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## Market failures and government failures in West Africa: Which strategies for the future?

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**Wirtschaftswissenschaftliche Fakultät  
der Eberhard-Karls-Universität Tübingen**

Market Failures and Government  
Failures in West Africa:  
Which Strategies for the Future?

Nouhoum Ganaba\*



**Tübinger Diskussionsbeiträge**

Wirtschaftswissenschaftliche Fakultät  
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Which Strategies for the Future?

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## Abstract

Structuralism and orthodox economics failed to help African countries overcome their backwardness because these countries lack efficient institutions and have not reached the critical value of human capital beyond which an economy generates self-sustaining development. These findings legitimized the following propositions: because development requires a strong mobilization capacity, African governments should decentralize to levels where loyalty and transparency are high. Since decentralization merely facilitates consensus on basic principles but does not affect the quality of goods produced and the competitiveness of an economy, it must be supplemented by a sufficient stock of knowledge that can adapt and master advanced technologies.

## 1 Introduction

As in all developing countries, African governments are assigned with the task of correcting their markets for an efficient allocation of resources and of shifting the production possibility frontiers of their respective economies outwards. That is, beyond allocation, stabilization and distribution functions, they also have to promote sustained economic growth and higher living standards. Unfortunately, after nearly four decades of independence, few African countries can look back on a period of real economic progress, whereas East Asians are successfully closing the gap between their countries and the Western World. This brings us to the question of why African economies failed to catch up with the rest of the world. A justifiable answer is that African economies are disadvantaged because of home-made failures: governments have not been able to generate the sufficient conditions for sustainable economic growth and development. These failures bedeviled all efforts to set African countries on a course of self-sustaining growth.

Although it is obvious that many errors have been made, arguing that there is no role for government in African economies is indefensible. Rather, it is the appropriate role of government in the process of development that is the contentious issue. To state it explicitly, we are interested in the conditions under which an African government can go beyond the Nozick vision of "minimal state" in interfering with economic activities to propel its country out of backwardness without obstructing markets in their roles as motors of economic advancement. This approach clearly goes beyond the discussion of states and markets as being alternatives. It can, however, be justified. In the early stage of independence, strong interventionist development programs derived from structuralist theories of general inflexibility had been implemented. But with the passage of time, these programs revealed themselves to be flawed and inadequate. The IMF and the World Bank the

countered with their therapy based on monetarism and neoclassical principles of competition: the Financial Programming and the Revised Minimum Standard Model (RMSM), respectively (Chand 1989; Khan and Montiel 1989; Khan and Montiel 1990; Tarp 1993). A wave of liberalization, privatization and expenditure reductions shook the countries involved. But after more than a decade of market-guided reforms, many observers claimed that strong-adjusters were not performing better than non-adjusters (Economic Commission for Africa 1989; Mosley and Weeks 1993). There remained a growing concern and controversy over solutions chosen and over means of reforming African economies.

The findings that both market and non-market guided patterns failed to promote development in Africa legitimize two interrelated questions. What is it in the nature of African economies that has made it so difficult to successfully implement both orthodox economics and structuralism? Which policies will help to remedy the current situation? The present article is an attempt to answer to these questions. It first claims that economic development requires institutional efficiency. In most African countries, however, there is a conflict between the objective function of the ruling body and that of citizens who "see the state and its development agents as enemies to be evaded, cheated and defeated if possible, but never as partners" (Ayittey 1995). Discrepancies between goals led to cooperation and compliance problems that have crippled central authorities' ability to efficiently influence economic activities. Consequently, necessary infrastructure for economic development could not be provided in a timely manner. The second claim is that human capital, work ethic, entrepreneurship and managerial skill determine the development path followed by an economy. Yet, the peculiarity of most African countries is that the stock of these inputs is at a very rudimentary level. They are neither deeply rooted in social structures nor are they widespread. Thus, African countries lack the appropriate initial forces that could jerk them out of a stagnant situation of low growth and set them on the optimal development path.

As a corollary, any reform policy aiming at getting economic development on track would have to concentrate on efforts to restore a developmental state untrammelled by crises of legitimacy and on building up an optimal stock of knowledge which induces sustainable increases in growth. Hence, the task here is to provide an understanding of economic and political circumstances under which development in Africa is being proposed and to clarify why the aforementioned strategies may help to counterbalance unworkable economic policies in which African governments are currently mired down. To keep the scope of the investigation manageable, it will be limited to the 16 members of the Economic Community of West-African States (ECOWAS).

The article is organized as follows. Sections two and three show that both structuralist and neoliberal theories failed to straighten out economic development in Africa. Section four highlights the relevance of decentralization and knowledge in economic de-

velopment. Decentralization does not merely hold together unintegrated ethnic groups living in countries where governments grow preoccupied with private and sectarian advantage, or factional struggle. It also facilitates an efficient provision of social overhead capital. Yet, decentralization may explain how to get growth started but not how to best perpetuate it. This is where the role of knowledge comes in: a large component of economic growth is explained by increases in innovations and inventions, and the growth of knowledge remains the most important factor which contributes to increases in the productivity of input factors. Thus, even under constraints of limited physical inputs, a country can record high growth rates over a long period if inventions (creation of new knowledge) enable the production of new goods or a more efficient use of existing ones (e.g. capital-saving and labor-saving innovations). Unless African countries acquire and master advanced knowledge, their economies are doomed to stagnation. The work concludes with section five.

