Is Globalisation Good for Africa?

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Abstract: Globalisation or market integration in Sub-Saharan Africa is closely linked to the structural adjustment programmes. In this paper we focus on their dependence on politics and institutional characteristics of the countries concerned. In particular, we argue that one important explanation for the dismal performance of many African countries, in spite of all the measures taken towards market liberalisation, is a lack of willingness or ability on the part of the politicians to respect the restrictions imposed on their behaviour and policy choices by the liberalised markets. The point we make in this paper is that market integration magnifies the effects of policies. We look specifically at the increased exposure to international prices and returns on assets make the economic equilibrium relations, the law of one price (LOP) and uncovered interest parity (UIP), relevant guidelines for economic policy. We illustrate the arguments by presenting the case of Zimbabwe. It is a good example where the lack of respect for the restrictions imposed by international markets has led to an economic crisis with negative growth rates and a process away from globalisation.

Keywords: Globalisation; structural adjustment; institutions; economic growth; Law of one price; uncovered interest rate parity; Zimbabwe.

JEL-codes: O1, O2, F4

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1. Introduction

Globalisation has several meanings in the public debate, but the economists' usage tends to refer to the integration of economies with regard to markets for goods, factors of production, and technology. By this definition we can identify two recent eras of globalisation, namely the one of the late 19th century up to World War I, and then the epoch covering the last few decades.

As far as the recent era is concerned it is clear that the speed of economic integration generally has increased. Goods thus flow more easily across the globe than they used to do.[1] This is due to a combination of technological progress, which has lowered transport costs, and improvements in trade related service sectors, and trade liberalisation measures that certainly have been quite extensive. It is also notable that the common language dummy in their regressions on trade flows went from significantly positive to insignificant, which seems to suggest that inter-country contacts are less hindered by language barriers than they used to be. English is possibly taking over as the universal language.

During this process of international economic integration most parts of the third world have seen considerable economic improvements, while Africa stands out as having been left behind.[2] Global inequality as measured by the Gini coefficient in purchasing power terms and with country weights has decreased since 1968, but the bottom ten percent of the distribution has seen its share of the global GDP decline (Melchior, Telle, Wiig, 2000). This category largely comprises Africa. So why has Africa not done better during the recent era of globalisation?

Globalisation or market integration in Sub-Saharan Africa is closely linked to the structural adjustment programmes. Hence, in this paper we focus on structural adjustment programmes and their dependence on politics and institutional

[1] Subramanian and Tamirisa (2001) show that the elasticity of trade flows with respect to distance has fallen by 30% between 1980 and 1997.
[2] In Bigsten (2002), it was argued that Africa during the last twenty years had liberalised their inward-oriented trade regimes, but that the African economies had been marginalized from the international economy in several ways.

characteristics of the countries concerned. In particular, we argue that one important explanation for the dismal performance of many African countries, in spite of all the measures taken towards market liberalisation, is a lack of willingness or ability on the part of the politicians to respect the restrictions imposed on their behaviour and policy choices by the liberalised markets. Before structural adjustment, the scope for domestic policymakers was wider, since controls made prices, and hence production and consumption, react slowly to changes in policy. However, after liberalisation prices react quickly to policy changes. Good policymaking is thus more important in a liberalised environment than in one with many controls in the sense that deviations have stronger negative effects on economic growth. The point we make in this paper is that market integration magnifies the effects of policies.

Implementation of structural adjustment programmes creates opportunities for rapid growth, but it also increases the risk of low or negative growth. This feature is probably more pronounced in many African countries than elsewhere. Most of them have weak governments that for various reasons are less likely to pursue growth-oriented policies. In addition, they are regularly exposed to serious external shocks, such as terms-of–trade changes and drought, requiring policy action that often is unpopular among the general public.

The paper is structured in the following way: Section 2 discusses economic growth and its determinants in Africa in general. Section 3 reviews the process of international economic integration in Africa, and Section 4 analyses the political economy of adjustment in Africa. In Section 5 the prerequisites for successful integration into the world market are outlined. It is noted that increased exposure to international prices and returns on assets make the economic equilibrium relations, the law of one price (LOP) and uncovered interest parity (UIP), relevant guidelines for economic policy. Section 6 illustrates the arguments by presenting the case of Zimbabwe. It is a good example where the lack of respect for the restrictions imposed by international markets has led to an economic crisis with negative growth rates and a process away from globalisation. Section 7 ends the paper with some concluding remarks.

2. Economic growth in Africa

At the aggregate level one can decompose growth into a share that is due to factor accumulation and another share that is due to total factor productivity growth. The interesting question is, of course, what determines factor accumulation and productivity growth, and we will focus on that after looking at some growth decomposition results.

O'Connell and Ndulu (2000) have decomposed growth in a cross-section of countries and grouped the results by region and period. Table 1 shows that Africa has done worse than other regions on all counts, that is with regard to the contribution to growth from capital accumulation, human capital accumulation, and productivity growth.

Table 1: Growth accounting decomposition by region, 1960-1994

			Contributions to growth of:		
Region or half-decade	Number of countries	Observed growth	Physical capital	Education	Residual
Growth decomposition by region 1960-1994					
SSA	21	0.41	0.61	0.23	-0.42
LAC	22	0.91	0.67	0.35	-0.11
SASI	4	2.33	1.17	0.30	0.86
EAP	9	3.86	2.20	0.50	1.15
MENAT	11	2.82	1.50	0.41	0.91
INDU	21	2.70	1.29	0.33	1.08
All countries	88	1.82	1.08	0.34	0.4
Deviations from sample means by region, 1960-1994					
SSA	21	-1.41	-0.48	-0.11	-0.82
LAC	22	-0.91	-0.42	0.02	-0.51
SASI	4	0.50	0.08	-0.03	0.46
EAP	9	2.04	1.12	0.17	0.75
MENAT	11	0.99	0.41	0.07	0.51
INDU	21	0.87	0.20	-0.01	0.68
All countries	88	0	0	0	0
Sub-Saharan Africa, deviations from half-decade full-sample means					
1960-64	21	-1.66	-0.53	-0.08	-1.05
1965-69	21	-1.47	-0.47	-0.10	-0.90
1970-74	21	-0.55	-0.24	-0.19	-0.13
1975-79	21	+1.97	-0.56	-0.20	-1.20
1980-84	21	-1.55	-0.50	-0.10	-0.95
1985-89	21	-0.24	-0.35	-0.07	-0.17
1990-94	21	-2.44	-0.70	-0.04	-1.71
All periods	21	-1.41	-0.48	-0.11	-0.82

Source: O'Connell and Ndulu, 2000, p. 29.
SSA – Sub-Saharan Africa, LAC – Latin America and the Caribbean, SASI – South Asia, EAP – East Asia and Pacific, MENAT – Middle East and North Africa, INDU – Industrialised countries

O'Connell and Ndulu also do a standard cross-country growth regression, which essentially confirms that Sub-Saharan Africa stands out negatively from the rest of the world. Like other studies of this type, this regression suffers from non-robustness. Policy variables are closely correlated and it is also pointed out that institutional variables often covary very tightly with initial conditions and demographic variables. Still, while individual policy variables seldom perform consistently across specifications, it is rare for a set of policy variables to be jointly insignificant in a growth regression. The results below can be seen to give an indication of the joint significance of the policy variables included.[3]

Table 2: Decomposition based on a pooled regression

		Contribution of:			
Region	Deviation of actual growth from sample mean	Baseline variables	Political instability	Policy	Residual
SSA	-1.14	-0.12	0.11	-1.05	-0.15
LAC	-0.93	-0.20	-0.10	-0.18	-0.46
SASI	0.68	1.59	-0.21	-1.17	0.57
EAP	2.35	1.48	0.07	0.65	0.14
MENAT	0.71	0.18	-0.03	0.04	0.56
INDU	0.18	-0.65	0.04	0.80	0.01

Source: O'Connell and Ndulu, 2000, p. 40.

