

CHAPTER 46

ECONOMICS AND POLICY

Some Lessons from Africa's Experience

AKBAR NOMAN AND JOSEPH STIGLITZ

46.1 INTRODUCTION

SUB-SAHARAN Africa (which we also refer to in this chapter simply as Africa) has experienced reasonably rapid growth of nearly 5% since the turn of the century. But this followed a "lost quarter century" during which, after a prolonged collapse, per capita income in 2000 was still below its level of 25 years earlier as was the share of manufacturing in GDP. By 2008 per capita income had just about recovered to its previous peak more than three decades earlier, but the share of manufacturing in GDP has yet to do so.¹ Along with the economic meltdown of the former Soviet Union and Eastern Europe in the transition to a market economy, this possibly ranks as one of the biggest economic disasters in history since records of national accounts began. (The current crisis in parts of southern Europe may be on the way to joining this select list.)

The size and diversity of the region means, of course, that averages have much to conceal. There have been many successes in Africa in many dimensions in different periods, including GDP growth and managing the resource curse. There have been substantial periods of considerable successes in natural resource-abundant economies like Cote d'Ivoire, Mozambique and above all Botswana, the fastest growing economy in the world during 1960–2000. Even more impressive are several countries without natural resource wealth—such as Ethiopia, Ghana, Tanzania, Rwanda, and Mauritius—that have achieved reasonably rapid growth exceeding 5% for a decade or more. These countries clearly owe their growth resurgence to rather deeper transformations of economic policies, institutions, and structures. While much of the enhanced growth since the turn of the century is attributable to booming commodity prices and hydrocarbon discoveries,² the long history of resource-rich countries

¹ Noman and Stiglitz (2012).

² There is some controversy on the relative roles of commodity booms and improved policies and on different types of policies, but that the former have been very important is beyond dispute.

that have mismanaged their prices are no guarantee of suc

While much research has of East Asia,³ relatively little of the economic failures and question, Why did the region ing its lost quarter century? accelerating the resurgence o

In answering those questi especially governance. We ad ad hoc and over-generalized as ends and means. It is cle: little that economics has to failure on political failure: ec body of research investigatir inequality that are more likel armed conflict is beyond the

We focus, in particular, o century": (i) prioritization e ernance and of markets; (ii begin our discussion with ar

46.2 E

The facts of Africa's lost q income between 1980 and : alization, with the value ar in 2013, this share was bel even more sharply and its s 1970–79 to 2.5% in 1980–19 But the explanation of the the role of the structural ad

The period of Africa's s of reform programs typic cies, spearheaded by the l of a particular brand of e

³ For example, the World B Commission report, (2008) cc (1996), Helmann, Murdoch, a

⁴ World Bank World Dataf

⁵ Jomo, K.S. and von Arnir

that have mismanaged their wealth shows that an abundance of resources and booming prices are no guarantee of success.

While much research has focused on the lessons of success provided by the experiences of East Asia,³ relatively little attention has been paid to insights to be gleaned from the study of the economic failures and successes of Sub-Saharan Africa. We focus in particular on the question, Why did the region go through such a prolonged period of economic decline during its lost quarter century? What are the lessons for policy, especially for sustaining and accelerating the resurgence of growth there and elsewhere?

In answering those questions, much attention has been focused on institutional issues, especially governance. We argue here that Africa's experience highlights the limitations of ad hoc and over-generalized institutional explanations that confuse cause and effect as well as ends and means. It is clear and obvious that where states have failed or at war there is little that economics has to offer as solutions. But it is too simplistic to blame economic failure on political failure: economic failure contributes to political crises. There is a growing body of research investigating the determinants of conflicts, including, notably, the forms of inequality that are more likely to give rise to conflict. This set of issues about failed states and armed conflict is beyond the scope of this essay.

We focus, in particular, on the following subset of issues raised by Africa's "lost quarter century": (i) prioritization and sequencing of reforms; (ii) institutions both of public governance and of markets; (iii) static efficiency versus dynamic gains; and (iv) finance. We begin our discussion with an overview of the debate over the lost quarter century.

46.2 EXPLAINING AFRICA'S LOST QUARTER CENTURY

The facts of Africa's lost quarter century are well-known—a steady decline of per capita income between 1980 and 1995 and a recovery to the 1980 level as late as 2005; deindustrialization, with the value added of manufacturing to GDP yet to recover (indeed, at 11.0% in 2013, this share was below its 1975 level of 17.7%).⁴ Africa's share of world trade shrank even more sharply and its share in global foreign direct investment went down from 5.1% in 1970–79 to 2.5% in 1980–1989 and 1.9% in 1990–1999 before rising to 2.4% in 2000–2006⁵. But the explanation of the lost quarter century remains in dispute. In particular, what was the role of the structural adjustment policies foisted on the sub-continent?

The period of Africa's severest economic decline, 1980–1995, was also one of a plethora of reform programs typically reflecting the advice and conditionalities of external agencies, spearheaded by the IMF and the World Bank. These programs were manifestations of a particular brand of economics that came to be labeled the "Washington Consensus"

³ For example, the World Bank's study of the East Asia Miracle (World Bank, 1993) and the Growth Commission report, (2008) confirming the insights of that earlier study; Stiglitz (1996), Stiglitz and Uy (1996), Helmman, Murdoch, and Stiglitz (1997), Amsden (1989 and 2001), Wade (1990), Chang (2003).

⁴ World Bank World DataBank.

⁵ Jomo, K.S. and von Arnim, R. (2012).

POLICY
Experience

STIGLITZ

ly as Africa) has experienced
ury. But this followed a "lost
r capita income in 2000 was
cturing in GDP. By 2008 per
re than three decades earlier,
with the economic meltdown
n to a market economy, this
ry since records of national
may be on the way to joining

verages have much to con-
nsions in different periods,
have been substantial peri-
onomies like Cote d'Ivoire,
nomy in the world during
t natural resource wealth—
at have achieved reasonably
es clearly owe their growth
stitutions, and structures.
y is attributable to booming
r of resource-rich countries

nd improved policies and on
eyond dispute.

(WC).⁶ Here and elsewhere (Noman and Stiglitz 2012) we explain how those policies contributed to the lost quarter century (on balance, notwithstanding some positive effects); how it was anticipated that the policy reforms would lead to the creation of new jobs reflecting the countries' (static) comparative advantage, even as old jobs in protected sectors were destroyed; and how it was anticipated that the improved policy frameworks would attract foreign direct investment. Jobs were destroyed by the liberalization measures; but the hoped-for new businesses and FDI did not materialize. Defenders of the Washington Consensus argued for "doubling down." The problem in their view was not that the policies were wrong, but that they needed to be accelerated and extended. These responses were reminiscent of those of medieval bloodletters to the failure of their remedies: what was needed was more bloodletting. Later in this chapter we will describe how these failures also gave rise to a search for new explanations for successful development—including a focus on "governance." (It is perhaps too easy and misleading to blame the Bretton Woods institutions for imposing the conditions based on this flawed doctrine: it was not just that other institutions, notably the US Treasury, also supported these policies; but also that these policies reflected what became the dominant orthodoxy in economics, neo-liberalism. The influence of this doctrine lingers—including in some of the responses to the global crisis that broke out in 2008—notwithstanding its failures and empirical and theoretical research showing the inadequacies in the underlying theories, and presenting mounting evidence against its postulates. Some countries almost seemed to take pride in formulating "IMF programs without the IMF.")

Just as there is controversy surrounding the causes of the lost quarter century, there is controversy concerning Africa's recent resurgence, both its causes and its sustainability.

