval, and therefore on adherence of the borrowing country to IMF conditions. Most credit from other multilateral institutions (e.g. the Inter-American Development Bank) and even private sources is also contingent on the IMF's seal of approval. As a result of this arrangement, the Fund and the Bank have the power to impose their policies on dozens of governments throughout the world.

It is, of course, difficult to separate out the causal relationships between various economic policies — what has come to be known as "the Washington consensus" — and the dramatically reduced economic growth of the last two decades. But they can be seen in any number of case and country studies, and although the results vary, the errors are often the same.

For example, since 1997 the IMF and its allied creditors have made serious policy errors that have undoubtedly reduced cumulative economic growth for hundreds of millions of people. In the Asian financial crisis, the Fund's drastically tight monetary policies (interest rates as high as 80% in Indonesia) and fiscal austerity deepened the recession and threw tens of millions of people into poverty. Although the regional economy has now recovered, the lost growth and increased poverty is still significant.<sup>16</sup> And Indonesia, the largest of the five crisis countries (including South Korea, Thailand, Malaysia, and the Philippines) with more than 50% of their total population, has yet to recover, after a 13.4% decline in GDP in 1998.

In Russia in 1998, the IMF insisted on maintaining an overvalued fixed exchange rate, which required raising interest rates as high as 150%. These policies not only led to excessive foreign debt

<sup>16</sup> World Bank, "East Asia: Recovery and Beyond," June 1, 2000.

burdens, but also maintained a speculative bubble in the financial sphere, and drained the real economy of investment capital. The overvalued ruble kept imports artificially cheap, hobbling domestic production, and exports overly expensive — until the currency collapsed in August of 1998. The IMF supported a similar policy in Brazil. The government raised interest rates to more than 50% and borrowed billions from the Fund in November of 1998 to stabilize its overvalued currency — only to have it collapse just a few months later.

Was growth unnecessarily reduced in these cases by the Fund policy, as Stiglitz,<sup>17</sup> Sachs,<sup>18</sup> and others have argued? The answer to any question of this type depends on a counter-factual. Defenders of the status quo argue that all of these cases would have been worse without the IMF's policies.<sup>19</sup> While it is always difficult to say what the counter-factual would have been, there are some strong indications in each of these cases. For example, in Indonesia, the extremely high interest rates failed to prevent the currency from losing more than three-quarters of its value. It is difficult to imagine how much further the currency would have fallen, or how preventing a further slide could be worth the bankruptcies and economic collapse caused by these interest rates.

There is also the counter-factual of Malaysia, which, rather than use sky-high interest rates to defend its currency, imposed currency

controls. In spite of widespread opposition to this move from both multilateral and private foreign creditors, and the lowering of its international credit rating, Malaysia emerged from the crisis with the smallest percentage of lost output among the five countries.<sup>20</sup>

For the interventions in Russia and Brazil, the Fund's argument for sacrificing output in order to defend the currency was that devaluation would lead to runaway inflation. We now know that this argument was wrong. Inflation in Russia for the year following the devaluation (1999) was 36%, and was about 25% in the first half of 2000. Inflation in Brazil was 8.9% for 1999, and was down to 1.4% for the first five months 2000. The Russian devaluation in particular has been helpful in jump-starting the country's stagnant industrial sector, with manufacturing production increasing by 12.8% and the trade surplus tenfold after the collapse of the ruble.

As independent economists have noted for many years,<sup>21</sup> all of these errors are part of a pattern of macroeconomic policies that have a pronounced bias toward reduced growth. Getting rid of a current account deficit by shrinking the domestic economy, for example, is a Fund strategy that has been deployed for decades. So however much "fiscal discipline" and policies that contain inflation may be helpful in some instances, these medicines are often quite lethal when prescribed inappropriately or in overdose.

There are other problems as well: IMF and World Bank economists do not necessarily know enough about specific country conditions

to be making some of the decisions that they make. And they may have multiple objectives that do not necessarily coincide with the interests of borrowing countries. For example, it is now widely recognized that the opening of financial markets in East Asia was the primary cause of the Asian financial crisis, as it led to an enormous build-up of short-term foreign debt relative to reserves. The sudden reversal of capital flows that followed, which amounted to 11% of the combined GDP of Indonesia, South Korea, the Philippines, Thailand, and Malaysia, was devastating. The IMF and its patron, the US Treasury Department, promoted this opening of capital markets, and even sought to amend the Fund's charter so as to be able to exert authority over the capital accounts of member countries.<sup>22</sup> But the crisis countries, in particular, had no need for the huge inflows of portfolio investment that ended up destabilizing their economies; they had very high domestic savings rates. As Stiglitz has noted, the push for capital account liberalization may have had more to do with the search by US mutual funds for foreign investment outlets than it did with the needs of borrowing countries.<sup>23</sup>

## LIBERALIZATION IN THE TRANSITION ECONOMIES

While inappropriate economic policies may have sharply slowed growth in the less developed countries, and interrupted it in East Asia, their effect on the transition economies of the former Soviet Union and Eastern Europe has been even more drastic.