In the past, African governments supported inefficient import-substituting activities. These activities operated behind high tariff walls, with preferential treatment in getting scarce foreign exchange resources for importing machinery and inputs. This bias, along with the overvalued exchange rate, resulted in exports not expanding as they could have. Trade reforms and policies that aim at reducing the anti-export bias, ensures that resources are better allocated. The other way that trade policies can enhance growth is by helping the export sector to get access to technical knowledge from world markets. By integrating with global markets, firms in the export sector are forced to become more competitive. The trade reforms have always been part of a

[3] The variables included in this specification are log of initial income, life expectancy, age dependency ratio, growth of potential labour force participation, terms of trade shocks, trading partner growth, landlocked, political instability, financial depth, inflation, black market premium, government non-productive consumption/GDP, ratio of manufacturing trade to GDP, and fiscal deficit and grant/GDP.

wider structural adjustment programme under the tutelage of the IMF and World Bank, aiming to reduce the gap between domestic and international prices.[4]

Rural growth constraints

Factor accumulation in rural Africa over the last 50 years occurred mainly in labour and human capital, but to a very limited extent in physical capital. A major reason for the low levels of savings according to Collier and Gunning (1999a,b) is first that the economic environment is very risky. Farmers have responded to this by diversification and by holding liquid assets to be able to smooth consumption. Secondly, land right systems have made rural investments unnecessarily illiquid Thirdly, farmers are held back from entering lucrative investments if they are lumpy in a risky environment with poorly developed credit markets. They are instead locked into low-return, capital-extensive activities. Other reasons for this in the case of Africa is that movable wealth may attract violence, which may be a strong disincentive to accumulate in other factors than land. There is also often a high level of implicit taxation of successful individuals within the extended family system. In addition, rural investment is held back by the lack of social capital. There is a lack marketable property rights and a multiplicity of social obligations as part of the rural insurance system.

Rural productivity growth can also be driven by the reallocation of activities from less productive to more productive farmers, but this is constrained by the imperfect land, credit and labour markets. Collier and Gunning (1999b) note that learning from others is confined to rather limited groups because rural households tend to have a limited network. Nor has learning-by-doing or innovations across the whole population been successful.

Urban growth constraints

Collier and Gunning identify five major constraints on growth of urban firms in Africa, namely risk, lack of openness, lack of social capital, poor public services, and

[4] That distortions have been severe is indicated by a comparison done by O'Connell and Ndulu (2000, p. 26), which shows that for the period 1970-1989 the share of investment in GDP at constant international prices in SSA was10.1%, while its share at current domestic prices was 18.9%. The numbers for industrialised countries at that time were 26.6% and 24.3%. This suggests that investment in Africa was very expensive relative to GDP.

lack of financial depth. First, firms in Africa face high price risks, and it is particularly problematic when it is very hard to reverse investment decisions. There are very limited markets for second-hand capital or for firms as a going concern. Local suppliers to the firm are often unreliable which means that firms tend to carry large stocks of inventories. Firms also enter into state-contingent contracts. Lack of openness is also identified as a major constraint on investment in Africa. Foreign exchange controls made some investments hard to undertake, and overvalued exchange rates did, earlier at least, often make a mockery of economic calculations of economic returns on investments. Some investments done in highly distorted settings such as Tanzania turned out to have no economic value at all once the economy was liberalised and world market prices arrived. The liberalisation has also implied increased competition and many firms do actually complain about this. The movement from the old environment to a new competitive one is not painless, and in for example Zambia many of the old manufacturing industries were not viable in the new open environment but went bankrupt. Now the survivors are expanding, however, and some non-traditional exporters are actually successful also in export markets. However, so far these have mainly had to be found within the region. Exports to the North, which is the real challenge, are still stagnant (Bigsten, Mkenda, 2002).

It is not self-evident that manufacturing production will expand, when African economies liberalise. Wood[5] argues that this is not where African economies in general have their comparative advantages because of its abundance of natural resources and lack of human capital that is required for manufacturing. An alternative view would be that growth is constrained by the high costs of transactions, energy, and other inputs that are intensive in manufacturing. The notion here is then that these costs are policy related rather than intrinsic. The Wood hypothesis suggests that trade reform would kill off the major part of African manufacturing, and that this is just as well since it is intrinsically uncompetitive. The alternative thesis suggests instead that reforms of trade policy and service delivery would create an environment where African manufacturing could grow. There is not general agreement on this issue, but it

[5] See for example Wood (1994), Wood and Berge (1997), Wood and Mayer (1999).

seems possible that many countries in Africa could compete also in manufacturing if the environment is benevolent.

There is also a lack of social capital, which is a big problem in the risky environment of Africa since it affects contract enforcement,. African courts are often unreliable and they are open to political influence. The legal process is slow and the outcomes are uncertain. In an environment where there is essentially no credit rating institutions businessmen have to rely on kin-groups. The extent and character of the kin-group then determines what can be achieved in business. In Kenya, the Asian ethnic minority has an advantage over African owned manufacturing industry since they can exploit their relatively well-developed private information network, while African entrepreneurs have to rely to a higher extent on their own direct observations (Bigsten, Kimuyu, Lundvall, 2000).

Poor infrastructure stands out as a severe constraint on growth in African manufacturing.[6] This is of course related to the poor functioning in general of the public sector and this is one of the areas in which structural adjustment measures have found it hardest to bring about improvements.

The shallowness of financial markets is a hindrance for growth, although the problem of lack of finance is sometimes exaggerated. Many businessmen tend to believe that they will do fine if they just get credit, but the main constraint on their development is rather poor productivity.

The traditional social structures or social capital of Africa developed in response to the need to deal with the difficult and risky economic conditions that prevailed. The family, the village or some kin group helped reduce problems of adverse selection and moral hazard in rural areas. Apart from the insurance function they also helped with inter-generational transfers and the management of common resources. The traditional societies managed to devise coping mechanisms for the traditional environment, but these also came to constitute a break on investment and specialisation.

[6] See Bigsten and Kimuyu (2001) for evidence on Kenya.

Overall conclusion

The picture that emerges from this brief review is that economic life in Africa is risky and the effect of this on growth is compounded by poor contract enforcement mechanisms, poor infrastructure and the uncertainty about the macroeconomic environment. We will come back to the discussion about the reasons for the persistence of poor institutions and bad policies.