Not surprisingly, advocates of the WC policies believe that Africa's recovery is sustainable—if only the countries persist in the WC policies, to which they give credit for the revival. Thus Shanta Devarajan, the Chief Economist of the World Bank's Africa Region, was quoted in a recent interview as saying, "There is no question that one of the major reasons for Africa's growth over the last 10–15 years is because of [sic] macro-economic policies have improved. Average inflation is half of what it was in the 1990s. Fiscal deficits are down; current account deficits are down. The reason is that African policymakers followed Structural Adjustment Programs over the last 10–15 years. It worked, it delivered results. It delivered economic growth and poverty reduction. You can't dispute that."⁷

That interpretation ascribes little weight to the boom in commodity prices, or to the success of the countries like Ethiopia, Botswana and Rwanda that, while adopting some of the WC consensus policies, resisted others. It ignores the deindustrialization that accompanied the WC policies and the fact that outside of the natural resource sector, FDI has remained anemic. It ignores too the particular failures of some of the critical reforms in some of the countries in areas such as agriculture and finance. More generally, even if it were true that these countries were successful in increasing GDP

⁶ John Williamson coined the term Washington Consensus, describing the consensus of policies surrounding the reforms advocated by the Washington based institutions in Latin America. But the term has come to refer to a broader set of policies, advocated not only in Latin America but in other developing countries and today, often referred to as being based on "neo-liberalism." See Williamson (1991, 2008) and Stiglitz (2008).

⁷ "World Bank: 'Structural Adjustment Programmes Worked in Africa,'" Think Africa Press (London). [Interview]. Lambert Mbom 10/05/2013.

because of the structural a of the performance of the (see the report of the Con Social Progress, published more generally to the high ing notably the adverse im

That extraordinarily con lusionment with the struct ing undisputable causal lin that the slavery to defunct abolished.⁸

The disagreements conc an on-line debate in *The Ecc*. The argument for Africa's 1 growth for more than a de and considerable increase the sustainability of recent the "conventional" definitic mary agriculture and extra value-added services."

In an earlier paper (Non and sustainability of Africa ing that while there is reas policy improvements, espec there are real concerns abou countries. These stem from only has foreign investment a disproportionate share of may also serve to disguise 1 transforming economies to ultimate source of sustained improvement in growth rat policies—implying a one-ti conducive to sustained faste

Suffice it to say, much methodology used by econ

⁸ "The ideas of economists ai wrong, are more powerful than i men, who believe themselves to l some defunct economist. Madm some academic scribbler of a few *Employment, Interest and Money*

⁹ Available on <http://www.ec>

¹⁰ This issue is a focus of *Afric Transformation Report: Growth V*

because of the structural adjustment policies, this interpretation does not take account of the performance of the economy in terms of broader (and better) measures of success (see the report of the Commission on the Measurement of Economic Performance and Social Progress, published as Stiglitz, Sen, and Fitoussi, 2009), and in particular and more generally to the high cost of such benefits as ensued from the WC policies, including notably the adverse impact on poverty.

That extraordinarily confident assertion in the face of widespread and far-ranging disillusionment with the structural adjustment programs indicates the difficulties of establishing undisputable causal links between economic policies and outcomes. And it illustrates that the slavery to defunct economists to which Keynes famously alluded remains to be abolished.⁸

The disagreements concerning the sustainability of Africa's growth were highlighted by an on-line debate in *The Economist* magazine in March 2013 on the topic, "Is Africa Rising?"⁹ The argument for Africa's resurgence emphasized, in particular, the revival of fairly rapid growth for more than a decade, reduction in poverty, improvements in social indicators and considerable increase in foreign investment. The gist of the argument questioning the sustainability of recent growth emphasized the disappointing record judged against the "conventional" definition of development: "the transition of economies based on primary agriculture and extractive industries to economies focused on manufacturing and value-added services."

In an earlier paper (Noman and Stiglitz 2012) we examined the debate over the source and sustainability of Africa's resurgence in some detail. Here we confine ourselves to noting that while there is reason to cheer and be optimistic about Africa's prospects and that policy improvements, especially better macroeconomic management have been important, there are real concerns about the nature of the growth and its sustainability in many (most?) countries. These stem from the lack of economic transformation referred to above.¹⁰ Not only has foreign investment been overwhelmingly concentrated in extractive activities, but a disproportionate share of the growth in employment is in informal activities where jobs may also serve to disguise unemployment. In sum, there has been little or no progress in transforming economies to be based on the learning and associated dynamism that is the ultimate source of sustained growth and development. Noman and Stiglitz (2012) ask "is the improvement in growth rates a result of the elimination of distortions caused by previous policies—implying a one-time gain—or the result of a policy environment which is more conducive to sustained faster growth" (to the kind of learning that we focus on in section 4).

Suffice it to say, much controversy remains regarding these matters. The standard methodology used by economists for quantitatively ascertaining the relative importance

⁸ "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influence, are usually the slaves of some defunct economist. Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back." Keynes, John Maynard (1936 [2007]) *The General Theory of Employment, Interest and Money* (London: Macmillan), p. 383.

⁹ Available on <http://www.economist.com/debate/overview/249>

¹⁰ This issue is a focus of African Center for Economic Transformation (ACET) (2014) *African Transformation Report: Growth With Depth*.

of different factors has, itself, come under attack. Such studies look at the differences in performance (for instance, as measured by growth rates) in different countries and/or different periods and relate them to different “explanatory” factors.¹¹ Critics focus on deficiencies in measurement both of the performance variables (GDP) and of the explanatory variables; the problem of causation (does trade cause growth or growth trade); the problem of simultaneity (the oil price shock of the 1970s lowered real income of oil importing countries and resulted in inflation though some have seemed to suggest that the cause of the decline in real income was an increase in inflation¹²); and the problem of “omitted variables.” (Some third factor explains why some countries responded to the oil price shock by allowing more inflation; it was not the inflation itself, but this omitted third factor, which is to blame for the poor performance.) Advocates of the methodology say that, notwithstanding these concerns, it is the best or “least-worst” way of sorting out the relative roles played by different factors.¹³

Some defenders of the WC policies, even while conceding that they were not always as successful as hoped—and in some cases may even have had serious adverse effects—assert (i) the problems were not with the policies themselves but with the way they were implemented, and (ii) that the criticisms are the results of hindsight: there was no alternative at the time and without the experience that we have had, those policies represented the best option. But both of these are unpersuasive. There *was* something wrong with the policies: they were based on simplistic and “incorrect” models of how economies perform and what makes for sustainable growth. Moreover, given the prevalence of failure, one must observe that good policies have to be designed to be implementable by those that responsible for the task. If they cannot be, then they are not good policies; at the very least, they have not been adequately adapted to the circumstances at hand (Stiglitz 2002). The second claim, that the criticisms are just a matter of hindsight, is a very curious assertion, given that WC and associated “structural adjustment” policies were always highly controversial, especially in Africa and especially for ignoring the lessons of successful development.

¹¹ Note that the methodology that has become so popular in development of randomized controlled experiments is not really relevant for answering these fundamental questions: there is not a large set of seemingly similar countries among which one can randomly choose some to be exposed to structural adjustment policies and others given some “placebo.”

¹² Even studies that attempt to look at the relationship more carefully, by showing that countries exposed to similar shocks that did better in controlling inflation, are not immune to such criticisms; for there may be (and typically are) differences between these countries that account for differences in policies or differences in outcomes from similar policies, and it is difficult, if not impossible, to control for all of these differences.

¹³ Noman and Stiglitz (2012), p. 19. The deficiencies in the standard methodology are illustrated by the controversy over whether East Asia’s growth was caused by trade liberalization. Advocates of trade liberalization note that trade and growth are correlated. Correlation does not, of course, imply causation. The fact that the increase in trade preceded trade liberalization suggests that trade liberalization had little to do with the success of these countries. See Greenwald and Stiglitz (2014) and Charlton and Stiglitz (2013). So too, the interpretations and policy implications for such analyses conducted in the early years of the transition from Communism to the market (World Bank WDR 1996) have been questioned by subsequent events, and even subsequent studies using similar methodologies. See Godoy and Stiglitz (2006).

The first generation, in general, such as the 1970s, probably far below the 1980s. The wrong shouted out by the 1970s (bad policies) or because they are shocks. The difficulty of turning to the inadequate implicit economic model speed, sequencing and policies admit that at least

But part of the explanation for the inefficient attention was paid to the important because economic theory had long eliminated only some of the economic theory had long Lancaster and Lipsey 1967 short shrift.¹⁴

This is clearly demonstrated by agricultural pricing, and trade was marked by more job displacement there was a shortage of entry in the financial sector to provide financing of agricultural marketing by farmers, as a result of lower prices farmers being exploited by market reform advocates hoped would be the reforms that would have

46.3.1 The pacing of

While this argues for complementing reforms mean that points to the vital importance of the poor supply response from take was excessive ambition.