These countries are not included

<sup>17</sup> Joseph Stiglitz, "The Insider: What I learned at the World Economic Crisis," *New Republic*, April 17, 2000.

<sup>18</sup> Steven Radelet and Jeffrey Sachs, "The East Asian Financial Crisis: Diagnosis, Remedies, Prospects," Harvard Institute for International Development, April 20, 1998.

<sup>19</sup> Rudi Dornbusch, letter to the *New Republic*, May 29, 2000; Letter from Thomas Dawson, "A Response to an Article in *Barrons*," April 15, 2000, International Monetary Fund (see [http://www.imf.org/external/np/vc/2000/04\\_1500.htm](http://www.imf.org/external/np/vc/2000/04_1500.htm)).

<sup>20</sup> World Bank, "East Asia: Recovery and Beyond," June 1, 2000.

<sup>21</sup> See, e.g., "The Revival of the Liberal Creed: The IMF, the World Bank, and Inequality in a Globalized Economy" (Lance Taylor and Ute Pieper) in Dean Baker, Gerald Epstein, and Robert Pollin (eds.) *Globalization and Progressive Economic Policy: What are the Real Constraints and Options?*, 1998.

<sup>22</sup> International Monetary Fund, "Communiqué of the Interim Committee of the Board of Governors of the IMF," Press Release Number 97/44, September 21, 1997.

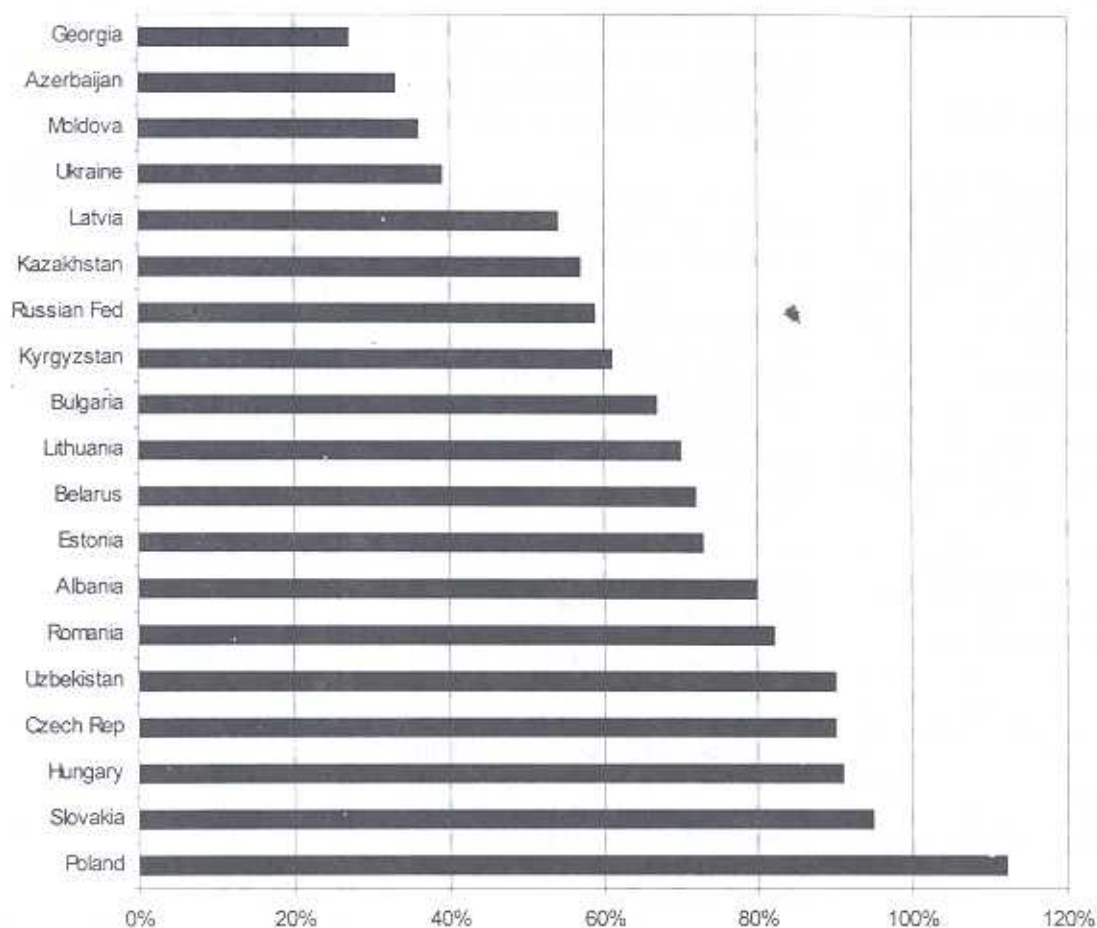
<sup>23</sup> "IMF and World Bank Accountability: Closing the Gap Between Rhetoric and Reality," Panel with Joseph Stiglitz, sponsored by the Heinrich Boll Foundation, June 8, 2000.