3. Is Africa integrating with the global economy?

Africa's share in world export fell from 3.5% in 1970 to 1.5% in 1997, and its share in world imports fell from 4.5% to 1.5% during the same period. That Africa's share of world trade has declined is thus abundantly clear. Another question that one may pose is whether its current share is atypical relative to some benchmark. Studies that have approached this issue have done it in somewhat different ways, but generally they have used gravity models. Foroutan and Pritchett (1993) compared Africa with other Third World Countries and concluded that the intra-Africa trade pattern is not atypical and that distances impose similar restrictions as in other similar regions. Coe and Hoffmaister investigated North-South trade and found that in 1970 Africa "overtraded" with the North, while in the 1990s its trade flows were not different from those of comparable non-African countries. Rodrik (1999) just looked at aggregate trade and found that Africa's total trade is not atypical after controlling for income, size, and distance to the world markets.

Subramanian and Tamirisa (2001) investigate in greater detail, whether Africa undertrades or overtrades, and how the trading pattern has changed over time. They test all dimensions mentioned above, that is total trade, within Africa trade, and trade with developed and other developing countries. The paper uses a global benchmark for its assessments.[7]

In Africa Subramanian and Tamirisa (2001) distinguish between Francophone and Anglophone Africa. Africa includes 16 countries comprising about 90% of total

African trade. The data used show that over the period 1980-1997 Anglophone African trade grew by 2.1% per year, while Francophone trade grew by 1.6% per year. For the Anglophone countries trade within the region grew by 9.4% per year and trade with the South by 8.9% per year. Trade with the North, however, only grew by 0.9% per year. Francophone trade with the South grew rapidly, but from a very low base.

A comparison with the trade of other developing countries shows that also relative to other developing countries Africa under-perform. An even more distressingly, Africa has gradually disintegrated from the rest of the world, while the rest of the developing world has been rapidly integrating.

There are basically two interpretations of the pattern of international economic integration. One of those argues that Africa has not benefited from globalisation because it has not globalised or attempted to integrate its economies with the world market. The declining share of Africa in world trade is taken as a result of the policy stance chosen. There are many studies that suggest that international economic integration is beneficial for growth (see the survey by Collier and Gunning, 1999a). This view suggests that it is crucial to Africa's economic recovery that it pursues export promotion policies and to open up further (World Bank, 2000, Sachs, 2000).

The second interpretation suggests that Africa has taken advantage of trading opportunities as well as would be expected given its level of development. This view is supported by studies that suggest that Africa is not trading "too little" given its underlying characteristics and trade determinants such as size, income, and geography (Foroutan and Pritchett, 1993, Coe and Hoffmaister, 1999, Rodrik, 1999). This view suggests that the causality runs from growth and productivity to trade, and that the policy focus needs to be on the broader range of issues determining productivity.

Moreover, it is particularly in trade with the North that Africa has been lagging behind, and this is particularly serious since it is via this trade that many of the expected benefits of globalisation would come. The results do not depend on the

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[7] It applies non-linear least squares and bootstrapping to allow for the non-normality of residuals. This

concentration on commodity exports, and the situation looks even more acute when one notices that the rest of the developing world has integrated at a rapid pace with the rest of the world including the North. It thus seems as if Africa really needs to worry about its lack of participation in international trade. This could, of course, both be in the form of developing the trading system, and introducing measures that facilitate export diversification and increase productivity and competitiveness.

Whichever way one looks at the debate on the causal relationship between trade and growth few would argue against the notion that it is hard to envisage rapid growth without a trade expansion in Africa. Opening up is essential for such a trade expansion to take place, and we would thus argue that it is a necessary condition for rapid growth. However, it is abundantly clear that it is not sufficient. The rest of the paper is discussing the problems of pursuing a policy aimed at growth in a more open and internationally integrated setting, and the reasons as to why things may go wrong.

4. The political economy of adjustment in Africa

We believe that the opening up of African economies has acted as a constraint on the behaviour of economic policy makers. Some countries like Uganda, have observed the constraints put on its choices, and it has done very well economically. However, leaders of other countries, and the example we have chosen is Zimbabwe, still act as if they are unaware of the constraints or, which may be more likely, act in accordance with more fundamental incentives. We will first discuss the basis for this argument on a general level, and then more specifically consider the case of Zimbabwe.

Successful market economies must have an underpinning of sound institutions. Rodrik (2000) provides the following list:

(a) The first is secure *property rights*. North and Thomas (1973) and North and Weingast (1989) show that the establishment of secure and stable property rights was a key factor behind the development of western economies. It is not self-evident, however, that the property rights have to look exactly the same everywhere. Rodrik actually prefers the term control rights, which allows for

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is a methodological improvement compared to the previous studies.

different forms of rights. These are upheld by a combination of legislation, private enforcement, and custom.

(b) It has also been shown that markets don not function well when participants are involved in fraud and anti-competitive behaviour. There economies need a set of *regulatory institutions* that regulate the conduct in goods, services, labour, asset and financial markets.

(c) Economies also need to have *fiscal and monetary institutions* for macroeconomic stabilisation.

(d) Rodrik also argues that economies need *institutions for social insurance*. In traditional economies this was handled by family and village linkages and support systems, which tend to weaken once modernisation of the economy takes place. Such programmes could be of the traditional transfer type like in Western welfare societies, but it can also take other forms. Social insurance is important since it legitimises the market economy and provides social stability and social cohesion. Economic insecurity may breed backlashes to reforms, and the control of it may therefore have high payoffs by making much needed reforms politically feasible.

(e) Societies should also have some *institutions for conflict management.* Many countries in Africa are, for example, ethnically diverse, and they need some mechanisms to settle disputes. Social conflicts divert resources from productive activities and create uncertainty with negative effects on economic activity. Rodrik discusses coordination failures in which social factions fail to coordinate on outcomes that would be mutually beneficial. Developed societies have institutions that reduce the likelihood of such failures. Institutions of this nature listed by Rodrik (2000, p. 13) are "the rule of law, a high-quality judiciary, representative political institutions, free elections, independent trade unions, social partnerships, institutionalised representation of minority groups and social insurance". These institutions "tend to increase the incentives for social groups to cooperate by reducing the payoff to socially uncooperative strategies".

So what can we say about these institutions in the context of Africa? One fundamental part of the institutional structure is the state. It is in a way a meta-institution that determines or influences the ways in which a whole range of institutions in the economy works. Africa's peculiar history and its specific conditions may help explain why the African state works in a certain way and why policies are formulated in a certain way. It is therefore important to investigate in some detail how the state works and how globalisation impulses are transmitted through it. Rodrik suggests that one should accept institutional diversity, and that the appropriate institutional structure is not uniquely determined. Still, we need to discuss whether African institutions, particularly the state, are providing a god basis for economic development. Another aspect of Africa that is important in the debate on state formation is its ethnic diversity. This is the second dimension that we focus in our discussion in this section.

The Emergence of the African State

The African states of today emerged out of the colonial system in the early 1960s. It seems plausible to assume that the character of the state today reflects this history. Engelbert (2000) even argues that the root cause of poor African growth is to be found in policymaking, and that this is constrained by the lack of continuity of the African state from the colonial to the post-colonial era. This constrains the choices open to African governments. "Specifically, the relative power payoffs of developmental policies for political elites are lower in countries where the state was arbitrarily imposed over pre-existing institutions leading them to resort instead to redistributive policies that retard or hinder growth" (Engelbert, 2000, p. 1822). Africa has a large concentration of states with little or no embeddedness into pre-colonial institutions and pre-existing norms of political authority. This makes the economic performance weaker according to Engelbert. The interpretation of the good Botswana case by Acemoglu, Johnson and Robinson (2001) is consistent with this view.