¹⁴ Indeed, even as the advocates of liberalizing trade risk markets, could make *everyone* losers. Everyone could be a loser.

46.3 SPEED, SEQUENCING, SELECTIVITY

The first generation of the so-called “structural adjustment programs” in Africa were, in general, such an acute failure with severe economic contraction and growth rates invariably far below those projected at the times they were adopted that the issue of what went wrong shouted out for attention. Reform programs may fail because of their inherent weaknesses (bad policies, or at least policies inappropriate to the circumstances of the country), or because they are not adequately implemented, or because of unanticipated exogenous shocks. The difficulties of parsing these issues are an important source of controversy. Before turning to the inadequacies of the content of the reform programs and the underlying or implicit economic model on which they were based, we turn to lessons from Africa for the speed, sequencing and selectivity of reforms. We noted earlier that even defenders of the WC policies admit that at least in many cases there were failures in implementation.

But part of the explanation of the widespread failure in implementation was that insufficient attention was paid to the pacing and sequencing of reforms. Sequencing is especially important because economic reforms to remove distortions face the second-best dilemma: eliminating only some of the many distortions may make matters worse. While standard economic theory had long emphasized the importance of second best considerations (see Lancaster and Lipsey 1956; Meade 1955)—advocates of WC policies gave these concerns short shrift.¹⁴

This is clearly demonstrated by Africa’s experience with, for example, financial sector, agricultural pricing, and trade policy reforms. One of the reasons that trade liberalization was marked by more job destruction than job creation was that in most of the countries; there was a shortage of entrepreneurs, especially those with capital, and an absence of a financial sector to provide funds to the entrepreneurs that already existed. The elimination of agricultural marketing boards often did not lead to as much, if any, higher prices for the farmers, as a result of lower transactions costs, as had been hoped; rather, it sometimes led to farmers being exploited by monopolistic middle men. The competitive marketplace that the reform advocates hoped would arise spontaneously did not emerge—partly because some of the reforms that would have enabled the emergence had not yet been put into place.

46.3.1 The pacing of reforms

While this argues for comprehensiveness in reforms, limitations in the capacity for implementing reforms mean that not all reforms can be put into place simultaneously; and this points to the vital importance of prioritization and sequencing. The initial explanation for the poor supply response from the purveyors of the reform programs was to say that the mistake was excessive ambition. They attempted to do too much. (Particularly in the aftermath of

¹⁴ Indeed, even as the advocates of WC/neo-liberal policies starting urging (“forcing”) African countries to liberalize their trade regimes, it was shown that trade liberalization, in the absence of good risk markets, could make *everyone* worse off. It was not just that there were some winners and some losers. Everyone could be a loser. See Newbery and Stiglitz (1984).

the East Asia crisis, it was recognized that far too many conditions had been imposed on the countries; in some cases, the excessive conditionality had even undermined the coherence of the policies by sending out so many signals that they were unintelligible. This led to attempts to streamline conditionality by reducing the number of conditions in the first wave of reforms of the reforms.)¹⁵

Thus, one lesson of the programs that failed in Africa is that reforms need to be mindful not just of the second-best dilemma, but also of the "absorptive" reform capacity the ability to digest and respond to the myriad of changes. This concern applies to both government—in the political economy sense—and private agents. Moreover, no reform is ever perfect. Any successful implementation process must entail learning, both about what is working and what is not, and adapting policies in response to what is learned. Information about reforms and what they entail is neither costless nor instantaneously and universally available. The "quality" of the reform may decrease as the "quantity" of reforms undertaken increases.

This is not a general argument for always going slow¹⁶; there may be threshold effects that require decisive, critical minimum efforts. Thus, for example, when Ethiopia launched its reform program in the early 1990s, it moved rapidly to establish macroeconomic stability, dismantle collectivized agriculture, and establish a system of famine prevention. But Ethiopia has been much more measured and gradual in other areas, such as financial liberalization. While it might be argued that, in some areas, Ethiopia could have moved faster (e.g. telecommunications),¹⁷ its mixture of rapidity and gradualism has generally served the country well, with its economy growing at a rate approaching 10% per annum during nearly a decade that culminated in the global crisis of 2008. Further afield, perhaps the most notable case of combining fast and slow reforms is that of China; its success stands in marked contrast with the "shock therapy" of the former Soviet Union.¹⁸ In China the initial focus was predominantly if not exclusively on agriculture and subsequently on two-track price and privatization reforms. The privatization agenda did not really start strongly until after a host of new enterprises (mostly TVEs, Township and Village Enterprises) had been created. In the case of the India, the world's second most populous country, a different sort of gradualism might have worked.¹⁹

The issue is thus not a simplistic one of how fast or how slow policies should be implemented, but one of priorities and sequencing, given the country's capacities for implementation, given the transactions and opportunity cost of any set of policy measures, and given the country's ability to gather information about the successes and failures of each policy

¹⁵ Whether these attempts actually succeeded is another matter: there was a tendency to reduce the number of conditions by simply combining them so that what might otherwise be two or three conditions were often combined into one.

¹⁶ Indeed, in some cases, it may even be easier to move simultaneously on several fronts than to move ahead on one front, especially if that front is not well chosen. If trade liberalization is undertaken before a vibrant financial sector that provides finance to new enterprises is created, the government will be forced to address a host of other economic and social problems: how to deal with the consequences of the mounting unemployment.

¹⁷ Though even here, it was arguably wise to resist the policies of selling off licenses to foreign firms, instead focusing on procuring particular services from foreign providers.

¹⁸ See Stiglitz (1999).

¹⁹ See Ahluwalia, Montek S. (2002).

measures and to adapt the
tation and flexibility, in v
quickly is an important in

46.4 THE OF

The economic model und
get "prices right" and con
and development in conc
a particularly vivid testar
a strong set of unfounded
turing and the financial s

While there was a stu
marketing boards, the fi
well functioning (e.g. co
overnight once impedim
Often this turned out to
tives faced by farmers d
by the non-existence or
shortfalls added to the
Cereal yields in Africa p
hectare—in a period du
as a package, were a disn

Similarly, in the case
them market-determine
financial markets that w
auctions were to determi
interest rates (10–15% w
ment. No doubt, at least
economic transformation

The financial follies th
tions of financial marke
tered markets. They sho
developed greater capac
the risks associated with
risks.

²⁰ There were, of course, importance of public invest
of the use of land may have
government subsidies for fe

measures and to adapt the policies in response. An approach that allows for experimentation and flexibility, in which successes can be scaled-up and failures can be abandoned quickly is an important ingredient of success.

46.4 THE INADEQUACY OF THE AGENDA OF "GETTING PRICES RIGHT"

The economic model underlying the WC postulated that (trade) liberalization would serve to get "prices right" and combined with privatization and deregulation would unleash growth and development in conditions of macroeconomic stability. Africa's lost quarter-century is a particularly vivid testament to how wrong these beliefs were; this postulate was based on a strong set of unfounded assumptions. Take for example the cases of agriculture, manufacturing and the financial sector.

While there was a strong case for liberalization of agricultural markets and ending marketing boards, the first generation of WC reforms assumed that such markets were well functioning (e.g. competitive) or would emerge and become well functioning almost overnight once impediments like pricing regulation and marketing boards were removed. Often this turned out to be mistaken and, as we have already noted, the prices and incentives faced by farmers did not improve as expected. Moreover farmers were constrained by the non-existence or severe imperfections of input and credit markets. Infrastructural shortfalls added to the constraints facing farmers, especially in more remote areas. Cereal yields in Africa pretty much stagnated between 1960 and 2005 at around 1 ton per hectare—in a period during which yields were soaring elsewhere.²⁰ The reforms, viewed as a package, were a dismal failure.

Similarly, in the case of financial sector reforms, liberalization of interest rates to make them market-determined typically faced the pitfall of a total lack of financial markets, or financial markets that were thin and highly imperfect, e.g. for government securities whose auctions were to determine the rates. The all-too-common result was exceptionally high real interest rates (10–15% was not uncommon) and the absence of long-term credit for investment. No doubt, at least in some countries, this was an important contributor to the limited economic transformation, and indeed the deindustrialization of Africa.

