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RECLAIMING POLICY SPACE

Domestic Resource Mobilization and Developmental States

UNITED NATIONS

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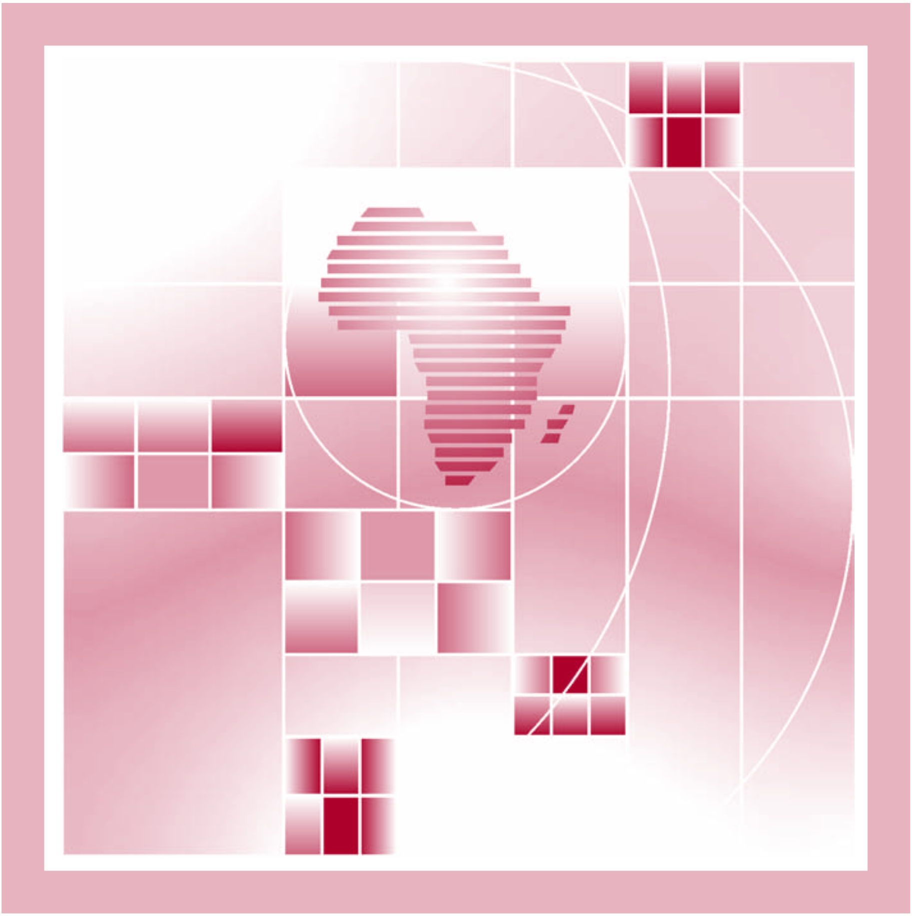

Notes

1 Starting with the United Nations Financing for Development (FFD) Conference in Monterrey, Mexico in 2002, a series of meetings have been held culminating in the Group of Eight (G8) heads of State meeting in Gleneagles, Scotland, United Kingdom, in 2005, which proposed doubling aid to Africa from its 2004 level to $48 billion a year by 2010. This proposal, together with the one cancelling all multilateral debts of the heavily indebted poor countries, was subsequently endorsed at the United Nations World Summit in New York in 2005 (see UNCTAD, 2006a).

2 In South Africa, one mobile phone banking company, WIZZIT, set up in March 2005 to provide services to those who have difficulty accessing formal financial services, has already acquired over 50,000 customers (Ivatury and Pickens, 2006).

3 In Kenya, for example, the cost of finance was cited as a "major" or "severe" constraint by 80 per cent of small firms. Access to finance similarly affected 56 per cent of small firms (Blattman et al., 2004). In Mozambique, credit problems were rated as the most important constraint affecting firms: 75 per cent of firms there cited access to credit, and 84 per cent cost of credit, as large or severe problems (Nasir et al., 2003).

4 In Kenya, for example, the interest rate paid out on government bonds reached 50 per cent in 1993 (Nkurunziza, 2004).

5 To limit risk, banks are required to respect solvency ratios fixed by the central bank. A bank has excess liquidity when, for a relatively long period, it maintains liquidity well in excess of the amount required by prudential regulations.