Africa has the highest concentration of states where the process of state creation was exogenous to their society and where the leadership or elite inherited the state rather than shaped it. The new rulers had little power and had to deal with groups with competing loyalties. People came to view the African state not so much as an outcome of social contract, an instrument of collective action, or reduction of transaction costs, based on common ideological convictions, but as an alien institution; they did not agree about the rules of the political game or that it should be played at all. Opposition focused not so much on policies as on the government itself.

Because of this, African politics display high instability with constitutional deadlocks and military coups, secession attempts, and civil wars.

For the ruling elite, power is thus fragile. The lack of state legitimacy has limited policy options. Successful implementation of policies requires a certain level of societal loyalty. When bureaucrats are not loyal to the state and private agents distrust the institutions, the politicians will find it hard to implement policies effectively. Instead they tend to resort to personal rule and neo-patrimonial policies. They "substitute patron-client links for the lack of moral right to rule, to replace the state with an informal web of ad hoc political alliances, and thereby provide the regime with a semblance of social foundations" Engelbert, 2000, p. 1824).

Neo-patrimonialism relies on the creation and maintenance of rents such as those derived from trade restrictions, and a preference for distributive over long-term investments. Neo-patrimonial policies lead to widespread distortions in market mechanisms in order to allocate resources along political rather than economic criteria.

The relative payoffs of developmental versus neo-patrimonial policies depend on state legitimacy. In the low-legitimate setting neo-patrimonial policies yield the greatest relative short-term payoffs to elites in term of consolidation of their power. They bolster domestic support by directing public resources to private actors through unofficial channels and networks. Systematic use of state resources to build allegiances may eventually bring about a state collapse. In legitimate states institutions and rules do not face the challenges of pre-existing loci of power and are therefore able to use the state apparatus to implement development polices, which further enhances their legitimacy over time in a virtuous circle of capacity and development.

This analysis suggests that underlying the problems of Africa is a crisis of governance. African leaders do not choose bad policies because they don't know any better. The historical circumstances determine the relative returns in terms of power of different strategies.

The Redistributive State, Ethnicity and Conflicts in Africa

Many have argued that the ethnic diversity of Africa breeds political conflicts or civil wars that reduce economic growth. It is also clear that ethnic diversity is correlated with slow economic growth (Easterly and Levine, 1997). What one may ask is whether this is the case irrespective of the form of government. Collier (2000) sets up a median voter type of model and uses this to investigate whether there is a difference in terms of impact depending on whether the government is democratic or dictatorial. His result show that ethnic diversity is only detrimental to growth in societies where there are limited political rights, while democratic societies are generally able to handle the potential conflicts without generating negative growth effects.

Azam (2001) sees the problem of state formation in Africa as a transition process that starts from a situation with ethnic division. He argues that ethnic capital provides many of the services that the state has taken over by the modern state in rich countries such as security, education, and rules of behaviour. Most African states are as yet not able to deliver these services adequately. Therefore they have to go through a phase of federation of ethnic groups before they can provide a credible substitute to ethnic capital. The existing system of redistribution within and among groups is a key to creating the solidarity links between them, and a breakdown in this system may lead to political violence or civil war.

The state and the ethnic groups are connected through the participation of ethnic elites in the state. Ethnic groups or in-groups invest collectively in its ablest members to migrate to the cities to become involved in the urban elite. This is a means to ensure political participation of the group. In peaceful African countries a system of incursion of the educated members of various ethnic groups into different institutions has evolved, whereby the state buys loyalty from the groups through its educated urban "delegates". The maintenance of peace is one of the prime tasks of the state in Africa, but ethnically dominated governments have often neglected this. The ethnic group is normally the basis for a rebellion as the many links that exist among the members provide an efficient way of overcoming the free-rider problem involved in organising an uprising.

In the typical African state the political elite is composed of people from different ethnic groups, who play the part of delegates from their group. People are there to receive high salaries or incomes that can be the basis for remittances back to their kin, but they may also collude to tax the rural constituency. Many distortions in African policymaking have their roots here. Thus, the urban elites may be to extract more for the rural areas than they remit back. But, notes Azam, this system is also instrumental in creating a new solidarity network that can help push ethnic links into the background.

The African state according to Azam is thus a means of federating different ethnic groups via a coalition of its elites, and it thus entails two interlined redistribution systems. The first is a system of transfers within or between ethnic groups, whereby the urban elite remits money back to the village (regularly or when there is a shock). The second system is one with redistribution between ethic groups, through the elite or via the budget. When the benefits of public expenditures are widely distributed the delegates of the ethnic groups can obtain renewed support of the state from their backers. Azam's model is thus a redistribution-based model of the state.

The state buys loyalty from its social base via remittances from its urban workers or via the provision of public services. Insurgencies occur when some group is excluded from the sharing of the government resources. Insurgencies are generally led by the most educated of an ethnic group (Clapham, 1998), and they buy loyalty from their followers by securing resources for their group. The likelihood that a group gets excluded is particularly high when the resources of the state are based on mineral resources. Collier and Hoeffler (1999) show that the share of minerals in exports is a significant variable in the explanation of civil wars.

Azam thus argues that civil conflicts occur when the government is unable to deliver the kind of public expenditure that the people want with a strong redistribute element, such as education and health. He shows in a model that a government that is able to commit credibly to its announced public expenditure mix will rely more on redistributive expenditures and less on repression, than a government that can renege on its promises, once the potential opponents have reduced their involvement in the rebellion. Weak governments imply a repression bias, while strong governments will rely more on redistribution.

The policy problem for the African state is to substitute state-provided services for ethnic-capital, in the long run, starting from a situation with strong endowments of ethnic capital. The aim of the benevolent state during the transition should be to federate the different ethnic groups, and not to destroy their role. A tool is the provision of public goods with a strong redistributive content such as education and health care or the payment of high wages and salaries that then can be redistributed privately.

Why Does Ineffective Policy Persist?

Policymaking depends on the interaction between interest groups in different ways. There is extensive corruption and lack of effective control of mismanagement, and the interaction between politics and ethnic rivalries does make it hard to establish long-term stable and undistorted strategies (see Bigsten and Moene, 1996). It may also be argued that also apart from the ethnic dimension, the economic structure tends to influence political outcomes. For example, standard trade theory suggests that a country should optimally adjust its economy according to its comparative advantages. But what if the comparative advantages imply a policy that is counter to what is politically desirable? For example, if a country is land (or natural resources) abundant it may be inappropriate to let the wages of labour increase too fast, while we know that higher urban wages have been politically desirable in Africa (See Bigsten and Kayizzi-Mugerwa, 2000).

But why are there no effective forces that can guarantee good governance. There is obviously a lack of democratic control also in the countries that have been (partially) democratised. The government in power often tends to look to the interests of its core supporters rather than the welfare of the country as a whole. The external pressure for democratic change has also been weak until recently, but it is possible that the economic reform programmes to some extent have contributed to political openness. It has been argued that what is lacking are agents of restraint that can force governments to behave responsibly and to introduce sensible economic policies and then to stay on track. The increased openness and debate in most African countries may in the longer term contribute to a change in this direction, but so far one cannot say that there in general has been a major change in government behaviour. Therefore much remains before the political process can produce effective government and policy making.