The financial follies that led to the Great Recession of 2008 have highlighted the imperfections of financial markets even in advanced industrial countries and the dangers of unfettered markets. They showed how even in "sophisticated" economies, under-regulated banks developed greater capacities in exploiting unsophisticated borrowers than in ascertaining the risks associated with different firms that might create jobs or even in managing their own risks.

²⁰ There were, of course, a number of contributing factors. The WC policies also underemphasized the importance of public investments in technology, including extension services. Increased intensification of the use of land may have contributed to a decline of land productivity. WC policies proscribed government subsidies for fertilizer. The green revolution never really came to Africa.

Privatization, trade policy and related reforms compounded the difficulties posed by (and confronting²¹) the financial sector that emerged from WC reforms. While there was much to be said for rationalizing the trade regimes and public sector enterprises, the structure, pacing, and sequencing of trade liberalization and privatization led to the deindustrialization of Africa, instead of the emergence of a more competitive and vibrant sector and one that attracted the foreign investment that had been expected and promised.

46.5 INSTITUTIONS

The question of why WC reforms did not work as predicted fed a renewed interest in institutions. As Thandika Mkandawire puts it, the failure of the “good policies” of “getting prices right” prompted those multilateral institutions and aid donors advocating such policies to turn their attention to an institutional agenda.²²

An earlier literature had recognized the importance of institutions and indeed explained economic success as a result of institutional innovations. Perhaps the best known of this type of analysis is Alexander’s Gerschenkron’s iconic analysis of how continental European countries narrowed and caught up with England, which led the way the founder of industrialization and modern economic growth.²³ His work showed the importance of the role that the state can play in fostering institutions conducive to growth as it did, especially by filling a void in finance, in the late developing European countries of the 19th century. In particular, Gerschenkron argued that the later the start of development and the greater the degree of relative backwardness, the larger should be the state’s role in helping channel capital to nascent industries. There is a large literature on the *development state*, emphasizing the role of the state in successful development, not just in the East Asian “miracle” economies but also in many of the now developed countries elsewhere.²⁴ This literature notes the important role the state played in creating the institutions that were central to development.

Of course, markets can, themselves be viewed as institutions. But in practice, the market is a far cry from what is depicted in standard textbooks, or assumed in the models underlying neo-liberalism and WC policies. We have come to see them as often highly imperfect. (Indeed, in the United States, in the aftermath of the Great Recession, there is a reform agenda called “making markets act like markets,” emphasizing that they are often not competitive and transparent—Adam Smith pointed out that there were strong forces to reduce competition, and recent literature in the economics of information has noted corresponding forces to reduce transparency.) It is clear that markets are not (i) self-creating; (ii) self-regulating; or (iii) self-stabilizing. To function in the manner that economic theory

²¹ Openness, by increasing the risks arising from external shocks, increased the challenges confronting financial institutions in assessing the risks associated with different borrowers and managing those risks.

²² Mkandawire (2012).

²³ Gerschenkron (1962).

²⁴ On East Asia, see for example Amsden (1989, 2001), Wade (1990), Stiglitz, World Bank (1993). Ha-Joon Chang (2003) covers both East Asia as well as the developed countries of North America and Europe.

postulates, requires a pl enforcement, property ri for managing the multip tions and asymmetries (i account of coordination f

What good institution are addressed are critical answers. The 2008 crisis States (including in some here too the neo-liberal W case of development bank attempting to reform and

Belatedly, as the failure cies in public governance. out well; too often public would manage those assets Stiglitz (2002) observed, to

These concerns led to t Africa under the label of of the relative roles of the “night-watchman” role for better. (Even then, the ager tion to the importance of “good governance” agenda i governance” that emphasize “transformative” institution bureaucratic hurdles, corrup ally poor implementation of ing the role of the state.

To be sure, corruption an nomic outcomes. (And this banks in the developed cou center of the Great Recession contributions and revolving ported the reckless financial ticular view of which institu designed:²⁸ a view that is em

²⁵ It should be clear that there i Africa should be wary about adop The appropriate legal framework s Kennedy and Stiglitz, 2013)

²⁶ See Meles Zenawi (2012), Mu

²⁷ Of course, as in Africa, ideas suffered from cognitive capture jus

²⁸ As a specific example: it was c central banks focusing (exclusively

ie difficulties posed by (and
is. While there was much to
surprises, the structure, pac-
l to the deindustrialization
vibrant sector and one that
nised.

renewed interest in institu-
policies" of "getting prices
dvocating such policies to

ions and indeed explained
the best known of this type
ontinental European coun-
e founder of industrializa-
ortance of the role that the
did, especially by filling a
19th century. In particular,
the greater the degree of
ing channel capital to nas-
e, emphasizing the role of
miracle" economies but also
e notes the important role
elopment.

But in practice, the mar-
r assumed in the models
see them as often highly
Great Recession, there is a
sizing that they are often
here were strong forces to
ormation has noted cor-
s are not (i) self-creating;
ner that economic theory

ed the challenges
ent borrowers and managing

tz, World Bank (1993).
es of North America and

postulates, requires a plethora of other institutions such as laws²⁵ pertaining to contract enforcement, property rights, corporate governance and competition, as well as institutions for managing the multiple problems arising from externalities and information imperfections and asymmetries (including those associated with "agency" and delegation), and on account of coordination failures.

What good institutions are, how they are created, and how institutional deficiencies are addressed are critical for developmental success, but unfortunately, there are no easy answers. The 2008 crisis exposed fundamental institutional weaknesses in the United States (including in some of its most venerable institutions, e.g. the Federal Reserve). But here too the neo-liberal WC served Africa poorly. Some of the policies weakened (or in the case of development banks and marketing boards, eliminated) state institutions, rather than attempting to reform and strengthen them.

Belatedly, as the failure of the WC policies become evident, blame was shifted to deficiencies in public governance. Privatizations failed, it was argued, because they were not carried out well; too often public assets were turned over to private agents not on the basis of who would manage those assets the best, but on the basis of who would pay the biggest bribes. As Stiglitz (2002) observed, too often privatization was more aptly labeled "briberization."

These concerns led to the emergence of a particular agenda of institutional reforms in Africa under the label of "good governance" (GG). This agenda reflected a particular view of the relative roles of the state and markets. It assigned what Meles Zenawi refers to as a "night-watchman" role for the state, confining it to what is required to make markets work better. (Even then, the agenda was excessively narrow, paying, for instance, too little attention to the importance of financial regulation.) In Mushtaq Khan's words, this so-called "good governance" agenda is more accurately referred to as an agenda of "market-enhancing governance" that emphasizes what Thandika Mkandawire calls "restraining" as opposed to "transformative" institutions in Africa.²⁶ The focus of GG is on public governance related to bureaucratic hurdles, corruption, feeble enforcement of contracts and other laws, and generally poor implementation of the sort of policy initiatives that were mostly directed at reducing the role of the state.

To be sure, corruption and lack of competence of state institutions can lead to bad economic outcomes. (And this is not only true in developing countries: the failure of central banks in the developed countries to regulate adequately the financial sector were at the center of the Great Recession; and American-style corruption played a big role, as campaign contributions and revolving doors were pivotal in legislative changes that led to and supported the reckless financial sector.²⁷) But the GG agenda has been used to promote a particular view of which institutions are important for development and how they should be designed:²⁸ a view that is embedded in neo-liberalism and its precepts on the roles of the

²⁵ It should be clear that there is not just a single, best "rule of law," and that developing countries in Africa should be wary about adopting wholesale legal frameworks from an advanced industrial country. The appropriate legal framework should be particularly attentive towards promoting development. (See Kennedy and Stiglitz, 2013)

²⁶ See Meles Zenawi (2012), Mushtaq Khan (2012), and Thandika Mkandawire (2012).

²⁷ Of course, as in Africa, ideas mattered as well: many of the regulators in the developed countries suffered from cognitive capture just as they did in the developing world.

²⁸ As a specific example: it was often argued with the GG agenda that there should be independent central banks focusing (exclusively) on inflation. While this particular institutional view was questioned

state and markets, and a view that gives short shrift to other institutional arrangements, such as the role of cooperatives and other not-for-profit institutions.²⁹

This view is profoundly ahistorical. It sees flawed public institutions as hindrances to markets performing in the way the neo-liberalism presumes that they perform when they are unencumbered. It fails to pay attention to institutions that can improve on or substitute for markets (e.g. by addressing market failures).