## **2 Disillusionment with Interventionism**

The subdiscipline development economics was born in the 1940s. To begin with, development was understood as the capacity of a backward country to maintain, on average, a sustainable annual growth rate of at least five percent over a very long period, and an increase in the contribution of industrial and service activities to GDP at the expense of agriculture. Later on, the fight against poverty, unemployment and inequality was included in the notion of development (Seers 1969; Todaro 1979). Scholars of development economics, then, diagnosticized the nature of developing economies and worked out conditions under which these goals could be achieved. They found out that market structures were different from those ones of industrialized nations: the neoclassical theory of perfect competition and flexible prices did not prevail. Imperfection was caused by institutional and structural rigidities, an inadequate price mechanism due to the absence of strong substitution effects, and by the absence of large scale items referred to as infrastructure. Supply was limited by production technologies based on fixed coefficients (Tinbergen 1958), by constraints on the availability of foreign exchange, capital and manpower (Chenery and Strout 1966), and because per capita income was so low that savings required to increase the stocks of reproducible capital could not be supplied (Nurske 1953). Demand, in turn, was constrained by poverty and the small size of domestic markets. Inelastic demand and supply had the consequence that changing relative prices could not set relevant quantitative adjustments in motion. Furthermore, terms of trade were unfavorable either because the ratio of export prices of commodity goods to import prices of manufactured goods was decreasing (Prebisch 1984) or the return per

unit of input in the production of export goods relative to imports was falling because of the low productivity of tropical farmers (Lewis 1954; Lewis 1978).

The advice for political elites followed readily. Let alone, markets could not bring about a socially optimal allocation of goods and services. The prevailing structure of relative prices was misleading and could not lead to an optimal allocation of resources. The price mechanism needed to be supplemented or supplanted by government measures. Implicitly, the assumption was that development planning models, involving industrialization and protection, would have to be formulated. Structuralists had then to answer to questions as to why the central planning of investment would benefit the society more than aggregate investment made up of individual decisions, and where to find the capital necessary to finance development projects.

Apparent justifications for government intervention were found in the provision of social overhead capital which facilitates production (e.g. education, transport facilities, communication, security, health care, and the like), and the presence of indivisibilities which implied that the provision of infrastructure, necessary for markets to perform their allocative role well and for economic development, might not be privately profitable in the short-run. In other words, many firms had no interest in providing them. Thus, projects that were either too large or too costly to be handled by private investors and in which the disadvantages of large-scale institutions would be minimal were to be carried out by governments. Another strong case for governments was the belief that, in general, intervention facilitates cooperation and lowers the costs of market transactions.

Governments were urged to intervene directly in contributing to the simultaneous "balanced growth" of markets for industrial output (Rosenstein-Rodan 1943). They were supposed to play the role of investment planners to facilitate market transactions which mediate the interdependence among economic agents, the absence of which was the main hindrance for a backward economy to be propelled by a price-guided system (Scitovsky 1954). They had to quicken the pace at which resources were extracted from agriculture (with labor surplus) to industries in order to provide the savings necessary to finance government activities and capital accumulation (Lewis 1954). Thus, economic development was thought to require a high rate of capital accumulation for industrialization and a shift of labor force from low-productivity agriculture to high productivity manufacturing (Kuznets 1955). However, the production of manufactured goods had to reflect domestic income elasticities. Backward agriculture-dominated countries should not rely on the production of tradable goods because investments and not international trade maximization were the relevant variable in growth models (Chenery 1961). In addition, price and income elasticities of demand for agricultural products (in which developing countries had comparative advantage) was very low on world markets (Lewis 1969). Western nations were developing and consuming synthetic substitutes.

Most African countries obtained their independence in the 1960s, a period dominated by structuralist views. Their governments faced the difficult task of nation-building. They had to alleviate poverty, transform subsistence economies into modern ones, counterbalance commodity trade asymmetries with former colonial masters and new partners from industrialized countries, and defuse ethnic division and other system-threatening events. Under these circumstances, centralized states were not only defensible but also absolutely necessary in order to integrate, unify and develop newly independent nations. Unfortunately, poor economic performances challenged interventionism. As early as 1966, the Economic Commission for Africa warned that central planning and intervention "had little, if any, impact on the overall development of West African countries, and can at best be taken as an expression of the desires of governments or the hope of small groups of experts." Subsequent investigations confirmed this trend (Bates 1981; World Bank 1981; Hyden 1983; Sandbrook 1986). In summary, highly centralized planning and control of development activities provided poor results. Although governments played a major role in the allocation of investments, economic growth remained very low comparatively. Even where growth rates were high, their benefits usually trickled down to only a tiny fraction of people, and income disparities between rich and poor widened. Between 1960 and 1982, Ghana experienced a yearly average decline in per capita income of 1.3% (an estimated drop in real living standards of about 25%). In the period 1965-1986 Liberia, Guinea-Bissau, Senegal, Mauritania and Niger also recorded negative average annual growth rates of GNP per capita (World Bank 1988). Positive growth rates recorded in the subregion ranged from 0.2% (in Sierra Leone, Benin and Togo) to less than 1.5% (in Gambia, Ivory Coast, Mali and Burkina Faso). Despite the increase in oil prices and savings rate that rose from 12% in 1960 to 20% in 1987, Nigeria experienced only a 1.1% annual rate of increase in per capita income (World Bank 1983 and 1989). Table 1 shows how the average real GDP per capita grew in the 1970s. It was negative in eight countries, and less than three percent in the remaining ones.