We have argued that certain types of economic reforms are desirable and we have also pointed out that some of those are hard to implement in the African context. When they are formally implemented, they are often done so in a biased and ineffective way, which means that the outcomes will not be what we expected.

5. What is required for *successful* integration?

The implementation of structural adjustment programmes has been the most important step taken by African economies towards integration into the world economy. The standard package has included trade liberalisation and the creation of a foreign-exchange market, de-regulation of domestic markets, including the financial sector and privatisation, reduced budget imbalances, tax reforms and public sector reform. These measures have meant to make the countries' allocation of resources more economically rational. At the same time as the reforms have "got the prices right", they have also implied that the countries have become more sensitive to the actions of economic agents, domestic and foreign. This feature of globalisation has been important for the growth performance of many Sub-Saharan countries.

A consequence of opening up of an economy and integrating it with the world market is increased exposure to international prices and returns on assets. Most of this exposure can be captured by two simple economic equilibrium relations that are expected to hold in well-integrated markets, the law of one price (LOP) and uncovered interest parity (UIP). The former implies that similar goods should have similar prices even if they are produced and sold in different countries. The explanation for why it holds in an integrated market is that price divergences make it profitable to move goods from the low-price-country to the one with high prices. And when economic agents engage in such trade prices will go up in the low-price-country and go down in the high-price-country. When LOP holds for every good, or on average for all goods, then the purchasing power parity theorem (PPP) holds.

The UIP relation states that the expected return on a financial asset should be approximately the same two countries. Here the mechanism is the same as for LOP: people will move their assets to the place with the highest expected return and this will lead to convergence of the returns. The two relations can be written as,

$$P_k \approx E * P_k^* \qquad LOP$$

$$i \approx i^* + \frac{\Delta E^{\exp}}{E} \qquad UIP$$

where P_k is the price of the good k, i is the return on a financial assets, E is the exchange rate, ΔE^{exp} is the expected change in the exchange rate, and an asterisk indicates foreign prices or interest rates.

In practice LOP and UIP do not hold exactly even when markets are well integrated. There is a number of reasons for this, transportation costs, limited information, difference in risks, etc. Moreover, all goods that are not trade internationally. Yet, the two relations do restrict movements of prices, interest rates and the exchange rate because there are limits on how far away they can be from their equilibrium values without having strong negative effects on economic growth.

Before structural adjustment, there were very weak or no forces maintaining LOP and UIP in most Sub-Saharan African countries. Domestic prices could therefore differ considerably from international prices of similar goods. The major reason was the restrictions on international trade in the form of import quotas and tariffs, bans on exports, and limited access to foreign currency. It was simply much harder to make a profit by exploiting price differences in such an environment than in a country with free trade. Moreover, interest parity did not hold because domestic interest rates were set administratively at low levels, the domestic currency was not convertible, and the authorities controlled capital flows in and out of the country.

The efficiency of the system of controls on international transactions varied between countries. In many countries smuggling was common, there were thriving parallel markets for foreign exchange and goods, and companies used transfer pricing to keep foreign exchange outside the home country. Nevertheless, substantial deviations from LOP and UIP where common. These are likely to have had negative effects on the economic performance, but in the controlled economy environment the effects were often not obvious to policymakers or people in general because they were smaller than in open economies, and appeared slowly over time. Hence, policymakers did not bother much about LOP and UIP.

Structural adjustment has increased the potential for international arbitrage considerably. Evidence of this is the removal of many restrictions on international trade, the decrease in importance, or disappearance, of parallel markets for foreign exchange and the creation of official foreign exchange markets, and the increase in capital flows. There is thus reason to believe that in Sub-Saharan countries LOP and UIP have become important equilibrium relations to whom the authorities must pay attention, and they thus restrict the policy choices of the government considerably. Moreover, external shocks, such as drought or changes in export prices, now have a stronger effect on the parities, since domestic prices, interest rates, and to some extent the exchange rate, are allowed to adjust quickly to changes in the market forces. Since this can generate large short-run deviations from equilibrium, there is a greater need for government action to facilitate the adjustment after shocks.

Policymaking in a country that is getting integrated in the global economy is thus very different from that in a controlled economy. For example, an expected decline of exports, or careless statements by leading politicians, can generate large capital outflows and a drop in the value of the local currency. The increase in the exchange rate can then rapidly be transmitted into higher domestic prices of basic commodities. Hence, to benefit from globalisation policymakers have to accept the discipline imposed by the LOP and UIP restrictions. On the other hand, if they do not, the negative consequences are far more serious than before structural adjustment.

One could presume that integration into the world market would serve as a disciplining device, forcing policy makers to exercise caution and not to suggest policies that depart from the new market economy path. This should push countries in general towards increased macroeconomic stability and towards a better growth performance: if the policy makers stray away from the narrow path, the punishment from the market is going to be more severe than under the old control regime. However, one can question the effectiveness of this disciplining device in the case of African governments. It is rather worrying to read the final punch-line of the review of the political economy of African growth provided by Bates and Devarajan (2000, p. 40): "Rather than being the primary purpose of politics, policy choice is often better viewed as a by-product". The point is that the way the competition for power is structured has a major impact on what policies are actually implemented. And one might well add, that it has a major effect on *how* they are implemented.

6. The case of Zimbabwe

Zimbabwe's structural adjustment program was initialised late in 1990 and was planned to last until 1995. In general the program was implemented according to plan, and in some respects even faster than that. However, there were repeated failures to meet the targets for the budget deficit. Together with a combination of policy mistakes and external shocks, the accumulation of public debt that resulted from the budget deficits, set off a current account crisis in late 1997. Without this development, it is likely that the popularity of the government would have been much better today and that many of the disastrous events that have taken place during recent years could have been avoided. Below follows a brief account on the developments that led to the current crisis. It highlights that care must be exercised by the authorities because of the constraints imposed by LOP and UIP and that adequate policy responses to external shocks are important for the maintenance of a high levels of economic growth.

In Zimbabwe, the connection between the authority's economic policy and the economic performance has been very clear. Hence, it serves our purposes well. Nevertheless, the relevance of the case of Zimbabwe can be questioned for, at least, two reasons. First, Zimbabwe could be claimed to be an exception because policies are mainly determined by President Mugabe's preferences, and it is therefore of limited interest in this context. Second, one could argue the economic difficulties are due to structural problems inherited at independence, such as the unequal distribution of land, and that the political tension and public disorder are the main cause for the country's dismal economic performance. In our view, neither of these two objections is relevant. Mugabe is not a special case in Sub-Saharan Africa, even though his policies have generated a lot of public attention. In fact, one fundamental problem is that governments often take measures to keep them in power that are in conflict with good economic policy, as described in Section 4. The second objection has some validity, in particular for the years 2001 and 2002. Nonetheless, the increase in violence and insecurity has not been the major cause of the economic crisis: as argued below, it is mainly due to economic imbalances. There is also ample evidence of the devastating economic effects from other countries with similar macroeconomic problems; two examples are Sweden in 1992 and Argentina in 2002.