An influential argument for the importance of the standard GG agenda is based on statistical relationship between growth and governance as measured by the standard indicators. But it is highly questionable whether there is in fact a meaningful statistical relationship. More precisely, Khan (2012) shows that developing countries can be divided into high-growth “converging” economies and low-growth “diverging” economies, and that within each group there is no relationship between growth and these measures of governance. And a look at the factors that could explain whether a country is in the high or low performing group suggests that GG is unlikely to be a decisive factor. Indeed, it may well be that causality runs the other way: for instance, when a country is doing poorly, public officials are poorly paid, and that makes them more susceptible to corruption.

The eminently desirable ends that the GG agenda encapsulates may well be good for and in turn be an outcome of development. But the GG reforms are neither necessary nor sufficient for economic success.

The GG agenda exhibited many of the same deficiencies that characterized earlier WC “reforms.” Too often, too little attention was paid to how such an agenda might be implemented. It sometimes seemed as if the proponents of the agenda believed in the power of a lecture: simply explain to the country why GG is essential for growth and the country will reform. And if the country do not reform on its own, make it a condition for assistance. But why should we believe that a country without GG would suddenly get GG just because of a lecture? Unless there are more fundamental reforms in the political and economic system, deep and sustained reforms are likely to be resisted.

The previous section argued for the importance of setting priorities and sequencing of institutional reforms. The critical question, typically not addressed by the advocates of the GG agenda, is which of the reforms should be given priority, and how the prioritization and sequencing of these reforms should be meshed with other economic reforms. Arguably, no country has ever implemented the GG agenda first and then developed—neither the now-advanced economies in the past nor the rapidly transforming ones of East Asia today. This may be partly because poverty and stagnation provide a context that is inimical to a GG agenda.³⁰

What is needed is not a simplistic market-enhancing, one-size-fits-all GG agenda but growth-enhancing governance. This entails a pragmatic focus on selected measures that are

before the 2008 crisis (Stiglitz 1998), the crisis has resulted in more extensive doubts. Countries with less independent central banks performed better than those with more independent central banks. The United States began focusing its monetary policy on *employment*, not inflation; and it was widely recognized that the excessive focus on inflation had detracted attention from a far greater risk, that of financial fragility.

²⁹ Bangladesh provides what is arguably the most striking example of the important role that such institutions can play as exemplified by BRAC and the Grameen Bank.

³⁰ See, for example, Mushtaq Khan (2012).

most relevant for the tasks a key issues confronting ecor Asia as well as those in whi vened in markets successful those adumbrated under th for the state to go beyond “ encourage and lead innovati facilitating learning and pr policies, sometimes referred to policies that go well beyor ance reforms should priorit implementation of effective such considerations.

The GG agenda originate the WC policies. If only cou (so claim the proponents of attracting foreign investmer lier prediction that the stru tradicted by the facts. Quite implementing the GG agenc in activities other than extra gushed in transformational,

To us, this failure is not a tural transformations well, fr are industrial and trade polic

46.6 STATIC] LEARN TI

Allocating a given amount c static efficiency, as desirable : Development and growth, a forms—including closing th countries. But there may be those that contribute to learr balance is at the core of succ

³¹ Mazzucato (2013).

³² Many of which we have refer (2012) and Yoshi (2012) explain hc structural transformation.

institutional arrangements, such as independent central banks, and how the prioritization and sequencing of economic reforms. Arguably, no country has been developed—neither the now-developing ones of East Asia today. This is a context that is inimical to a GG agenda based on statistical indicators. But the statistical relationship. More can be divided into high-growth economies, and that within each group of governance. And a look at the low-performing group suggests that causality runs the other way: officials are poorly paid, and that

the GG agenda is based on statistical indicators. But the statistical relationship. More can be divided into high-growth economies, and that within each group of governance. And a look at the low-performing group suggests that causality runs the other way: officials are poorly paid, and that

regulates may well be good for and that are neither necessary nor sufficient.

that characterized earlier WC policies. Such an agenda might be implemented if the country believed in the power of a market-led growth and the country will not be a condition for assistance. But suddenly get GG just because of a political and economic system,

ing priorities and sequencing of economic reforms. Arguably, no country has been developed—neither the now-developing ones of East Asia today. This is a context that is inimical to a GG agenda based on statistical indicators. But the statistical relationship. More can be divided into high-growth economies, and that within each group of governance. And a look at the low-performing group suggests that causality runs the other way: officials are poorly paid, and that

one-size-fits-all GG agenda but based on selected measures that are

extensive doubts. Countries with independent central banks. It was not inflation; and it was widely seen as a far greater risk, that of

of the important role that such

most relevant for the tasks at hand depending on the particular stage of development and the key issues confronting economic management. The so-called developmental states of East Asia as well as those in which development occurred before the Second World War intervened in markets successfully in ways that required governance capacities other than simply those adumbrated under the GG agenda. In saying this we echo Mariana Mazzucato's call for the state to go beyond "simply fixing 'market failures'" to become entrepreneurial and encourage and lead innovation.³¹ In the next section, we show that enhancing growth entails facilitating learning and promoting economic transformation. Doing so requires explicit policies, sometimes referred to as industrial policies, though the term has come to be applied to policies that go well beyond promoting *industry*. Accordingly, growth-enhancing governance reforms should prioritize enhancing those capabilities that facilitate *learning* and the implementation of effective industrial policies. Africa has suffered because of the neglect of such considerations.

The GG agenda originated in part, as we noted earlier, as an explanation for the failure of the WC policies. If only countries had had GG, then the WC policies would have succeeded (so claim the proponents of the WC). The countries would have grown rapidly, including by attracting foreign investment in non-extractive activities. But this prediction (like the earlier prediction that the structural adjustment policies would bring growth) has been contradicted by the facts. Quite a few African countries that have made reasonable progress in implementing the GG agenda have had little or no success in attracting foreign investment in activities other than extraction of mineral resources. Domestic investment too has languished in transformational, learning-intensive sectors, especially manufacturing.

To us, this failure is not a surprise. Markets on their own typically do not manage structural transformations well, for reasons related to their inherent limitations.³² What is needed are industrial and trade policies that promote learning, the subject to which we now turn.

46.6 STATIC EFFICIENCY VS. DYNAMIC GAINS: LEARNING, INDUSTRIAL, AND TECHNOLOGY POLICIES

Allocating a given amount of resources at a point in time in a way that is consistent with *static efficiency*, as desirable as it may seem, may actually impede development and growth. Development and growth, and societal transformation, depend on *learning*, in all of its forms—including closing the knowledge gap that separates developing and developed countries. But there may be a conflict between policies that enhance static efficiency and those that contribute to learning (see Greenwald and Stiglitz 2006, 2014). Striking the right balance is at the core of success in achieving growth and development. The neoliberal WC

³¹ Mazzucato (2013).

³² Many of which we have referred to earlier, e.g. imperfections of capital and risk markets. Gaffeo (2012) and Yoshi (2012) explain how these imperfections give rise to labor market frictions, impeding structural transformation.

policies paid no attention to learning, seemingly unaware of the potential conflict, and thus failed to strike the right balance.

Patent laws illustrate the trade-off: they restrict the availability of knowledge, a public good, and confer monopoly power, thus entailing static inefficiency but the rationale for these "distortions" is that the resulting loss in static efficiency will be more than offset by the dynamic gains from investment in new technologies that they encourage.³³ Patents also, of course, give rise to rents—a forceful demonstration that rent seeking can be channeled in ways that promote economic progress.³⁴ Building governance capabilities to ensure that rent seeking is so directed ought to be a vital aim of reforms that serve to move the economy to a sustained, higher growth path.

Industrial policy in the broad sense in which the term has come to be used refers to any actions that aims to alter the allocation of resources (or the choice of technology) from what the market left to itself would bring about. In this broad sense industrial policy is not confined to industry but refers also to policies aimed at other sectors, notably modern services like finance or information technology and agriculture. Indeed the green revolution in South Asia can be said to be a prime example of successful industrial policy.³⁵ African agriculture languished, in part because it had no such significant policy support.