6 There is evidence of public investment crowding in private investment. In a cross-country analysis of the determinants of private investment in 41 developing countries covering the period 1980–1999, Levine (2005) found that one per cent of GDP spent by the Government on capital expenditure is associated with a 0.18 per cent increase in private fixed investment the following year. Although this relationship is positive, the effect appears small, particularly given the extent of the need for private investment.

7 For example, the fact that, between 1992 and 2004, 62 per cent of aid to developing countries spent on technical cooperation was directed to social sectors while only 7 per cent was allocated to infrastructure reflects where the donor community puts more emphasis (see UNCTAD, 2006).

8 During the period 2000–2005, Africa's fertility rate was almost twice that of other developing regions. Latin America and the Caribbean and Asia each had 2.5 children per woman, whereas the rate in Africa was five children per woman (UNECA, 2005c).

9 The situation is, however, somewhat complicated as this observation does not take into account the lower life expectancy rates that have been recorded across much of sub-Saharan Africa because of the high incidence of AIDS-related deaths. For example, there have been dramatic declines in life expectancy, particularly in Southern Africa (see Johnson et al., 2007: 33–34).

10 On the characteristics and operations of the different types of microcredit institutions, see Steel et al. (1997). See also http://www.microfinancegateway.org/ for other microfinance models.

11 The multiplier effect is the dynamic by which investment increases incomes of economic agents such as workers and firm owners involved in the production process. Provided the additional incomes are not fully consumed, there is an increase in savings, which

are later reinvested, creating a virtuous cycle of higher investment, higher incomes and higher savings. The accelerator effect refers to the positive effect of economic growth on private fixed investment. An economy in expansion increases global demand, which in turn necessitates an increase in national output. If the economy's total productive capacity cannot cope with this demand, new investments are needed, which induce economic agents to save in order to take advantage of such opportunities. The result is further economic growth due to the multiplier effect.

12 The expression "original sin" was coined by Eichengreen and Hausman (1999) to characterize the financial fragility of developing countries that cannot use their domestic currency to borrow abroad due to their inconvertibility or to borrow long-term domestically due to the lack of domestic long-term credit instruments. This situation creates a currency and a maturity mismatch deriving from the fact that the returns on investments financed by foreign currency are in domestic currency that cannot be used to pay for the debt. The maturity mismatch is the result of the fact that most banks hold short-term deposits that cannot be used to finance long-term investments in the absence of developed bond markets.

13 Irresponsible use of bonds can worsen a Government's debt position. In addition, the use of bonds may crowd out private investment when banks prefer to invest in bonds rather than productive sectors of the economy, as has been observed in some countries.

14 The Gini coefficient is the most widely used measure of income inequality. It ranges from zero to 100. High values mean high inequality. The five most unequal countries in Africa are Namibia with a Gini coefficient of 74, Gabon with 64, South Africa with 62, the Central African Republic with 61 and Lesotho with 58 (see Bigsten and Shimeles, 2003).

15 This communication constraint has, however, recently been reduced by the availability of mobile telephony.

16 This list is dominated by Southern and francophone African countries. It is highly likely that these countries' banking sectors are dominated by South African banks for the first group and French banks for the second.

17 The costs of taxation and regulation are not included, as they apply only to formal sector lending institutions.

18 The Usury Act was originally enacted in 1968 to outline the conditions governing credit transactions in order to fight against usury. Among other things, maximum interest rates were fixed at 25 per cent for loans below Rand 6,000 and 22 per cent for higher amounts. These ceilings were revised in the Usury Act Exemption Notice. The threshold amount of the loan increased from Rand 6,000 to Rand 10,000 and the repayment period was not to exceed 36 months. For details, see http://www.acts.co.za/usury/index.htm.

19 Lending decisions require accurate information about the borrower. This information is about credit history such as the amounts of past loans; and repayment patterns such as late payments, defaults and bankruptcies. This information, sometimes aggregated into a "credit information index", is collected from several sources, including public registries and private bureaus. When banks get this information and find that the applicant is creditworthy, they may decide to lend. However, if such information does not exist or if the lenders do not access it, they do not lend.

20 These barriers are not particular to Africa, but they are more severe in the continent than elsewhere.

21 The cost of entry is the cost of obtaining a permit to operate a firm, which includes fees – the costs of procedures and forms, photocopies, fiscal stamps, legal and notary charges, etc. (Djankov et al., 2002).