in the above tables, but they must be counted among the most severe long-term failures of IMF policies. Figure 2 below shows the

GDP per capita of nineteen transition economies in 1997. After 8 years, only Poland had caught up with its pre-transition (1989) level of GDP.

Figure 2: Transition Economies: 1997 GDP as a Percentage of 1989 GDP



Source: Stiglitz (1999)

Russia has been perhaps the biggest failure of all, suffering a decline in GDP (over 50%) rarely seen in the absence of war or major natural disaster. The number of poor people (living on less than \$4 dollars a day) soared from two million to 60 million by the mid-nineties.<sup>24</sup> Some of the errors

made here were specific to transitional economies — most importantly the rapid privatization in the absence of necessary legal and institutional structures, and the enormous destruction of physical and social capital that resulted. But other mistakes were part of the IMF's modus operandi: con-

tractionary macroeconomic policies and reckless liberalization of not only trade, but the capital account (which combined with the other incentives to de-capitalize existing industries led to enormous flight of capital out of the country). Perhaps most importantly, as Stiglitz has noted, there was "a misunderstanding of the very foundations of a market economy" and "an excessive reli-

<sup>24</sup> Joseph Stiglitz, "Whither Reform: 10 Years of the Transition," paper prepared

for the World Bank Annual Conference on Development Economics, Washington, DC, April 28-30, 1999, p. 2.

ance on textbook models of economics," and in particular, "the neo-classical model." (Stiglitz 1999, p. 5). Stiglitz also shows that part of the problem came from "confusing means with ends: taking, for instance, privatization or the opening of capital accounts as a mark of success rather than means to the more fundamental ends." These criticisms would apply generally to IMF and Bank policies in many developing countries as well.

## CONCLUSION

Part of the process of "globalization," as the rules are being written, is an attempt to reverse the balance that had been achieved between markets and non-market institutions in the "mixed economies" of modern capitalism. The regulation of financial markets has been undermined, sometimes with disastrous consequences — as in the Asian financial crisis. Speculative bubbles are more easily inflated with the increase in international capital flows — as in the US stock and currency markets today.<sup>25</sup> Unions have been weakened, as noted above, especially in the United States. The ability of national governments to regulate or even tax corporations has also been reduced. Corporate income taxes provided 32% of US federal tax revenue in 1952; in 1999 it was only 10%.<sup>26</sup>

Nonetheless it must be stressed that these changes are a result of deliberate decisions by policy makers in the various national governments. These governments have decided — and for the less developed countries, often under pressure from the IMF and World Bank — to shape the process of globalization in a certain way. The results are not an inevitable by-

<sup>25</sup> See Dean Baker, "Double Bubble: The Implications of the Over-Valuation of the Stock Market and the Dollar," Center for Economic and Policy Research, June 2000.

<sup>26</sup> *Economic Report of the President*, 2000.

product of technological changes in communications, transportation, or other industries. Where powerful corporations have an interest in enforcing national laws against the forces of technology and international competition, successful and even increasing efforts have been made to do so. This has been the case with "intellectual property rights." To benefit pharmaceutical companies and the entertainment industry, countries have been forced to rewrite their own laws in order to comply with US copyright and patent laws.<sup>27</sup>

This form of protectionism, which involves the enforcement of a monopoly over a certain product by a drug company or entertainment conglomerate, continues to grow. The World Trade Organization, formed in 1995, made the extension of intellectual property claims a major priority, while at the same time advocating the reduction of other barriers to international competition, such as tariffs on agricultural goods. From a strictly economic perspective, both are forms of protectionism, in which certain producers are legally protected from competition.<sup>28</sup> Yet the protection of industry or agriculture is widely judged to be inefficient, counter-productive, and futile in the face of the "new global economy," while the protection of patented drugs from generic competition is considered an appropriate national policy.