In one sense, industrial policies are unavoidable: all countries have industrial policies whether they know it or not. Public expenditure (e.g. the location of highways and the design of the education system) and regulatory and legal regimes (e.g. bankruptcy law) affect the utilization of resources. Our concern here, however, is more narrow: with the deliberate actions intended to promote particular kinds of activities, especially those that have come to be referred to as "Learning, Industrial and Technology" (LIT) policies (we shall use that term interchangeably with the more familiar "industrial policy").

LIT policies are multidimensional and take many different forms across and within countries. The most famous examples are those of the so-called East Asian "developmental state" economies, especially Korea, Taiwan, Singapore, and in an earlier era Japan. Japan is by no means the only rich country today that pursued LIT policies: they were central to almost all countries that caught with the technological frontier and became developed. (Ha-Joon Chang documents this insightfully and comprehensively).³⁶

There are, of course, good theoretical reasons why LIT policies are desirable. They focus on learning, especially by infant industries and economies (which are so prototypical in Africa); they address externalities, knowledge spillovers, coordination failures, and deficiencies in risk and capital markets.

They are *not* about picking winners and losers, as the issue is often misleadingly phrased. Properly designed LIT policies aim to minimize the risks of picking "losers," of state capture, and of industrial policies shifting away from their catalytic role in development and

³³ What constitutes a good patent law is another matter. The details of design make some entail more static losses and/or less dynamic gains than others. See e.g. Stiglitz.

³⁴ Arguably, the East Asian countries did this very successfully. See references cited in previous footnotes.

³⁵ In both India and Pakistan the green revolution was facilitated by policies of price support setting a floor on output prices as well as input subsidies, including notably for electricity that enhanced the profitability of tube-well irrigation.

³⁶ Chang, Ha-Joon (2003).

addressing deficiencies in management. What is emphasized is that such policy by no means the preserve of advanced industrial country regulate.

Indeed, the agenda of liberalization argued for on the basis that the market was captured and became the developed and developing countries rents and scope for anti-corruption and market manipulation.

Indeed, in the absence of liberalization, arguably been a major source of growth. Mineral rights have been captured, corruption and have been the result of rent-seeking, or spillovers that might be expected.

The fact that there have been failures for eschewing such policies were so evident in the run-up to the 2008-9 financial crisis, and financial policies, those failures. So too, we should not ignore the risks of LIT policies have risks, the risks in which governments have foregone the rewards of liberalization.

Thus, many of the criticisms on the risks and failures of liberalization are inherently exorbitantly costly. Those who have acquired such bad connotations are not a polite company. But Africa's failures are a result of these policies.³⁷ Elsewhere, liberalization has had outstanding successes.

Still, there are many who argue that liberalization is inappropriate for Africa because of the development in which the East Asian deficiencies in governance are a result of liberalization.

Limitations in state capture and the risks that industrial policies take in Africa—have shown that liberalization is not a panacea.

³⁷ Stiglitz (2002) described the risks of liberalization. Much of the inequality in wealth in Africa in the past 20 years and which Stiglitz (2010) performance, arose out of these failures.

³⁸ See Jourdan (2014) for an analysis of broader based growth in Africa.

³⁹ See Lin and Stiglitz (2014).

addressing deficiencies in markets. One of the major risks of LIT policies that its critics have emphasized is that such policies are vulnerable to capture and corruption. But such risks are by no means the preserve of LIT policies: as illustrated by the fact that Central banks, in the advanced industrial country were "captured" by the financial sector they were supposed to regulate.

Indeed, the agenda of liberalization and privatization in Africa, as elsewhere, which was argued for on the basis that it would limit the scope for capture and corruption, actually was captured and became the source of enormous corruption in many countries, both in the developed and developing world.³⁷ Frameworks were created that gave rise to enormous rents and scope for anti-competitive practices, the exploitation of workers and consumers, and market manipulation.

Indeed, in the absence of LIT policies, the emphasis on liberalization and privatization has arguably been a major source of corruption and a major impediment to development and growth. Mineral rights have been sold to foreign firms in processes that have given rise to corruption and have been totally divorced from any benefits of learning, technology acquisition, or spillovers that might have emanated from the development of these resources.³⁸

The fact that there have been some "failures" in industrial policies is no more a reason for eschewing such policies than the failures in macro, monetary, and financial policies that were so evident in the run-up to the 2008 crisis is an argument against having macro-, monetary, and financial policies. In the aftermath of the 2008 crisis, we have sought to learn from those failures. So too, we should seek to learn from the failures of industrial policies. While LIT policies have risks, they also have rewards. Indeed, there are few successful economies in which governments have not pursued such policies. Arguably, Africa has paid a high price for foregoing the rewards of LIT policies.

Thus, many of the criticisms of industrial policies are fundamentally flawed. They focus on the risks and failures of industrial policies, which were deemed to be inevitably and inherently exorbitantly costly, and invariably doomed to failure. Indeed "industrial policy" acquired such bad connotations that it could be said to have become unmentionable in polite company. But Africa's experience shows the enormous price of neglecting the pursuit of these policies.³⁹ Elsewhere, among those that attempted such policies, there were many outstanding successes.

Still, there are many who say such policies, while they may have worked elsewhere, are inappropriate for Africa because of the failure of governance. But at the early stages of development in which the East Asian countries adopted such policies, they too had far greater deficiencies in governance than they have today.

Limitations in state capacity (deficiencies in governance) may, of course, affect the form that industrial policies take. Several African countries—Ethiopia, Kenya, Mauritius, South Africa—have shown that they can manage industrial policies and use them to enhance

³⁷ Stiglitz (2002) described the process of privatization in many countries as one of "briberization." Much of the inequality in wealth and income that has become such a subject of concern in recent years and which Stiglitz (2010) has argued has had significant adverse effects on growth and economic performance, arose out of these poorly designed privatizations.

³⁸ See Jourdan (2014) for an excellent discussion how the development of natural resources can be the basis of broader based growth through the design of appropriate industrial policies.

³⁹ See Lin and Stiglitz (2014).

growth. These success stories show the potential, and they highlight the importance of the growth-enhancing GG agenda that we stressed in the previous section.

46.7 FINANCE AND SELECTED OTHER ISSUES

The availability of finance on appropriate terms is a key element of success with LIT policies and indeed more generally it is necessary to promote growth. The financial crisis of 2008 and the ensuing recession have drawn attention to the issue of making finance serve the economy rather than the other way round. In Africa, the reforms of the financial sector combined with macroeconomic stability served to do away with the highly negative real interest rates that had become somewhat common in Africa.⁴⁰

But in Africa, financial liberalization failed, not just because it led in some cases to instability, but more often than not saddled Africa with very high real interest rates and a dearth of long-term credit. At the same time the banking sector has tended to have excess liquidity, preferring short-term government securities to lending.⁴¹

In finance especially, the reform programs of Africa's lost quarter century completely ignored the lessons of success in development, especially of East Asia. The analysis of the extraordinary success of East Asian economies has shown the vital role of state interventions in finance. Stiglitz and Uy (1996) and Hellman et al. (1997)⁴² brought out the role of financial restraint (or mild financial repression), which held real interest rates low and enhanced access to and confidence in the financial system. They show that the system of financial restraint was highly effective in mobilizing savings—far more so than would have been the case had there been high real interest rates.

Ensuring access to long-term credit at moderate real rates, sometimes through development banks, promoted long term investments that are so essential to sustainable growth. Development banks in East Asia and elsewhere have played an important role in encouraging the kind of economic transformation based on learning and the LIT policies that we discussed above. Development banks have made important contributions in other regions at different stages: South Asia, especially India and Pakistan in the 1950s and 1960s, as well as Latin America, including notably in Brazil, Chile, and Colombia, not just in those earlier decades but also more recently.

In Africa too there is the example of the positive role played by a development bank in recent years in one of the very few economies in the region that still have such a bank: Ethiopia, where financing by the development bank was crucial to the impressive success of industrial policies that promoted the development of horticulture and manufactured leather exports.

⁴⁰ Note that the real interest rate in the United States and Europe in recent years has been negative. Hellman, Murdock, and Stiglitz (1997) distinguish between the potentially beneficial effects of mild financial restraint (often associated with slightly negative real interest rates) and financial repression, marked by highly negative real interest rates.