These poor performance levels were attributable to deteriorating economic management of extended and expensive public sectors, declining average returns in investment, and to discouraging effects of financial policies on private companies. The piece of empirical evidence cited to prove this trend consisted of the cases of Mali, Senegal, Mauritania, Guinea, Ivory Coast, Nigeria, and Ghana (Nellis 1986). Nellis showed that the percentage increase in state-owned or parastatal enterprises at the early stage and subsequent periods of independence was tremendous, and that the net worth of 36% of all state-owned companies in West Africa was, negative while 62% of them were running deficits. In Niger, the total deficit of public enterprises was evaluated at 4 percent of the GDP in 1982. Very similar situations were registered in Mali, Senegal, Sierra-Leone, Benin, Nigeria and Mauritania. Similarly, the weekly magazine "West Africa" claimed that the Ghanaian



government was owner of all or the majority of shares in 181 enterprises and minority shares in 54 others<sup>1</sup>. More than 50% of these enterprises were making losses. These losses rose from \$13 million in 1979 to \$136 million in 1982. In the time period 1982-85 state-owned corporations accumulated a deficit of \$175 million in Ivory Coast, parastatal ones in which the state owned more than 50% of shares lost \$10 million, whereas those in which state ownership was below 50% registered a profit of \$297 million<sup>2</sup>.

Because of mismanagement, the scarcity of financial resources and managerial skill, average returns on businesses in the public sector have been declining and the gap between revenue and expenditure has gotten quickly out of hand. These factors triggered growing budget deficits, inflation, unemployment, low saving and capital formation rates, growing foreign debt burdens, balance of payments deficits and loss of foreign exchange reserves. Consequently, demands were raised for foreign financial assistance in order to cope with growing shortfalls in central government receipts, confirming the suspicion that African governments were not able to successfully cope with the various economic difficulties of their respective countries. Many of the basic patterns of the "pioneers in development" came into question in the 1980s as international recession and rising interest rates worsened the situation. A fundamental reexamination of development thinking and strategy with the urgent task of breaking the growing power of central planning and mismanagement followed. From the framework of central intervention, economic development approaches shifted towards market-driven allocation of resources.

### **3 Down the Road of Market Economy**

In contrast to theories of early development economists, who preached massive state intervention, market economy has become the magic word and the curative medicine prescribed by mainstream economists. Markets were seen as the most efficient mechanisms for the allocation of scarce resources and the transmission of information, while the state was regarded as an exogenous factor of economic process, and skepticism was voiced about its ability to intervene in the economy without being counterproductive. State instruments used in the market process were accused of having impeded the smooth development of free markets. This impediment called forth a suboptimal allocation of various factors of production and commodity outputs, and distribution of income. Hence, reforms leading to the allocative efficiency of markets, in the sense that factor prices are determined by their marginal productivities, were needed.

The theoretical background of this vision is the first theorem of neoclassical economics which states that the interaction of rational profit and utility maximizers, on competitive markets covering all their needs (in goods and services), generates an efficient allocation of

resources. In equilibrium, prices are equal to marginal costs of production, marginal rates of substitution are equal across consumers, marginal rates of technical substitution are equal for goods produced, and the marginal rate of transformation between commodities in production is equal to the marginal rate of substitution in consumption. If, in fact, the optimal solution can always be obtained from competitive market forces, then government activity should be kept at its minimum level. The optimal allocation of resources would be achieved as resources flow to areas of their most valuable use as directed by market forces. Once these conditions are fulfilled, optimal investment will take care of itself. Growth and development are attributable to the efficient allocation of resources. The role of the government must be limited to that of enforcing contracts, defining and protecting property rights, maintaining law and order in the society etc.; for these are preconditions for the emergence and achievement of efficient markets.

However, atomistic decisions do not necessarily bring about a strong and developing economy. In many cases, individual choices driven by rationality do not add up to socially optimal solutions so that it takes a strong government to sort things out. This is the case in the presence of public goods, externalities in production or consumption, imperfect competition, and asymmetric information. Also, society may regard, on grounds of equity, the income distribution resulting from market process as inequitable even if it is pareto-optimal. The income distribution that emerges from competitive markets is tied directly to initial endowments, so that those who start with more of everything will end up with more income at equilibrium prices. In order to attain the socially desired distribution among individuals in the economy, a social welfare function in which considerations of distributional justice are embodied is also needed.

In summary, the neoclassical framework is that of perfectly functioning markets guided by the full flexibility of prices that equilibrate demand and supply. Prices include all information necessary for individuals to undertake transactions. In this context, we would expect "over-populated" developing countries, with very small capital-labor ratios, to specialize in labor-intensive production technologies that allow them to be competitive on world markets. An increase in the demand for their products will increase that of labor. This, in turn, will raise the price of labor (the real wage) up to the point where the market clears. The increasing real wages boost consumption as well as savings and hence affect both goods and capital markets. To save and increase its share of exports, domestic production of tradable goods must react to signals from international markets. By the same token, domestic firms must be flexible enough to adjust their respective capacities to conquer new markets if their comparative advantage were to be wiped away on old ones.