At the beginning of 1997, the prospects for the Zimbabwean looked quite good in spite of the large domestic debt. Although the IMF had declared Zimbabwe off-track at the end of 1995 and several donors withheld disbursements of foreign aid, the economy grew by 7.3% in 1996. Moreover, the losses of the public enterprises had been reduced significantly and the budget deficit as a ratio to GDP was declining. The improvement in fiscal policies and the budget presented for 1997/98 persuaded the World Bank that the economy was on the right track again, and it decided to release the second tranche of the second structural adjustment credit in mid-1997. However, just before the agreement was to be signed President Mugabe announced that more than Z$4 billion (3% of GDP) had been promised to war veterans in compensation and pensions.

The action taken by President Mugabe illustrates one of the fundamental problems in African politics: an interest group succeeds in obtaining a large share of the country's income from the President. Exactly how powerful the war veterans really were at the time is hard to know, but there is little doubt the issue of their compensation could have been handled in a much better way. Now the result was an unbudgeted and unplanned increase in public expenditures that made it impossible for the World Bank to release their money. Hence, the President ruined the chance of significantly increased public revenue, which would have made it possible to avoid falling into a debt trap that was widely expected.[8]

[8] Mugabe was aware of the debt problem but did not seem to understand its consequences. This is evident from the following statement he made soon after giving in to the war veterans "Have you ever heard of a country that collapsed because of borrowing" (Meredith 2002, p 138).

In conjunction with the failure to reach an agreement with the World Bank, three other important events took place. First, during late 1996 and early 1997 there were adverse developments in export volumes and prices, and a rapid increase in imports. This led to a large trade deficit and a downward pressure on the exchange rate. By defending the value of the currency, the authorities reduced foreign reserves sharply. Second, because of el Niño fears were created of a serious drought in 1998, which would raise food prices and reduce export income. Third, and most important, in an attempt to boost its popularity among the public after the agreement over compensation to the war veterans, the President announced that close to 1500, out of 4000, mainly white-owned commercial farms would be nationalised during 1998. The announcement was made without clarifying how the nationalisation would be financed or to what extent farmers would receive compensation for their property. In fact, the project seemed to be badly planned and there was a lack administrative capacity to carry it out in such a short period (Moyo, 1998).

The decision to carry out the reform so hastily was also evidence of a government desperately needing to buy loyalty, since it is hard to believe that public pressure for land reform was particularly strong at that time. The land issue had been on the agenda since Independence in 1980, but apart from redistributing of 3.6 million hectares of land and resettling 70000 families during the first half of the 1980s, not much had been done. Moreover, a new land acquisition act had been enacted in 1992 so the authorities could have revitalised the land reform already in 1993 (Moyo, 1998).

All this contributed to a severe currency crisis in November 1997, when the Zimbabwe dollar plummeted. To curb the crisis, the Reserve Bank ordered all companies to liquidate their foreign currency accounts, and tightened up monetary policy. Shortly after that the government announced tax increases to finance the war veterans' compensation. But the party conference held a few days later unanimously rejected this measure, and a wave of strikes hit the country. Over the following year the crisis deepened as basic food prices rose rapidly, and yet another currency crisis followed reducing the value of the Zimbabwe dollar by 50% against the US dollar. On top of this Zimbabwe entered the war in the Democratic Republic of Congo.

These events highlights the increased interaction between politics and the economy; liberalisation has created a situation where government policies are evaluated by the market in a way that makes costs and benefits much more visible to the public than in the old regime. Earlier, an event like the announcement of the badly planned land redistribution would not have led to any visible reaction at macro-level, at least in the short run. However, in a liberalised environment where international trade is free and there are markets for foreign exchange and agricultural commodities, the response is immediate.

One illustration of this is the rapid rise in prices of basic commodities in the beginning of 1998, which resulted in violent demonstrations. One of the responses of the government was to fix the exchange rate by decree, the purpose being to reduce inflation in general and stabilize food prices in particular. This was an important policy change that disrupted the arbitrage conditions, and led to very damaging effects on the economy. As no progress was made in reducing the budget deficit and stabilising the growth of the domestic debt, which were the fundamental driving forces behind the price increases, domestic inflation continued. As a consequence, the real exchange rate appreciated. Since the real exchange rate is the ratio between foreign prices, measured in domestic currency, and domestic prices, this affected LOP and PPP relations. One result was that foreign exchange shortages started to appear at the end of 1999.

The consequences of this policy for the nominal exchange rate (defined as Zimbabwe dollars per US dollar) are depicted in Figure 1. Two aspects stand out. Around the turn of the 20th century there were two prolonged periods with stable exchange rates, followed by a large devaluation in the first case, and one to come (at the time of writing) in the second case: the policy of fixing the exchange rate without stabilising prices is in fact bound to lead to large devaluations. The second aspect is the macroeconomic instability of the 1990s as evidenced by the rapid increase in the exchange rate compared to the 1980s.

The evolution of the real exchange rate is shown in Figure 2. It is clear that PPP and LOP do not hold over the period 1980 – 2000 since that would have implied a stable level. Nevertheless, comparing the real exchange rate with the nominal one in Figure 1 reveals that relative prices account for most of the variation in the latter. Moreover, trade liberalisation in the beginning of the 1990s seems to have generated a real depreciation, starting with a large devaluation in 1991. There are also indications of overvaluation in 1996 and 1997 because the real exchange rate appreciated even though inflows of foreign aid declined and the current account deteriorated during this period. The development during the following years shows how a policy of fixing the exchange rate in combination with high inflation leads to dramatic adjustments in the relative prices of domestic and foreign (US) goods, which are bound to have negative effects on the economy: the period after January 2001 is particularly alarming because of the rapid appreciation of the real exchange rate. In fact, in the parallel exchange market, which was re-born at the end of the 1990s, the rate was well over 350 Zimbabwe dollars to a US dollar, while the official exchange rate was 55 dollars.

Some of the consequences of trying to maintain a fixed nominal exchange and letting the real one appreciate have been the re-emergence of serious foreign-exchange shortages, a sharp contraction in international trade, and negative GDP-growth. The mechanism is straightforward. When foreign prices, measured in domestic currency, are low it is not profitable to export, which reduces the supply of foreign exchange. To some extent aid, foreign loans, and private capital inflows could generate the foreign currency needed, but all these sources have dried up. As a result, it is hard to obtain foreign currency at the official exchange rate. Since most firms need imported inputs to produce, they have to rely on the (illegal) parallel market, try to get locally produced inputs, or simply reduce production. This has led to a decline in domestic production as indicated by the downward spiral of GDP since 1997: it dropped by 7.3 percent in 2001 and is expected to decline by even more in 2002 (Financial Gazette, March 21, 2002). Furthermore, exports and imports have contracted by almost 30% since 1997.

In addition, to attempt to keep the exchange rate fixed to stabilise prices, the government has also re-introduced price controls on several basic commodities. Initially this was in response to food riots that took place after the devaluation had been transmitted into higher import prices. Although price controls can have beneficial effects in the short run, i.e. for a couple of months, it is not a good strategy when used over several years. With low prices, exports of goods with controlled prices become profitable for some economic agents but not for Zimbabwe as a country. For example, the government-run Grain Marketing Board appears to have exported maize grain to make profits during 1998 (see Muchero 1998), creating shortages and pressure for price increases in the domestic market for maize meal. Moreover, large amounts of maize (meal) were exported illegally to neighbouring countries; there is at least evidence that tons of maize meal were carried across the Victoria Bridge to Zambia before the authorities stopped the trade. After that people switched to trading in bread. The potential for the Grain Marketing Board and others to make profits from exporting during 1998 was very good, since the producer price was about one third of the actual export price (Durevall and Mabugu, 2000).