⁴¹ Rashid (2011) documents the adverse effects of financial liberalization on the availability of loans to small and medium sized enterprises and growth.

⁴² See, for example, Stiglitz and Uy (1993). See also World Bank (1993).

While there have been failures associated with A considerable learning by t success.⁴³ We now have a of a naïve faith in state int the answer is not to replac the reality of market failur and that ignores the limit credit to SMEs. (Even the l it desirable to have active a major role in the provis provider of lending supp mortgages are underwritt

The response of the W dismantle them. As with I made Africa pay the price than getting the risk-rewa demonstrated a capacity t might be expected to have

As with all areas of refor doning reforms but of le raises governance issues t that we have emphasized.

46.

One hopes that, Africa—the lost quarter century. V the manner in which they and poor performance of too little attention to cri capacity, including the c faith in markets, too muc and stable and that they c

Given the failure of tl agenda be broadened. F important for good econ

⁴³ In Africa, the failures of with loans often given on the economic environment char: of trade and exchange rate pc

⁴⁴ Shahe Emran and Stigli intervention, there will be an

While there have been failures (though nothing to match the scope and breadth of the failures associated with America's banking system), there have been notable successes, and considerable learning by the most successful of such banks on how to increase the odds of success.⁴³ We now have a much better understanding of these lessons than we did in the era of a naïve faith in state interventions that neglected the risks of government failure. Clearly the answer is not to replace that naïve faith with another in unfettered markets that neglects the reality of market failure and the risks that it imposes on overall economic performance, and that ignores the limitations of markets, for example, in providing long-term credit or credit to SMEs. (Even the United States, with its well-developed financial markets, has found it desirable to have active state provision of credit: the Small Business Administration plays a major role in the provision of small business loans, the Export-Import Bank is a major provider of lending support, especially for exporters like Boeing, and more than 90% of all mortgages are underwritten by the Federal government).⁴⁴

The response of the WC reform program was not to reform development banks but to dismantle them. As with LIT policies more generally, this stance against development banks made Africa pay the price of foregoing the potential rewards of development banks rather than getting the risk-reward ratio right. (This is especially true for those countries that have demonstrated a capacity to implement effective industrial policies. Countries that can do so might be expected to have the capacity to run an effective development bank.)

As with all areas of reforms and good economic management, the issue is not one of abandoning reforms but of learning lessons of successes and failures. Development banking raises governance issues that underline the salience of the "growth-enhancing governance" that we have emphasized.

46.8 CONCLUDING REMARKS

One hopes that, Africa—and the world have learned—or will do so quickly—the lesson of the lost quarter century. We have suggested that many of the policies that were pushed and the manner in which they were pushed contributed to the deindustrialization, low growth, and poor performance of Africa. There was too little attention to the benefits of "learning," too little attention to critical issues of pacing, sequencing, and the development of state capacity, including the capacity to implement growth enhancing policies; and too much faith in markets, too much faith, in particular, that markets on their own, would be efficient and stable and that they could lead to a developmental transformation.

Given the failure of the structural adjustment policies, it was natural that the reform agenda be broadened. Proper governance—both in the public and private sectors—is important for good economic performance; but we have argued that what we referred to

⁴³ In Africa, the failures often stemmed from some combination of poor governance of such banks, with loans often given on the basis of political influence rather than the merit of the project, and an economic environment characterized by macroeconomic instability, and other policy failings, especially of trade and exchange rate policies.

⁴⁴ Shahe Emran and Stiglitz provide a theoretical explanation for why, without government intervention, there will be an undersupply of loans to small businesses.

as the "good governance agenda," pushed by the international institutions, is both too narrow and too ambitious: it focuses on restraining the role of government, limiting its role to "enabling" the private sector; rather than developing the state capacities that have marked the Development State and have played such an important role in many of the most successful countries. We have argued, for instance, that industrial policies, including development banks, have played a critical role in many countries, including some in Africa, and could, in the future, play an even more important role.

We have illustrated these ideas looking at several concrete issues, in particular industrial policy and the reform of financial markets. But each area of policy can be viewed from the perspective of a *development transformation*. Consider, for instance, exchange rate policy. In natural resource-rich economies the market left to itself yields exchange rates that result in the Dutch disease—high exchange rates that inhibit both export and import competing industries. In Africa, this common problem is compounded in some heavily aid-dependent economies by aid inflows. But there are notable examples both of countries that are resource rich (Malaysia and Chile) and of those that are not (like China) that have managed their exchange rates in ways that have promoted growth and a developmental transformation.

Today is a particularly opportune time for a change in Africa's development strategy in the direction we have advocated. There are major changes occurring in the global economic landscape. China provides a very large and rapidly growing market for African exports, and not just for its natural resources. Moreover, wages in China are rising. There will be "space" in world markets for labor-intensive, simple manufactures that Africa could easily occupy, and eventually, for less labor-intensive and more complex manufacturers as well. To the extent such a window opens, it might not be for long: other low-income economies could fill the void rapidly. This enhances the urgency of the sort of trade, industrial, and financial reforms that we suggest should be high on the policy agenda of the region. This is the all more urgent given the heavy reliance of Africa's growth revival on a commodity/oil boom and the notable exceptions of Ethiopia and Rwanda, two of the fastest growing economies since 2000, which, instead of relying on natural resources, built transformational policies broadly in line with those we advocate.

ACKNOWLEDGMENT

Justin Lin, Célestin Monga, and other participants at an author's meeting in December 2013 in Beijing provided valuable comments that are gratefully acknowledged.

REFERENCES

- African Center for Economic Transformation (ACET) (2014). *African Transformation Report: Growth with Depth*. Accra and Washington, DC: ACET.
- Ahluwalia, M.S. (2002). Economic Reforms in India Since 1991: Has Gradualism Worked? *Journal of Economic Perspectives*, 16(3):67–88.
- Amsden, A. (2001). *The Rise of Economies*. Oxford: Oxford University Press.
- Amsden, A. (1989) *Asia's Next Century*. University Press.
- Chang, H.-J. (2003). *Kicking Away the Ladder*. London: Anthem Press.
- Charlton, A., and Stiglitz, J.E. Secretariat on Aid for Trade Commission on Growth and Inclusive Development.
- Gaffeo, E., Gallegati, M., and Lippi, M. (2007). *Macroeconomics for Walrasian Macroeconomics*. Experimental Economics Italia.
- Gerschenkron, A. (1962). *Economic Development*. Cambridge, MA: Harvard University Press.
- Godoy, S., and Stiglitz, J.E. (2007). *Transition Countries: 11 Years of Reform*. In J.E. Stiglitz, J. Yifu Lin, and B. Greenwald, B., and Stiglitz, J.E. (eds.), *The Role of Government in Economic Development*. Houndmills: Blackwell.
- Greenwald, B., and Stiglitz, J.E. (2001). *The Role of Government in Economic Development*. In J.E. Stiglitz, J. Yifu Lin, and B. Greenwald, B., and Stiglitz, J.E. (eds.), *The Role of Government in Economic Development*. Houndmills: Blackwell.
- Hellman, T., Murdock, K., and Stiglitz, J.E. (2007). "Paradigm," in M. Aoki, F. Capoen, and J. Stiglitz, J.E. (eds.), *East Asian Economic Development*. Houndmills: Blackwell.
- Jomo, K.S., and von Arnim, S. (2007). *Development in sub-Saharan Africa: Rethinking Development*. Houndmills: Blackwell.
- Kennedy, D., and Stiglitz, J.E. (2007). *and Economic Development*. Oxford: Oxford University Press.
- Keynes, J.M. (1936 [2007]). *The General Theory of Employment, Interest, and Money*. London: Macmillan.
- Khan, M. (2012). *Government and Economic Growth*. University Press.
- Lipsey, R.G., Lancaster, F., and Lipsey, R.G. (1963). *Journal of Economic Studies*, 24(1):11–32.
- Lin, J.Y., and Stiglitz, J.E. (2007). *Beyond Ideology*. Houndmills: Blackwell.
- Mazzucato, M. (2013). *The Entrepreneurial Mindset*. London: Anthem Press.
- Meade, J. (1955) *The Theory of Economic Growth*. Oxford University Press.

institutions, is both too narrow and too narrow, limiting its role to capacities that have marked many of the most successful, including development in Africa, and could, in particular industrial policy can be viewed from or instance, exchange rate itself yields exchange rates both export and import apounded in some heavily examples both of countries not (like China) that have growth and a developmental development strategy in the the global economic land- or African exports, and not ing. There will be "space" in ca could easily occupy, and rners as well. To the extent e economies could fill the trial, and financial reforms This is the all more urgent y/oil boom and the notable omies since 2000, which, policies broadly in line with

meeting in December 2013
pledged.

an Transformation Report:
Has Gradualism Worked?