The failure of the last two decades of globalization, structural adjustment, privatization, and "market fundamentalism" to raise living standards worldwide, and the dramatic decline in growth, espe-

<sup>27</sup> Agreement on Trade-Related Aspects of Intellectual Property Rights ("TRIPS" Agreement), Annex 1C, Marrakesh Agreement Establishing the World Trade Organization, Marrakesh, Morocco, April 15, 1994.

<sup>28</sup> One major difference is that while tariffs rarely raise the price of a good by more than 20 percent, patents and copyrights can raise it by percentages in the hundreds or even thousands.

cially in underdeveloped countries, should be cause for serious concern. The IMF and the World Bank should be using their enormous capacity for research to try to find out what has gone wrong. Most importantly, they should not pretend that they have the necessary expertise nor the answers to the difficult and often country-specific problems of economic growth and development, for it is clear that they do not. They could play a much more constructive role by helping to cancel the crushing, unpayable debt of the poorer countries and allowing each nation to choose its own path to economic growth and development. ■

## BLONDIE



International Herald Tribune  
(21/7/2000)

ከገጽ 19 የቀጠለ

ገጽ 28

$$\frac{\text{ግብር}}{2} = \left[ \frac{Y_h - 0}{2} \right] 0\% + \left[ \frac{Y_i - 120}{2} \right] 10\% + \left[ \frac{Y_j}{2} \right] 15\% \quad (2)$$

የሚለው በሚቀጥለው እኩልታ ተስተካክሎ ይነበብ።

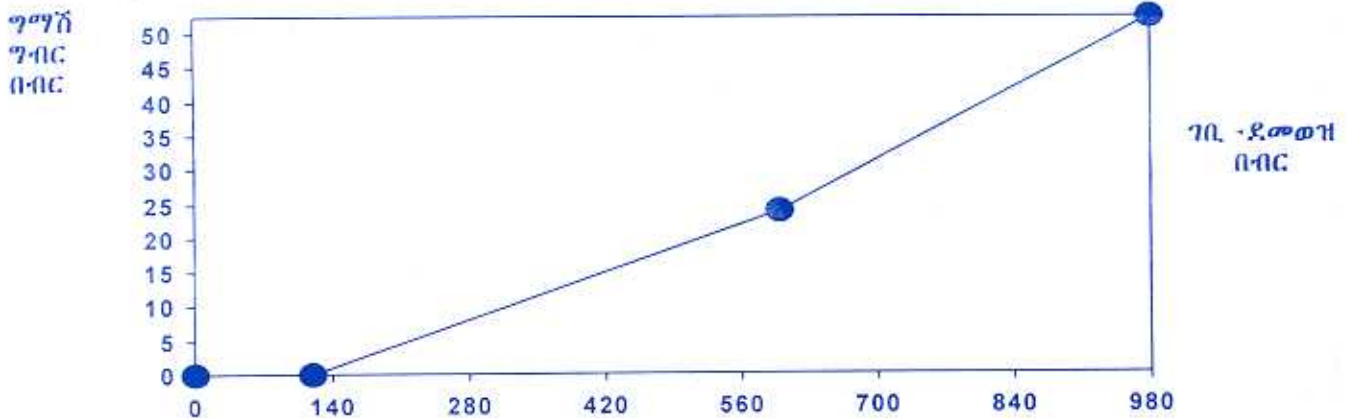
$$\frac{\text{ግብር}}{2} = \left[ \frac{Y_h - 0}{2} \right] 0\% + \left[ \frac{Y_i - 120}{2} \right] 10\% + \left[ \frac{Y_j - 600}{2} \right] 15\% \quad (2)$$

ገጽ 29

ተቀፅሎ 'ለ' . . . ምስል 'ለ' የግማሽ ደመወዝ ገቢ ግብር የየቀናት ግማሽ ደመወዝ ገቢ ውጤት መሆኑን ከግለሰቡ ገቢ ግብር ኩርባ (Individual Income Tax Curve) ቀጥሎ በተመለከተው ምስል ይስተካክል።

$$\frac{\text{ግብር}}{2} = \left[ \frac{Y_h - 0}{2} \right] 0\% + \left[ \frac{Y_i - 120}{2} \right] 10\% + \left[ \frac{Y_j - 600}{2} \right] 15\%$$

$$0 < Y_h \leq 120 : 120 < Y_i \leq 600 : 600 < Y_j \leq 980$$



ምስል 'ለ' . . . የገቢ ግብር ኩርባው የግለሰቡ ገቢ ባደገ መጠን ግለሰቡ የሚከፍለው ግብር ማደጉን ያሳያል። በተለያዩ ገጾች መጻፍት የሚለው መ/ቤት በሚል ይነበብ።