Orthodox economic theories were particularly advocated by the IMF and the World Bank which, in most the cases, set an agenda for economic reforms. The prerequisite for

obtaining badly-needed financial assistance was the commitment to adjustment policies aimed at stopping economic disarray in the countries in question. These policies were termed stabilization (consisting of an expenditure-switching and an expenditure-reducing policy) and structural adjustment programs. The stated objectives of liberal economic policies were threefold. In the short run, the major task assigned to policy was to restore economic balance. The relevant variables for these purposes were monetary aggregates (a ceiling on the annual growth rate of money and credit) and demand restraint. The transitory medium-term policy, conducted by the World Bank contrary to the first one which is identified with the IMF, focused on the supply-side of the economy, whereby exchange rate, interest rate, wages and prices were the determinant variables. The third step - the long-run approach - was that of structural change, growth dynamic and economic development.

At the risk of oversimplification, the components of the package of reforms involved are the following: devaluation and wage restraints to increase competitiveness in international markets; outward-oriented strategies to accumulate exchange reserves not only for counteracting external imbalances but also for debt servicing; tax reform and reduction in public spending to in order to promote savings, to curb inflation and to make resources available for the more productive private sector; privatization of state-owned and parastatal enterprises; and liberalization and deregulation in order to enhance competitive markets. Government activities had to then be reduced to those things that are necessary for the optimal operation of market forces. The dismantling of the protectionist umbrella made up of quotas, tariffs, overvaluation, discriminatory tax codes against foreign direct investments, and all other kinds of measures protecting the formal sector from competition with the informal and foreign sectors followed suit.

Over half of ECOWAS-member states subscribed to the IMF/World Bank conditionalities for market reforms in the period 1981-85. By early 1990, at least 15 of the 16 countries<sup>3</sup> were receiving stabilization and/or adjustment loans (Stewart 1995). New constraints put on state activities provoked mass unemployment and "IMF riots". Ghana experienced 25,000 labor redundancies in 1984-5 and 32,000 layoffs in 1985-6. Nigeria implemented its structural adjustment program by July 1986 causing between May and October 1987 the shut-down of 19 companies in Kano and 60% of industries operating at less than 26% of their capacities (Walton and Seddon 1994); an unstable exchange rate, and an effective interest rate fluctuating between 25 and 27% (Bangura 1994). Guinea had to squeeze its public sector by more than 55%, and Guinea Bissau by 24% (Sandbrook 1994). By letting its currency float and removing price subsidies, Sierra Leone suffered between June 1986 and January 1987 a devaluation of 86% (against the US Dollar), accompanied by an inflation of 300%. Togo, Benin, Niger, Liberia, Ivory Coast, Burkina Faso were also very badly hit (Walton and Seddon 1994). Twelve years of structural

adjustment together with a 50% devaluation of the CFA Franc in 1994 increased "living costs" in Mali at a rate of 117% (Le Monde Diplomatique 1994).

What happened to poverty and growth? In attaching more attention to improving macroeconomics imbalances, very little consideration, if any at all, was given to social costs and human dimensions of adjustment measures. This has been recognized by the World Bank itself (World Bank 1995). Because of the distributional implications it embodied, the implementation of adjustment programs came with very high costs and damaging effects. Austerity measures combined with recession worsened poverty, unemployment and inequality (Cornia et al. 1987; Stewart 1995). Adjustment is a time-consuming phenomenon that triggers adverse effects on various groups of society, and the growth that was expected to spread to the poor lagged. An example of empirical evidence in support of this viewpoint is that reforms have not been very successful in stopping the downward spiral of economic collapse throughout the 1980s. The decade considered to be one of massive privatization and market liberalism also happened to be the worst in the Sub-Saharan Africa's post-colonial period. The annual average growth rate was estimated at -1.1% (World Bank 1992). For West-African countries, Table 1 shows that average annual growth rates of real gross domestic product per capita of the period 1980-90 were lower than those of the period 1970-80 in 10 of the 16 countries (Togo, Nigeria, Guinea, Gambia, Ivory Coast, Mali, Burkina Faso, Liberia, Niger and Sierra Leone). From the same table, we can also identify a shift in the growth rates of the first six countries from positive to negative figures. Growth rate remained constant in Benin (-0.3%), while five countries showed some signs of recovery (Ghana, Cap Verde, Senegal, Guinea Bissau and Mauritania), though in the case of Ghana and Mauritania the rates were still negative.

If we refer to the period after 1985 as being one of the beginning of economic recovery as stated in "Africa's Adjustment and Growth in the 1980s" (World Bank 1989), a striking factor is that the performances of eight countries were worse during 1985-90 than they were in the 1970s: Mali, Liberia, Burkina Faso, Benin, Ivory Coast, Guinea, Gambia, and Togo. The first four were classified as being weak adjusters and the rest as strong adjusters (Mosley and Weeks 1993). All in all, there was no ground for believing that market orientation performed better than statism. Orthodox economics came under close scrutiny. The result was the birth or rebirth of new strategies and alternative approaches, including an "adjustment with a human face" (Cornia et al. 1987) and an "African alternative framework to structural adjustment programs for socio-economic recovery and transformation" (ECA 1989).

A logical next step is to wonder what caused negative growth rates and economic decay to be sustained over such a long period, and whether it is possible for African countries to break the stability of the existing low-income equilibrium their countries are trapped in. The purpose of these questions is to give an insight into why African countries failed

to catch up and whether they can imitate East Asian nations.