- Amsden, A. (2001). *The Rise of The Rest: Challenges to the West From Late-Industrializing Economies*. Oxford: Oxford University Press.
- Amsden, A. (1989) *Asia's Next Giant: South Korea and Late Industrialization*. Oxford: Oxford University Press.
- Chang, H.-J. (2003). *Kicking Away the Ladder: Development Strategy in Historical Perspective*. London: Anthem Press.
- Charlton, A., and Stiglitz, J.E. (2013). *The Right to Trade: A Report for the Commonwealth Secretariat on Aid for Trade*. London: Commonwealth Secretariat.
- Commission on Growth and Development (2008). *The Growth Report: Strategies for Sustained Growth and Inclusive Development*. Washington, DC: World Bank.
- Gaffeo, E., Gallegati, M., and Gostoli, U. (2012). An Agent-Based 'Proof or Principle' for Walrasian Macroeconomic Theory. CEEL Working Papers 1202, Cognitive and Experimental Economics Laboratory, Department of Economics, University of Trento, Italia.
- Gerschenkron, A. (1962). *Economic Development in Historical Perspective: A Book of Essays*. Cambridge, MA: Harvard University Press.
- Godoy, S., and Stiglitz, J.E. (2006). Growth, Initial Conditions, Law and Speed of Privatization in Transition Countries: 11 years later, NBER working paper no. 11992 (January 2006).
- Greenwald, B., and Stiglitz, J.E. (2006). Industrial Policies, the Creation of a Learning Society, and Economic Development, in J.E. Stiglitz and J.Y. Lin (eds), *The Industrial Policy Revolution I: The Role of Government Beyond Ideology*. Houndmills, New York: Palgrave Macmillan.
- Greenwald, B., and Stiglitz, J.E. (2014). Learning and industrial policy: implications for Africa, in J.E. Stiglitz, J. Yifu Lin, and E. Patel (eds), *The Industrial Policy Revolution II: Africa in the 21st Century*. Houndmills, New York: Palgrave Macmillan, pp. 25–29.
- Hellman, T., Murdock, K., and Stiglitz, J.E. (1997). "Financial Restraint: Toward a New Paradigm," in M. Aoki, H. Kim, and M. Okuna-Fujiwara (eds.), *The Role of Government in East Asian Economic Development*. Oxford: Clarendon Press, 1997, pp. 163–207.
- Jomo, K.S., and von Arnim, R. (2012). Economic liberalization and constraints to growth in sub-Saharan Africa, in Noman et al. (eds), *Good Growth and Governance in Africa: Rethinking Development Strategies*. Oxford: Oxford University Press.
- Kennedy, D., and Stiglitz, J.E. (2013). Introduction, in D. Kennedy, and J.E. Stiglitz (eds), *Law and Economic Development with Chinese Characteristics: Institutions for the 21st Century*. Oxford: Oxford University Press.
- Keynes, J.M. (1936[2007]). *The General Theory of Employment, Interest and Money*. London: Macmillan.
- Khan, M. (2012). Governance and growth: challenges for Africa, in A. Noman et al. (eds), *Good Growth and Governance in Africa: Rethinking Development Strategies*. Oxford: Oxford University Press.
- Lipsey, R.G., Lancaster, K. (1956). The general theory of second best. *Review of Economic Studies*, 24(1):11–32.
- Lin, J.Y., and Stiglitz, J.E. (eds) (2014). *The Industrial Policy Revolution: The Role of Government Beyond Ideology*. Houndmills: Palgrave Macmillan.
- Mazzucato, M. (2013). *The Entrepreneurial State: Debunking Public vs. Private Sector Myths*. London: Anthem Press.
- Meade, J. (1955) *The Theory of International Economic Policy: II. Trade and Welfare*. Oxford: Oxford University Press.

- Mkandawire, T. (2012). Institutional monocropping and monotasking in Africa, in A. Noman et al. (eds), *Good Growth and Governance in Africa: Rethinking Development Strategies*. Oxford: Oxford University Press.
- Noman, A. and Stiglitz, J.E. (2012). Strategies for African development, in A. Noman et al. (eds), *Good Growth and Governance in Africa: Rethinking Development Strategies*. Oxford: Oxford University Press.
- Rashid, H. (2011). Credit to Private Sector, Interest Spread and Volatility in Credit-Flows: Do Bank Ownership and Deposits Matter? DESA Working Paper No. 105 ST/ESA/2011/DWP/105 May 2011.
- Shahe Emran, M., and Stiglitz, J.E. (2009). Financial Liberalization, Financial Restraint, and Entrepreneurial Development. Available at SSRN: <http://ssrn.com/abstract=1332399> or <http://dx.doi.org/10.2139/ssrn.1332399>.
- Stiglitz, J. E. (1999). Whither Reform: Ten Years of the Transition, Annual Bank Conference on Development Economics, Washington, DC, April 28–30, 1999.
- Stiglitz, J.E. (2002). New perspectives on the role of the state, in H. Lim, Ungsuh K. Park, and G.C. Harcourt (eds), *Editing Economics; Essays in Honour of Mark Perlman*. Routledge-Taylor & Francis Group.
- Stiglitz, J.E. (2010). Interpreting the causes of the Great Recession of 2008, in Financial System and Macroeconomic Resilience: Revisited, *BIS Paper No. 53*, Basel, Switzerland: Bank for International Settlements, September, pp. 4–19.
- Stiglitz, J.E. (2008). Is there a post-Washington Consensus consensus? in N. Serra and J.E. Stiglitz (eds), *The Washington Consensus Reconsidered: Towards a New Global Governance*. New York: Oxford University Press, 2008, pp. 41–56.
- Stiglitz, J.E., Sen., A., and Fitoussi, J.P. (2009). *Mismeasuring Our Lives: Why GDP Doesn't Add Up*. New York: The New Press.
- Stiglitz, J.E., Serra, N., and Spiegel, S. (2008). Introduction: from the Washington Consensus towards a new global governance, in N. Serra and J.E. Stiglitz (eds), *The Washington Consensus Reconsidered: Towards a New Global Governance*. New York: Oxford University Press, pp. 3–13.
- Stiglitz, J.E., and Uy, M. (1996) Financial markets, public policy and the East Asian miracle. *World Bank Research Observer*, 1(2):249–276.
- Think Africa Press (London). Interview of Shanta Devarajan by Lambert Mbom, 10/05/2013.
- Wade, R. (1990). *Governing the Market: Economic Theory and the Role of the Government in East Asian Industrialization*. Princeton: Princeton University Press.
- Williamson, J. (1991). What Washington means by policy reform, in J. Williamson (ed.), *Latin American Adjustment: How much Has Happened?* Washington, DC: Institute for International Economics.
- Williamson, J. (2008). A short history of the Washington Consensus, in N. Serra and J.E. Stiglitz (eds), *The Washington Consensus Reconsidered: Towards a New Global Governance*. Oxford: Oxford University Press.
- World Bank (1993). *The East Asian Miracle: Economic Growth and Public Policy*. Oxford: Oxford University Press.
- Zenawi, M. (2012). States and markets: neoliberal limitations and the case for developmental state, in A. Noman et al. (eds), *Good Growth and Governance in Africa: Rethinking Development Strategies*. Oxford: Oxford University Press.

THE
IMMIN
DIV
Th

ALAK

In the last two decades growth and development population to its comp ment in a number of de population during such pushes a nation onto a of its population as a p portion of the populati what is called the "depe age population. Such a working age groups ca the maintenance and u these resources in turn the general population Since such a change necessarily only) an o dividend or a demogra graphic factors. It is a last forever—once the working age, depende that each succeeding g happen indefinitely. M