Another problem with the price controls is that they are selective; for instance, the producer price of maize is controlled but not prices on inputs used in maize production, such as fertilisers, pesticides and seeds. Since these are influenced by world prices, profits from maize production declines as world prices rise, in particular after large devaluations. Although it is possible for the authorities to adjust controlled prices in line with costs, they often do not do it for political reasons. As a result, production of goods exposed to price control declines. Hence, the shortages of maize experienced in 2002 are partly due to farmers having shifted to other crops.

One of the prices that the government has not relinquished its control over is the price of petrol. The policy has been to maintain a low price, making petrol widely available and keeping production costs down. Indeed, in 1998 Nigeria and Angola were the only Sub-Saharan countries that had lower pump prices than Zimbabwe (Bryceson and Mbara, 2002).

The evolution of world fuel prices in Zimbabwe dollars and domestic prices are depicted in Fig 3. Both prices series are set to unity in 1990, highlighting the slow adjustment of domestic prices from 1995 to the end 2000. During the end of the 1990s shortages of foreign exchange created shortages of fuel, and as a result consumption of petrol and diesel decreased by 40 percent between 1999 and 2000. In 2000 the low-price policy was abandoned as seen by the rapid increase in domestic prices. In real terms the prices of gasoline and diesel went up by 80 and 135 percent, respectively, between July 1998 and December 2001.

One consequence of keeping an artificially low price is higher consumption of energy than otherwise. This was of course one of the reasons for the price policy, but it contributed to the shortages of foreign exchange. However, there were other side effects. Since government kept local prices lower then world price, the government owned National Oil Company Of Zimbabwe (NOCZIM), which had a monopoly on importing fuel until 2000, made large operating losses and incurred a large debt. This led to cancellation of its credit lines and an even large shortage of fuel. Another side effect was that a great deal re-exports of fuel took place. It is hard to quantify its importance but it is well known that South African trailers were equipped with extra tanks so they could go to Zimbabwe to buy cheap gasoline. A comparison of gasoline prices in the region indicates the gains to be made: in 1998 the price in US cents of one litre was 26 in Zimbabwe, 43 in South Africa, 53 in Zambia, 55 in Mozambique and 31 in Botswana (Bryceson and Mbara, 2002).

Government policy has also influenced the UIP through its exchange rate policy and. Figure 4 compares the real Treasury bill rates in Zimbabwe and South Africa. They provide information similar to the UIP but are easier to construct because we do not have good information on the expected rate of change of the exchange rate. During the 1980s there was little relation between the two variables because of controls on capital flows. After liberalisation Zimbabwean interest rates rose sharply both in nominal and real terms, and from 1993 to 1995 returns to investment in Zimbabwe was high, leading to large inflows of capital. As the crisis the late 1990s unfolded there was first a period of very low real interest rates, and large capital outflows, then nominal and real interest rates shot up, as the ballooning government domestic debt and large interest rate payments increased demand for credit. Since interest rate payments reached almost 30 percent of GDP, the government decided to try to reduce these by issuing long-term bonds instead of Treasury bills. As a result interest rates on Treasury bills dropped to less than 10%, and real interest rates declined to less than –30%. However, the long-term bonds are not attractive enough for lenders and the government has embarked on process of monetising its domestic debt.

We thus conclude that the Zimbabwean government has paid little attention to the restrictions imposed on policymaking by the markets, and the result has been devastating for Zimbabwe. Although political instability, occupations of commercial farms and violence also have contributed to the economic problems, the origin and the basic driving force have been bad economic policy. This has made GDP decline for three years in a row, and by the end of 2002 the economy might have contracted by as much as 30 percent. Moreover, hyperinflation is around the corner as the domestic debt is being monetised: inflation was 117 percent in March 2002, up from 57 percent since the start of monetisation in January 2001. Hence, whatever policies implemented by Mugabe, the coming years will be very difficult for the Zimbabwean population. The least painful way out of the economic conundrum is a combined effort of the government and the international community to solve the debt problem, stabilise prices and generate economic growth.

7. Conclusions

So what is the way forward? Globalisation is not a panacea for development! It can help, but for the effects in terms of economic growth of opening-up are to be substantial other aspects of the economy also have to be in order. The macroeconomic policies must be right as well as the institutions supporting the economy. Excessive corruption, poor policies or poorly implemented policies will negate the effect of attempts to open up and integrate in the world economy. Will opening-up help the system to reform itself also in the more domestic dimensions? This is hard to prove one way or the other, but it does not seem unreasonable to believe that a more open environment will make it harder to be corrupt and to pursue counter-productive policies.

Hopefully the recent experience of Zimbabwe will provide a good example of the devastating effects of carrying out policies that ignore market mechanisms. Such polices could be implemented with less obvious negative effects before structural adjustment, that is when domestic markets were much less integrated into the world economy. However, economic success in a globalised world is dependent on policies that respect the constraints imposed by markets.

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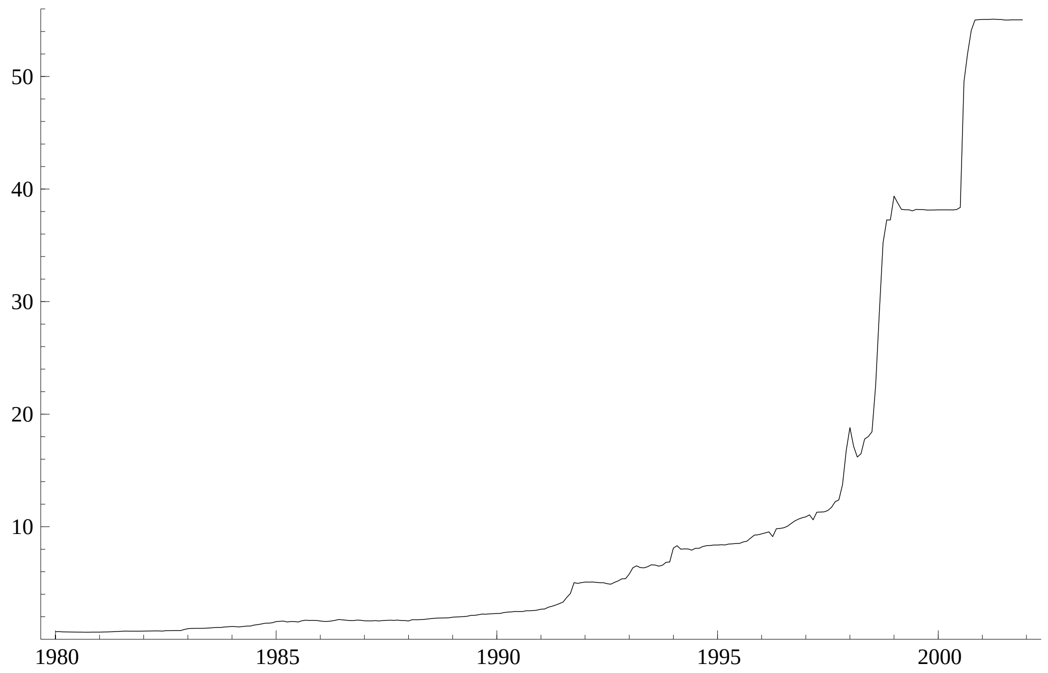

Figure 1. The Zimbabwe / US dollar exchange rate.