## 4 Strategies for the Future

For analysts concerned with alternative development strategies, the lesson that may be learned from African experiences is that the market-versus-state dichotomy is deceptive. Both failed to achieve their stated goals. Consequently, state and market must be regarded as mutually enforcing elements so that "when the market fails to achieve an optimal state, society will, to some extent at least, recognize the gap, and nonmarket social institutions will arise attempting to bridge it..." (Arrow 1963). The difficult task, then, is to find the appropriate mixture of market orientation and government intervention that leads to economic development. A closer look at the story of the development of East Asian Nations will help us to shed light on how governments can complement markets.

### 4.1 Learning from East Asian Nations

In their early development stage, East Asian Nations recognized that knowledge accumulation, which leads to technological progress, is an endogenous variable in growth models. This wisdom goes back to Confucius, who stated that "if you plan for a year, plant a seed. If for ten years, plant a tree. If for hundred years, teach the people." Since social returns to investment in knowledge are higher than private returns, central authorities implemented policies that promote the accumulation of human capital. They saw it as a national imperative to quickly acquire and master the practical knowledge that ensured Western firms a supremacy on both foreign and domestic markets. For this purpose, governments invested enormously in human capital, primarily using public funding for science and technological education to produce skilled engineers able to absorb and adapt the most advanced technology. They sponsored intensive research programs and created centers involved in R&D that smoothed market entry for different firms and/or enabled them to capture some of the diffuse externalities inherent to their branches. They also widely opened doors to the transfer of technology from foreign investments that were contributing to the expansion of domestic know-how.

Human capital accumulation was the first step. The second consisted of channeling resources to highly productive investments. Asian elites relied on carrot-and-stick policies that force their firms to be as competitive as foreign ones. But instead of supplanting markets, state intervention supplemented them by reducing uncertainties and risks inherent to certain categories of business by generating and disseminating information about opportunities, and by stimulating an attitude of expansion among entrepreneurs. In doing so, governments could, on the one hand, protect and/or subsidize strategic domestic

infant firms under constraints that the latter modernize their production technologies to face competition. Poorly performing firms were subject to penalties such as the withholding of government bank loans, industrial licensing, technical assistance or other methods. Taiwanese leadership, for instance, threatens local producers with allowing imports whenever they supply at prices much higher than foreign competitors (Wade 1988). On the other hand, governments exposed domestic corporations to international competition by strongly motivating them to begin exporting very early. They practiced a very aggressive and dynamic export-led growth strategy based on an allocation of resources in sectors where their comparative advantage was overwhelming. Participation in the world market subjected national governments to a set of constraints on policy choice: the requirements of economic efficiency hindered the adoption of measures antithetical to growth. Also, by exogenously determining prices, it imposed market discipline on the wasteful use of resources which the domestic market is not able to offer to protected suppliers.

The motivation behind these actions came from the objectives of attaining economic independence and self-reliance. These objectives stemmed from a humiliating history of colonization which begot a very strong economic nationalism. Asian nations viewed the invasion of foreign markets as a weapon that protects against dependence and were therefore engaged in a catch-up race. Outward-orientation has, however, not prevented them from conserving autonomy from international capital. The access of foreign corporations to their domestic markets was limited by the philosophy of giving priority to the interests of one's own nation. A potential threat of collusion with domestic ones against the central government was thereby defused. Whether this resulted from strong nationalism or a cultural tradition, by resisting the invasion of foreign capital, domestic politics "determined what role transnational capital would play in the domestic division of labor" (Lee 1993).

The list of factors that contributed to Asian success continues. In these countries, the conception of the creative and productive paternalistic state, behaving as a platonic social guardian, is deeply rooted in society. Citizens conceptualize the state as a developmental institution with the function of mobilizing all resources that further the well-being of the nation. Hence, there is a positive orientation to government so that the problem of legitimacy does not arise. Moreover, the existing strongly elitist system helped to set up an autonomous administration staffed by the most talented and ambitious managers recruited on the basis of meritocracy and more devoted to their mission of nation-building than to interests of any other special social group. In this context, it is easier to find a consensus on basic principles to which rulers could appeal for nationalism, sacrifice and solidarity. This, in turn, allowed the state and its apparatus to design and implement appropriate development policies.

Another factor that influenced Asian growth is that the state closely cooperates with the private sector. This cooperation is characterized by reliance on private enterpre-

unership, relative stability of export-promoting incentives (e.g. favorable real effective exchange rates), and commitment to private property and market-guided solutions whenever government has a comparative disadvantage (Balassa 1988). Furthermore, the private sector has always been involved in the formulation and implementation of policies which affect its interests. These policies paid off because the efficient orientation of investments and production enhanced the capacity of involved industries to supply international markets.

We should also mention the role that the cultural perspective, namely the Confucian tradition, played in the Asian entrepreneurial spirit. Confucianism goes beyond the philosophy of merely learning or knowing by heart. It motivates disciples to observe, interpret and adapt. It stimulates elites to accumulate human capital and spread it among masses by urging the latter to see in it a lot-improving tool; to behave in accordance with ethical principles based on self-sacrifice, diligence, delayed gratification, frugality, discipline, and thrift; etc. "Although explicit coercion was, in reality, frequently employed, the Confucian tradition helped to justify, and, to a certain extent, actually moralize, political authority, by stressing the collective interest and the ruler's responsibility to take care of the needs of the ruled" (Lee 1993). Moreover, Confucian virtues can be regarded as means of fostering competition in society. In contrast to neoclassical utility or profit maximizing rational individual, Confucianist-oriented people seek self-improvement in accordance with family values governed by mutual assistance and the belief that one's firm's success is ranked as a higher social goal and is linked to the extent to which the members of the family that own it are hard-working. This system enormously contributed to the economic development of East Asia insofar as it pushed people to efficiently engage entrepreneurial skill and labor, as well as the physical and human capital of their families and relatives in production activities. Do African countries have similar stimulating forces (group orientation, loyalty, Calvinist frugality or their like) that foster economic development?