ገጽ 30 በግርጌ ማስታወሻ (Footnote) ቁጥር 8 በሥራ ላይ ካለው የደመወዝ ገቢ ግብር ሕግ ሠንጠረዥ እምስት የደመወዝ ገቢ ግብር ማስከፊያ ፎርም-ላዎች ተሠርተዋል።  $0.10Y_i - 12 = T_i$  ;  $0.15Y_j - 42 = T_j$  ;  $0.24Y_h - 102 = T_k$  ;  $0.3Y_l - 302 = T_l$  እና  $0.4Y_m - 602 = T_m$  ናቸው ሃ የሙሉ ወር ደመወዝ ገቢ ማለት ሲሆን፣ T ግብር ነው የሚለው በዚህ ይተካ።

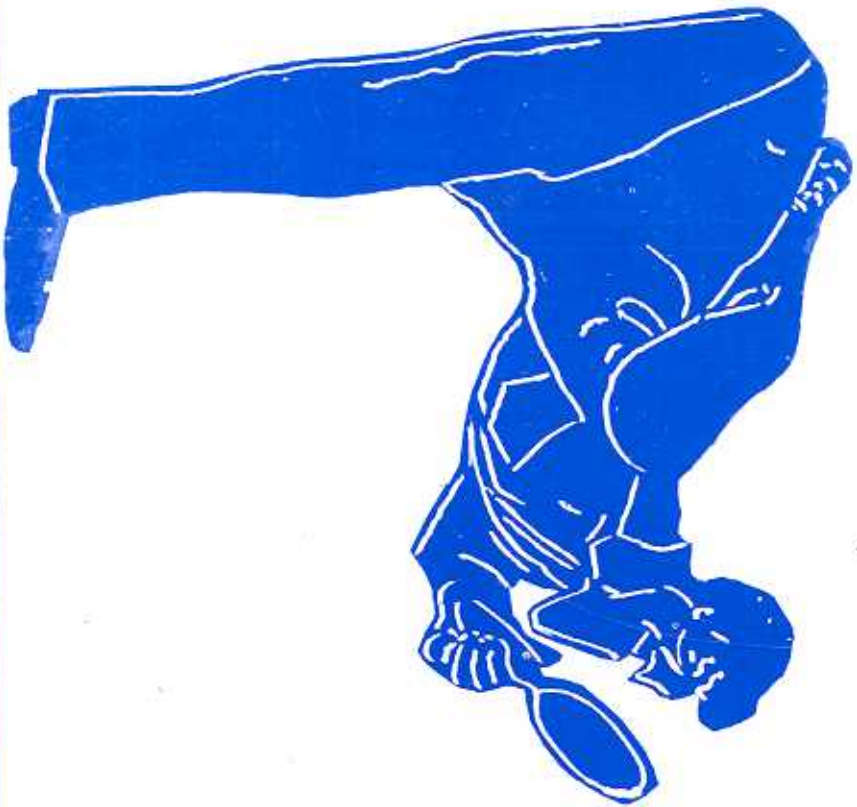
<sup>8</sup> በሥራ ላይ ካለው የደመወዝ ገቢ ግብር ሕግ ሠንጠረዥ እምስት የደመወዝ ገቢ ግብር ማስከፊያ ፎርም-ላዎች ተሠርተዋል።  $0.10Y_i - 12 = T_i$  ;  $0.15Y_j - 42 = T_j$  ;  $0.24Y_k - 102 = T_k$  ;  $0.3Y_l - 302 = T_l$  እና  $0.4Y_m - 602 = T_m$  ናቸው ሃ የሙሉ ወር ደመወዝ ገቢ ማለት ሲሆን፣ T ግብር ነው።

በግርጌ ማስታወሻ 22 . . . የሕግ ባለሙያዎች (ልደባዊ ሰነድ) የሚለው የሕግ ባለሙያዎች (ልደባዊ ሰነድ) በሚለው ተስተካክሎ ይነበብ።

በግርጌ ማስታወሻ 23 . . . በጥጻ85 የሚለው በጥ/85 ተብሎ ይነገባል።

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