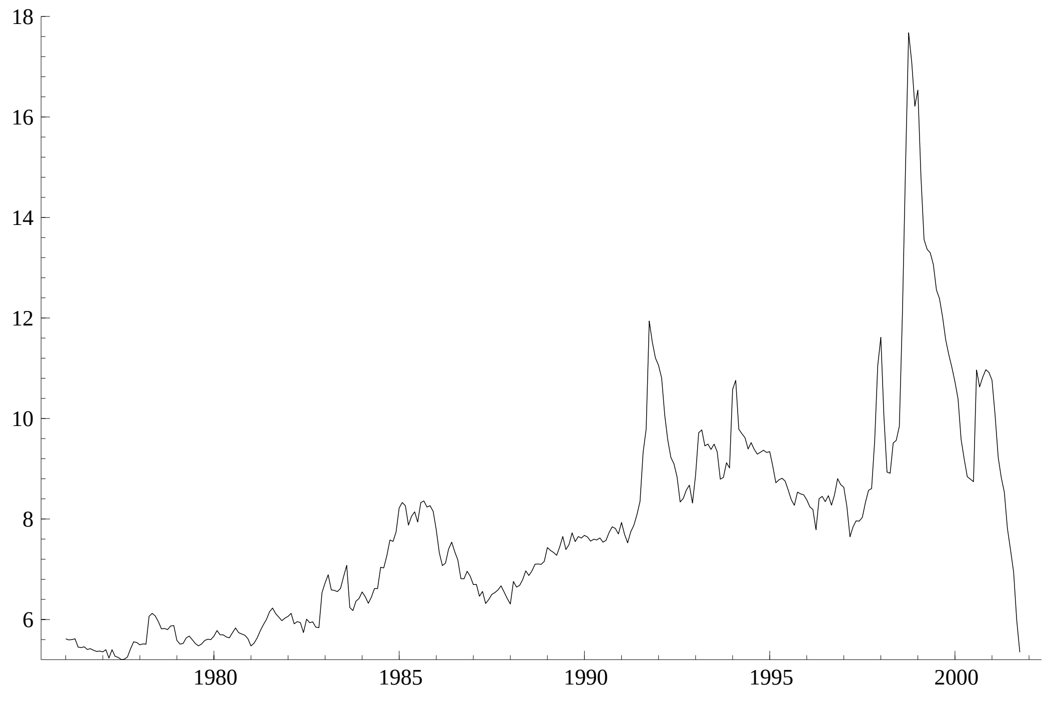

Figure 2. The real exchange rate defined as the US wholesale price index times the Zimbabwe – US dollar exchange rate divided by Zimbabwe's consumer price index.

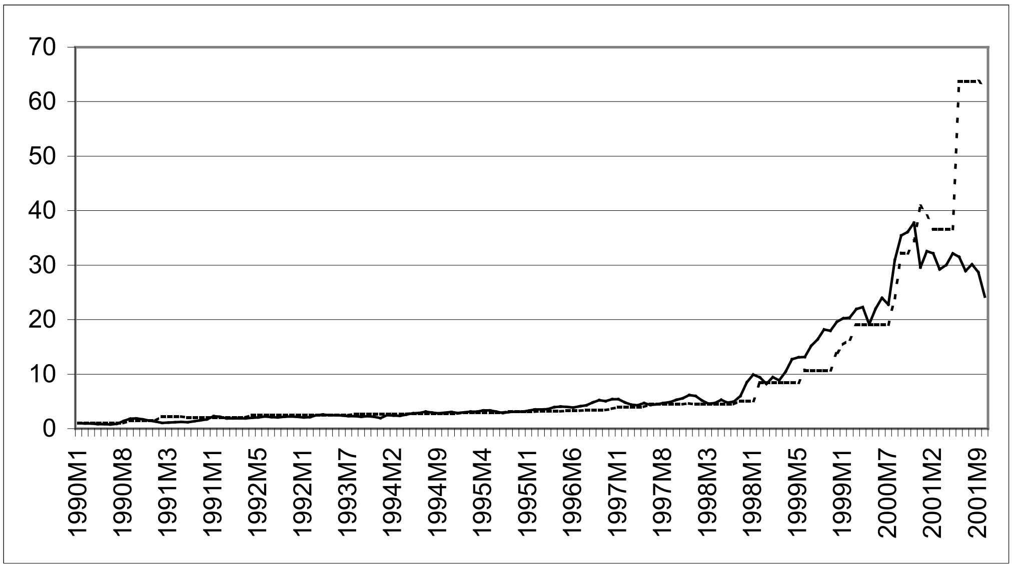

Figure 3. Indexes for the world price of petrol measured in Zimbabwe dollars (——) and the domestic gasoline price (········). The value in 1990:1 is set to unity.

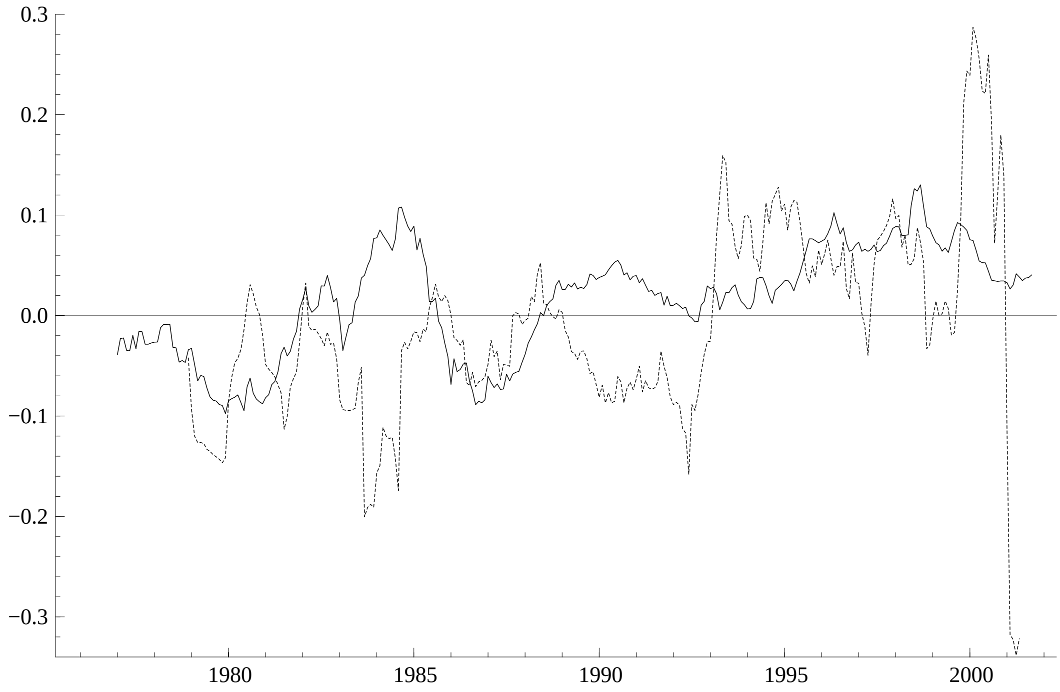

Figure 4. The real Treasury bill rate in Zimbabwe and South Africa.