## **4.2 Decentralization and Human Capital Formation**

To understand the persistent economic crisis in Africa, a distinction should be made between personal objectives of those acting in the public sector and the aggregate social welfare function which is supposed to be maximized through intervention. Central control or intervention in the African context is not simply an economic debate. Economic policy is influenced by political trends, particularly by the characters of government leaders whose main objective is to hold on to power as long as possible. For this purpose, they have to favor strategic regions or buy instrumental allegiance from viable groups of supporters through patronage or clientelism (Sandbrook 1986; Herbst 1990). That was why, by choosing a development path emphasizing state control and economic plan-

ning, significant efforts were made to develop institutions of state coercion and to exclude populations from social, economic and political decision-making. Poor and highly heterogeneous peasant societies had to act in accordance with these structures. Not surprisingly, there were few institutions in which populations and officials shared a common interest. Governments, therefore, could not create economic environments favorable to the formulation and implementation of appropriate industrial and trade policies or to an efficient allocation of resources.

The existing relations between rulers and those ruled are similar to multiperiodic static games. The players are governments and rational forward looking agents with perfect knowledge of authorities' objective functions. A game can, thereby, be defined as the supply of a development project (e.g. a dam or a bridge). Governments are first-movers and citizens are followers whose reaction function depends on past experiences with government policies. Let us assume that policy is not credible in the eyes of citizens. We see that, since current decisions of the latter are conditional on future expectations formulated under the consideration of experience, non-cooperation will be the dominant strategy. This results from individual beliefs that, once they contribute to the financing, the government has no incentive to provide the optimal level of the project. Officials would, instead, enrich themselves. Thus, conflicting interests generate low level Nash equilibrium pay-offs with pervasive national effects. African economies are stuck at such a low outcome equilibrium which largely explains the misfortune of many development projects.

The absence of cooperation weakened most government programs. They were doomed to fail from the very outset because of informational asymmetry between planners on the one hand and contributors, along with people in charge of monitoring operations, on the other. A simple but striking example is the case of income tax collectors in Eastern Nigeria who "would understate the number of households in a district and allow all households to share the tax burden of the households declared, with the collector keeping part of the savings" (Besley and McLaren 1993). Credibility generating self-correcting measures, which could strengthen popular support for centrally planned projects, were lacking. Consequently, development projects were unilaterally designed, controlled and managed by state civil servants, without any involvement of populations. Plans were often elaborated without serious cost estimates. They ignored limits on resources, and, in certain relevant circumstances, failed to take into consideration differing claims of various regions or groups. The goods produced were tailored not to the tastes of populations, but rather to prestige priorities defined by the central government. Moreover, implementation of plans was usually impeded by the unavailability of manpower, weak and faulty administrative structures, inappropriate economic models, etc. In many cases, projects have had no real positive effects on the economic situation of target zones or on their environ-



ment. Governments were, hence, engaged in activities in which they had no comparative advantage, breaking the basic rules of an efficient division of economic activity between public and private sector. Ineffective bureaucracies, rent-seeking activities and wasteful use of scarce resources were predominant. These factors called forth economic dualism that impinged upon decisions for private entrepreneurship and the market process. We conclude that, in order to obtain higher levels of collective welfare, binding agreements must be introduced into social life.

Since African governments cannot appeal for cohesion (either because of political, religious or ethnical reasons), the first proposition that comes into mind, in order to force sustainable cooperation, is to decentralize to levels where loyalty and transparency are greater. Development requires participation based on management and organizational flexibility. Hence, decision-making should not remain an exclusive good reserved for a relatively small circle of people. Crucial information and competent decision-making are dispersed at the local level. Decentralization, in this case, can be seen as a reaction to both the slowness with which central authorities respond to pressing social and economic problems of local populations and central planning's insensitivity to local variations in conditions and people's preferences.

More often than not, the success of the efficient allocation of public goods depends on the use of information and competence. If participation is limited to the central organ or if a monolithic conception of authority dominates administrative structures of the society, constant failures in managing large-scale and complex activities will be the result of governmental actions. Decentralizing responsibility is an organizational device that improves efficiency of development planning, implementation and management because it makes policy more responsive to local needs, and it involves locals in processes of both economic development and democratic governance. These values have been ignored in previous economic development strategies in Africa. This failure had fundamental implications for the ways in which development planning and administration was organized and carried out.

However, the establishment of a vertical structure of decision-making is merely a necessary condition that facilitates the provision of social overhead capital. It does not affect the quality of goods (tradable as well as non-tradable) produced in an economy. Nor does it determine the competitiveness of an economy in a world of interacting nations. Producing the optimal quantities and shifting the production possibility frontier of a country require a more complex set of factors guided by knowledge, entrepreneurship and effective institutions. Thereby, the latter play the role of a catalyst of growth that creates incentives to further investments in human capital, entrepreneurial development, and in R&D leading to innovation and technological progress. Let us investigate the extent to which African governments contributed to the accumulation of these inputs.