22 Unless specified otherwise, the data in this section are from World Bank (2007a). The methodology and assumptions underlying the data are from http://www.doingbusiness.org/MethodologySurveys. One caveat, however: these data should be used with care for two reasons. Firstly, they generally show large differences between Africa and the rest of the developing world, but it is not clear why. Secondly, these data are new, so they are unable to show Africa's progress over time. As discussed earlier, there is no question that economic institutions have improved in Africa in the last few years. Given these limitations, these data should be interpreted as indicative of trends (see Johnson et al., 2007).

23 It seems that some of the procedures are not necessary. They include a license to play music to the public, irrespective of the line of business, performing an official audit at start-up, certification of marital status, etc. For a list of these procedures, see Djankov et al. (2002).

24 These statistics are based on official cost, procedural and time requirements. Bureaucratic delays and corruption are not considered. If they were, it is more likely that they would further increase the cost of entry.

25 The REI is a composite index that attempts to measure the rigidity resulting from regulations on hiring, working hours and firing of workers, which are also composite sub-indices based on several components. REI and its three components take values from zero to 100, with higher values implying more rigid regulations. REI is a simple average of the three sub-indices (see World Bank, 2007c for the detailed methodology).

26 Other countries with a rate of 20 per cent of salary or higher are Algeria, Burkina Faso, Chad, Egypt, Equatorial Guinea, Gabon, Guinea, Guinea-Bissau, Mali, Senegal, Seychelles, Sudan, Togo and Tunisia. Three quarters of the countries in this list are former French colonies, suggesting that they may have inherited France's pro-worker labour regulations.

27 These aspects of investor protection are not very relevant to investors in Africa, where firms are often small and managed by their owners. However, investor protection is highly relevant for foreign investors, including transnational corporations.

28 This practice may be reflective of developing economies but is not limited to them. In the United States, Warner (1977) shows, using evidence relating corporate bankruptcy of railroad firms between 1933 and 1955, that the use of the formal legal system made the case more complex, longer and more expensive than it would have been if creditors had agreed to negotiate directly with their debtors.

29 Note that the taxes considered here are more than income or profit taxes. They also include social security contributions and other labour taxes paid by the employer, property taxes, turnover taxes and other small taxes, such as municipal fees and vehicle and fuel taxes (see World Bank, 2007c).

30 For a detailed analysis of this issue, see UNCTAD (2005).

31 Information on both variables was available for 39 African countries. Three outliers, having recorded extraordinarily high GFCF rates over the period, namely Lesotho,

Mauritania and Sao Tome and Principe, were removed from the data, so figure 5 is based on 36 African countries.

32 The first-tier NIEs are Hong Kong (China), Taiwan Province of China, the Republic of Korea and Singapore; the second-tier NIEs are Malaysia, Thailand and Indonesia.

33 See UNCTAD, 1996a, 1997, and the special issue of *The Journal of Development Studies*, Volume 34, No. 6, August 1998.

34 These elements, except otherwise stated, are extracted from Sindzingre (2004).

35 See the same source for the specific policy components of the reforms.

36 It should be noted, as discussed in the next paragraph, that the reasons for the demise of development banks transcend the enactment of new banking laws.

37 This challenge of translating savings into investment is faced by even those five countries (Algeria, Botswana, the Republic of the Congo, Gabon and Nigeria) that have attained high levels of savings (more than 30 per cent of GDP) in recent years (UNECA, 2007: 6-7). It could however, be argued that excess liquidity in the banking system is mainly caused by central bank monetary policy operations rather than by the banks' inability to convert deposits into loans. In such a case, a solution to the problem would be lower fiscal deficits, which would allow central banks to scale back their open market operations.

38 It should be recalled, however, that NEPAD has been criticized in some quarters as having little enforcement power, unclear responsibilities, and no clear plan of how to translate its broad objectives into well-specified and traceable goals (Funke and Nsouli, 2003). It has also been labelled as a "failure" by one of its founding fathers, the President of Senegal, Abdoulaye Wade (see UNCTAD, 2006a).

39 To date, 26 African countries have signed up to the APRM process. Three countries have completed the process, whilst reviews have been launched in 13 other countries.