During the colonial period, participation of Africans in matters of state was limited to clerical, administrative assistant and other junior posts. The higher-level positions including engineers, entrepreneurs, technicians, scientists and managers were held by non-African expatriates. With independence, African countries inherited a manpower with an insignificantly small technical, administrative and managerial experience. Trained cadres were poorly equipped to cope with the challenge of complex design, coordination, implementation and maintenance of large-scale infrastructure required at the first phase of nation-building. But even after having achieved the goal of independence, primary and secondary enrollment rates remained very low. In 1990, adult illiteracy rates were between 40 and 82% in at least 14 of the West-African countries (World Bank 1995). These rates paralyzed the enskillment of labor with the consequence that labor productivity also remained very low. Contrary to East-Asians, most African countries relied on skilled expatriates as permanent advisers or on an inappropriate transfer of Western technology. Reliance on foreign assistance has been a handicap to the ability of mastering and adapting advanced technology to domestic needs and international requirements. This, in turn, undermined their capacity to invent or innovate beyond the use of imported replicas. They could therefore neither diversify their production possibilities in order to satisfy demand from domestic markets nor could they invade foreign ones. African economies started to stagnate.

Symptoms of a long-run stagnation materialized first in the specialization in very few tradable goods and pervasive protection of domestic industries. For instance, 80% of the exports earnings of Mali, Guinea and Niger, and 90% of Nigerian ones came from Cotton, bauxite, uranium and oil, respectively (Sandbrook 1994). As for protectionism, it stemmed from inward-looking industrialization strategies thought to be a stimulus for growth and development. Under the umbrella of import substitution, they ended up with protected public manufacturing industries whose operations were unrestricted by any budget constraints. All deficits were covered by government receipts. Soft budget constraints decreased motivational efficiency with the consequence that firms were "overstaffed with redundant personnel who have no reason for being there than they must be maintained by someone at the expense of these public enterprises" (Mbanefo 1975). Protective structures, excluding competition from abroad and including import licenses issued or withheld without economically sound criteria, were so complex that almost no one could precisely sort out which industries were protected, why and how. Protection failed to discipline markets, and distorted prices and incentives. Because of a lack of technical know-how and managerial skill, domestic industries were forced to compete with one another for both foreign assistance and exchange to obtain viable inputs.

Purely inward-looking strategies failed because of technological, economical and political considerations. Protected industries were producing for small size markets and, hence,

could not grow enough to reduce their average cost per unit. The incremental capital-output ratios were relatively higher than those observed in export-oriented countries. An explanation that can be given for this is that industries producing for international markets have to possess efficient technologies in order to resist strong international competition. West African industries were producing under the umbrella of protection and were not threatened by market entry. They had, therefore, no incentives to develop labor intensive technology despite high costs of rarely available capital and the abundance of unskilled workers. On the other hand, small sizes of domestic economies either fostered conditions of imperfect competition or a huge number of small firms that were unable to merge and exploit economies of scale.

Yet, despite neoliberal insistence, one should be cautious when urging African states to anchor their economies to the global economy and "leave markets alone". The contribution of these countries to international trade is still limited to primary commodities. Meanwhile, these commodities have strong substitutes on world markets. They need, therefore, to adjust their mode of production by shifting it to more profitable alternative resources in which their disadvantage is not so overwhelming. However, this is not an easy task because of the amount of incentives and innovation needed for timely adjustment. Government intervention will be decisive in order to accelerate the pace of adjustment.

To compete with the rest of the world, these countries have first to build up productivity-improving human capital. Second, they have to weave together the different threads of private entrepreneurial talent, scattered in the informal sector, which has been bottled up by an inappropriate system of incentives inherent to statism and rent-seeking. We focus here on human capital, as an engine of growth, because it can be used to produce both new goods and new knowledge. "Yet since human capital is embodied knowledge and skills, and economic development depends on advances in technological and scientific knowledge, development presumably depends on the accumulation of human capital" (Becker et al. 1990). New growth theory (Romer 1986; Lucas 1988; Romer 1990; Grossman and Helpman 1991) as well as empirical studies (Barro 1991; Mankiw et al. 1992) supported this view. Technological progress (disembodied knowledge) stems from market-driven research and development activities carried out by profit-maximizing Schumpeterian firms. It positively affects the steady-state growth of an economy because, through knowledge accumulation, highly educated workers create new technologies that improve the productivity of labor and physical capital. Discoveries are non-rival; their positive spillovers reduce production costs of other firms and hence generate increasing returns to scale. It follows that differences in the amount of human capital belie convergent long-term growth paths related to Solow's model (Solow 1957). If, in a given country, the amount of human capital per worker is very low, the economy will be stuck at a stationary state of no growth. Countries with more human capital embodied in their workers, on the

contrary, can record a state of perpetual growth (Becker et al. 1990) simply because of their endowment in knowledge. That is, there exists a critical value of human capital accumulation below which a take-off and accelerated growth are not possible (Azariadis and Drazen 1990). However, once this threshold is reached, growth (and development) is self-sustaining, particularly because of contributions of ruling institutions to the spread of knowledge through research, training and adaptation of discoveries made elsewhere.

The first step toward weaving talent could be achieved through the dismantling of the intra-national barriers erected to protect public sector corporations against competition from the private sector. Unprofitable corporations will face the threat of being shut down or privatized. Both issues are binding constraints that motivate incumbent employees to minimize cost or face unemployment. As long as the unemployment resulting from such an option is less costly than losses incurred by maintaining production, the national economy will be better off since deficits will be reduced without having to increase taxes. A second advantage of this strategy is that it reduces opportunities for rent-seeking and its associated deadweight loss. A third advantage is that it lessens import quotas. Since national producers face the same constraints, no importer will be discriminated. All firms of a given sector will face the same prices and the allocation of the same import licenses. The national currency, in turn, will not be overvalued because of pressures from the domestic lobby to adjust the exchange rate to reflect changing relative prices between their goods and those of their trading partners.