40 There is a high risk of default stemming from a lack of collateral, but the main reasons are mostly due to the lack of credit history of most local enterprises. In addition, the weak legal and regulatory system renders foreclosure on assets an arduous and time-consuming, an undertaking most banks are unwilling to initiate (UNCTAD, 1996b; Brownbridge and Gayi, 1999).

41 Fourteen sub-Saharan African countries, for example, have interest rate spreads of more than 10 percentage points, and spreads are as large as 19 and 20 percentage points in Zambia and Malawi (see McKinley, 2005: 24). High spreads are also a function of operating and transactions costs.

42 The causes of imperfections in rural credit markets include shortage of realizable collateral, lack of ancillary institutions (e.g. insurance markets), high co-variant risk among borrowers, and the very severe problems of enforcing repayment of loan contracts (Besley, 1994).

43 See for example, Stulz (1999), and Mishkin (2001). Intriguingly, however, the latter described the use of prudential controls ("restricting how fast the borrowing of banks could grow, [which] might have the impact of substantially limiting capital inflows" as a "form of capital controls" (Mishkin, 2001: 27).

44 See Gemech and Struthers, 2003: 9 for a summary of arguments against financial liberalization.

45 For example, major aspects of the reforms were implemented before macroeconomic stability was attained; and new entry was liberalized before the promulgation of new

Banking Acts that raised minimum capital requirements (see Brownbridge and Gayi, 1999).

46 An early proponent of this hypothesis is Bates (1981). Later apologists include, for example, Frimpong-Ansah (1992), to whom the African state is simply a "vampire"; Chazan (1988) and Rothchild (1994), who propagated extreme views of the African State bordering on the congenitally incurably nature of the disease of the African State; and Chabal and Daloz (1999), who argue provocatively that African political elites thrive on disorder, the norm which has been institutionalized.

47 The rise of neoliberalism is explained by a variety of factors, including the induction of conservative Governments in the United States, the United Kingdom and Germany (then the Federal Republic of Germany), as well as the implosion of the welfare state, the stagflation of Keynesianism and the breakdown of central planning in Eastern Europe. Structurally, Governments have been forced to rethink the link between State–market relationships, and restructure this in favour of "markets" as part of the process of globalization. At the domestic level, state intervention became associated with authoritarianism, thus discrediting state involvement in the economy (Mkandawire, 2001: 294).

48 This fight was between the neoliberal critics of "interventionist" States (led by Anne Kruger) and the structuralists (Chenery and his team) that marked the McNamara era (see Mkandawire, 2001: 303).

49 The only exception is the African Alternative Framework to Structural Adjustment Programmes for Socio-economic Recovery and Transformation put forward by the United Nations Economic Commission for Africa (UNECA). This was not taken seriously by the intellectual and development community at the time, but with hindsight has proved to be a more accurate diagnosis of the African development problem and prescription (see UNECA, 1989).

50 See Mkandawire (2001) for a discussion of this "impossibility" thesis.

51 Even Africa's new political leaders have focused on the economics of nation-building, with their embrace of privatization and attraction of FDI, their initial objection to SAPs notwithstanding (see Mkandawire, 2001).

52 This explanation of Africa's lower TFP has been contended, however. Mkandawire (2001), for example, notes that the higher capital–output ratios in African countries could be due to the poorer infrastructure (relative to those of Asia) and the resource-intensive nature of African exports, and that a widely-cited study on TFP (Young, 1994) suggests that over this period the Republic of Korea had lower TFP than Botswana, Cameroon, Congo, Gabon, Guinea, Lesotho and Zimbabwe, whilst Singapore had a lower TFP than every African country in the sample of 66 countries. A recent econometric work for the period 1960–2000, however, suggests that TFP was higher in sub-Saharan Africa than in East Asia and the Pacific from 1960 to 1964. For all other periods, TFP was much higher in South Asia and East Asia and the Pacific than in sub-Saharan Africa (Ndulu and O'Connell, 2003; see also Table 6 in the text.)

53 Some Asian countries with a strong manufacturing base chose to restrict the increase in their debt indicators by expanding export volume via a variety of export promotion measures and industrial policies. Many other developing countries did not adjust in this way, either because their economies were not sufficiently diversified, or because they deliberately chose not to (UNCTAD, 1998a: 93; see also Balassa, 1981 and 1985; Kuznets, 1988).