This action should be accompanied by efficiency compatible measures that allow infant firms to gain the proficiency required to lower production costs. That is, state intervention should only provide sufficient incentives (e.g. tax holidays, interest subsidy) for lowering the cost of capital or information in order to induce firms to invest. To see the relevance of state intervention in favor of a timely acquisition of experience, the stress must be put on two relevant aspects of competition. First of all, it is to be noted that incumbent firms on world markets benefit from a competitive advantage acquired over time through learning by doing. Existing firms, hence, have accumulated experience that can help to design credible entry deterrence strategies, particularly if capital markets are imperfect. The threat of making losses can deter firms from undertaking operations that required high fix costs. Beyond this consideration, state intervention is necessary because experience is not congestible, and "much of the value to society of any given innovation or discovery is not captured by the inventor" (Romer 1990). They can be used by non-contributors through interfirm mobility of workers or spying activities. Intertemporal positive spillovers could lead to suboptimal investments, as in the case of public goods. Firms have no incentives to accumulate experience that may eventually lowers future marginal cost of potential rivals. Market failures arise. Difficulties with standard solutions proposed in the literature of public finance, such as the implementation of a Coase bargaining mechanism

that internalizes externalities, due to a shortage of technical means that facilitate the estimation of marginal benefits accruing to free-riders, are bound to fail.

## 5 Concluding Remarks

Two competing streams of thought, orthodox economics and structuralism, entrusted themselves with the task of investigating and finding solutions to the various economic difficulties faced by developing countries, in making more readily understandable which roles governments and markets should play. None of them were successful in Africa. Empirical evidence from West Africa supports this view. The next step was then to study the causal factors of economic setbacks in Africa. The article has shown that two essential conditions for a thriving economy remain unfulfilled in this region.

The first is that West African countries lack developmental states with the ability to mobilize resources for economic growth and development. This shortcoming can be partly explained by strong centralization in early stages of independence. Central authorities were not sufficiently equipped and informed to influence overall economic activities. Furthermore, they failed to endogenize and minimize the dynamics of clan politics and rent-seeking bureaucracy. Because governments had to take interests of conflicting groups that keep them in power into account, they lost their autonomy and credibility. Thus, one of the main hindrances to good performance in managing economic activity was that factional interests took precedence over national goals. Poor populations who do not identify themselves with such groups, very often evaded laws and regulations by refusing to cooperate with officials considered to be self-enriching mercenaries. Disjunction of interests created a situation of mistrust that hindered the provision of basic needs (social overhead capital) which were supposed to facilitate market transactions. The solution proposed to cope with this situation is to decentralize the decision-making process in order to enhance participation and quick reaction to local needs.

The second factor is that African countries are not endowed with the sufficient amount of human capital beyond which development is self-sustaining. Increases in labor supply and physical capital alone do not account for large variations in standards of living. The productivity of the labor force which depends on the stock of knowledge and skill embodied in workers, together with technological progress and external economies must also be considered. While the accumulation of human capital may stem from altruism, technological innovation (although dependent on human capital) is mainly the result of profit-maximizing activities. Since African states paralyzed entrepreneurial skill, they could not close the gap between them and the West as East Asian Nations did. In order to catch up, African governments must complement their markets because the latter may

fail to undertake the optimal investment in R&D.

## Notes

<sup>1</sup>See the 3-9 September 1990 issue.

<sup>2</sup>See the 29 October-4 November 1990 issue.

<sup>3</sup>Data is not available for Cap Verde.

**Table 1. Annual Average Growth Rates of Real GDP per Capita**

ECOWAS	1970-80	1980-90	1980-85	1985-90	1991-92	1992-93
Benin	-0,3	-0,3	0,8	-2,2	1	0
Burkina-Fasso	2,2	1,3	1,5	0,6	-2,2	-2,4
Cap-Verde	2,1	4	5,5	2,5	0,5	1,2
Gambia	2,2	-0,3	1,1	-0,9	-9,5	3,3
Ghana	-2,2	-0,5	-4	1,6	0,5	1,7
Guinea	3	-3,7	-5,4	0,2	0,1	1,3
Guinea-Bissau	-2	2,9	2,6	3,8	1,4	1,5
Ivory Coast	2,8	-3,8	-4	-4,6	-3,5	-4,5
Liberia	-0,8	-3,7	-4,6	-2,6		
Mali	2,4	-1,5	-6,2	2,3	4,3	-3,9
Mauritania	-1,2	-0,9	-2,2	-0,1	-0,7	2,7
Niger	-2,3	-4,3	-7,3	-1,7	-9,6	-2
Nigeria	1,6	-1,5	-5,7	1,9	2,7	-1,5
Senegal	-0,5	0,3	0,3	0,6	-1,2	-4,4
Sierra-Leone	-0,7	-1,2	-1,4	0,6	-6,8	-1,7
Togo	1,4	-1,2	-3,4	-0,3	-12,2	-15,4

Source: „Handbook of International Trade and Development Statistics“ United Nations Conference on Trade and Development 1994.

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