54 In sub-Saharan Africa, between 1980 and 1987, debt to GDP ratio rose from 38 per cent to 70 per cent, whilst the debt to export ratio rose from 150 per cent to 325 per cent. Per capita incomes fell by 14 per cent during the period (UNCTAD, 2004).

55 UNCTAD's own calculations show that between 1960 and 2004, Asia received some $40 billion more in aid than Africa; and during the 1960s, almost half of total global aid flows went to Asia, compared with about a quarter to Africa (UNCTAD, 2006b).

56 See, for example, Bangura (1992: 65–66), who asserts that the fact that the market reformers sought to reconstitute the relationship between foreign and local capital, with liberalization strengthening the hands of the former, among other things created opposition to the reforms among a new coalition of middle class professionals, industrial unions, etc.

57 These issues were raised by Mkandawire in his contribution, as a member of a Panel of Experts, to the debate on "The Impact of Foreign Direct Investment in Africa" during the 52nd Session of the Trade and Development Board of UNCTAD at the Palais des Nations on 10 October 2005.

58 See a detailed discussion of some of these issues in Mkandawire (2001: 299–302).

59 On the contrary, some of "clientelist" practices feature in the accumulation strategies of these economies. As an independent variable, neo-patrimonialism is not robust enough to explain economic low growth if accounts of high corruption in the NIEs, in the wake of the Asian financial crisis, are anything to go by. Neo-patrimonial states, including even those in Africa, have pursued developmental policies. The issue is that the Asian experience has been idealized to the extent of obscuring the appropriate lessons to be learnt from it. In effect, we have failed to identify correctly the very complex processes that underscore the successful performance of these countries (Mkandawire, 2001).

60 Several economists have argued that rents can be both productive and unproductive in their impact on the economy. Where the rent of a firm depends on the volume of its activities, rents become a function of its performance, the pursuit of which can lead to an increase in productivity. Rent-seeking thus becomes a spur to growth as its seekers attempt to capture as much of it as possible (Baumol, 1990; Rodrik, 2001b; Mkandawire, 2001, Sindzingre, 2004). The use of the Asian experience to discredit rent-seeking behaviour as not being consonant with the developmental State is thus not credible (Mkandawire, 2001).

61 The liberal democratic theory establishing a link between economic development and political democracy has been challenged, for example, by O'Donnell (1973), based on the Latin American development experience of the 1960s and 1970s.

62 For example, it has been argued that linking democracy with economic restructuring allows individuals and organizations to pose the question of democratic governance of public resources more sharply, and that this is a more realistic way of launching underdeveloped crisis economies on the paths of stable and sustainable democratization (Bangura, 1992: 82).

63 In terms of the proportion of the population subsisting on one dollar per day or less, the percentage for sub-Saharan Africa remained more or less the same at about 42 per cent over this period, although the figure peaked at about 48 per cent in 1996. The proportion in Latin America and the Caribbean declined slightly, from 10.8 per cent to 8.6 per cent after a peak of 13 per cent in 1984 (Chen and Ravallion, 2007).

64 Easterly (2001), for example, estimates a median per capita growth rate of 2.5 per cent for developing countries over the period 1960–1979, and a 0.0 per cent growth during the period of reforms, 1980–1998.

65 These economists gave much prominence to the trade problems of developing countries allegedly deriving from a conflict between ISI regimes and the growth of exports. They argued that overvalued domestic currencies, the result of tight exchange rate controls and expansionary production policies, favour production for domestic use rather than for exports, and therefore have adverse effects on growth. They brought about a change in the conventional thinking of many economists and policy makers at the time through a series of detailed country studies utilizing cross-country statistical analysis of the ISI process and the interactions between trade and growth; and newly formalized concept of effective rates of protection to compare ISI policies across industries and countries.

66 The Finance for Development Conference (2002) also underscores the need for mobilizing both public and private domestic savings as a basis for fiscal sustainability, within a framework of equitable and efficient tax systems and administration. It notes furthermore that improvements in public spending should not crowd out productive private investment (United Nations, 2002: 2–4).

67 The key objective of the Charter is to promote a competitive financial sector that reflects the country's demographics and contributes to the establishment of an equitable society by providing accessible financial services to the previously excluded segments of the population and by directing investment into targeted sectors of the economy. See http://www.fscharter.co.za/page.php?p_id=1 for details.

68 Rural investments have the potential to increase employment, improve the productivity of land, increase non-agriculture economic activity and induce technological improvements.

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