

Institutions and African Economies: An Overview

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Abstract

This article presents an overview of the current special issue 'Institutions and African Economies'. The findings include: (1) greater prevalence of democratic regimes improved both agricultural productivity and the overall growth of African economies, consistent with 'new institutionalism'; (2) higher institutional quality involving more binding constraints on the executive branch of government would raise economic growth via increased prevalence of 'syndrome-free' regimes; (3) in more democratic regimes, there is less corruption, but greater risk of conflict, from resource rents; (4) Nigeria represents a good illustrative case of the potentially corrosive nature of resource rents, with the policy implication that distributing the rents to the public might provide a solution to the resource-curse problem; and (5) while employment protection regulation does not appear consequential, greater difficulty in doing business results in less job growth in African manufacturing in the long term.

JEL classification: O11, O13, O15, O43, O55

1. Introduction

Understanding the role of institutions in fostering growth and development is important for all economies, but critical for developing countries where such institutions are often embryonic and the development challenge quite daunting. Nor has the requisite nature of such institutions been non-controversial historically. It is with this challenge in view that the current

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special issue ‘Institutions and African Economies’ has been produced. It contains the following articles: (1) The new institutionalism and Africa; (2) Growth of African economies: productivity, policy syndromes and the importance of institutions; (3) Resource rents, democracy, corruption and conflict: evidence from sub-Saharan Africa; (4) Addressing the natural resource curse: an illustration from Nigeria; and (5) Institutions and job growth in African manufacturing: does employment protection regulation matter?

2. New institutionalism and Africa

Since Douglass North’s seminal work on the importance of institutions for economic performance (North, 1990), ‘new institutionalism’ (NI) has increasingly gained currency in the economic literature (see, e.g., Rodrik *et al.*, 2004). But does NI hold for African economies?

To answer the above question, Bates *et al.* (2013) explore the relationship between political institutions and economic performance, at both the macro- and micro-levels. At the macro-level, they find that political reform Granger-causes per capita GDP growth for the African subset of global data, though not for the global sample. At the micro-level, moreover, they find that changes in national political institutions towards greater democracy in Africa are strongly associated with increases in total factor productivity (TFP) in agriculture. That Africa’s electorate is largely rural further suggests that the movement to majoritarian institutions has served to attenuate the ‘Batesian’ urban-bias policies of the past where governments pursued policies favouring (urban) consumers at the expense of the (rural) producers of agricultural products (Bates, 1981). The current evidence is, therefore, consistent with NI that the structure of political institutions influences the performance of economies, and that Africa’s shift towards greater degree of democracy has paid off in terms of improved economic outcomes.

The democracy–growth relationship may, however, be non-linear. As Fosu (2008), for example, finds for African economies, the initial transition to democracy can be fraught with risks of political disorder for instance, and may be growth-inhibiting. It is only when African countries have reached ‘advanced-level democracy’ that we can expect increasing democratisation to be growth-enhancing (Fosu, 2008).¹ If so, then how do countries overcome such risks during the transition process?

¹ Fosu (2008) estimates the threshold to ‘advanced-level democracy’ as at least 4.4 of the measure of either executive or legislative index of electoral competitiveness (1–7 range).

3. African economic growth: productivity, policy syndromes and institutions

Previous studies found that the main drag on Africa's economic growth generally in the 1980s was low productivity, rather than weak levels of investment *per se* (Devarajan *et al.*, 2001, 2003). This view is corroborated by the current finding, based on an extended sample period, that TFP has been the main source of explanation for the growth of African economies (Fosu, 2013). Not only was TFP responsible for the low growth in the 1980s and early 1990s, but also for the growth resurgence in the latter part of the 1990s.

Furthermore, 'policy syndromes' could provide a plausible explanation for the poor growth, with TFP as the most likely channel (Fosu, 2013).² Holding the executive branch of government in check might, moreover, constitute an effective antidote to the policy syndromes. Indeed, executive constraint (XCONST) could mitigate the potentially adverse effect of ethnicity on economic growth via limiting the likelihood of these policy syndromes (Fosu, 2013). Since extreme constraints on the executive might not be growth-enhancing, however, the challenge then is to seek and attain the optimal level of XCONST.

4. Resource rents, democracy, corruption and conflict

Resource rents have now become a curse for many African economies. Underlying the Prebisch–Singer hypothesis was the need to ensure that primary-product exporters would not suffer long-term deterioration in their terms of trade (TOT). Yet, under the 'resource curse' syndrome, improvements in TOT that led to greater rents would reduce economic growth, thus undermining the import of the Prebisch–Singer hypothesis. A higher level of institutional quality could, however, attenuate the risk of the resource curse (Mehlum *et al.*, 2006).

Arezki and Gylfason (2013) examine the impact of the interaction between resource rents and democracy on corruption for a panel of African economies. They find that larger resource rents lead to more corruption, but that the effect is lower for more democratic countries. Thus, greater

² By 'policy syndromes' it is meant: 'state controls', 'adverse redistribution', 'sub-optimal inter-temporal allocation' and 'state breakdown'. Details of the 'policy syndromes' taxonomy are presented in the two volumes, Ndulu *et al.* (2008a, b), which represent the main published output of the 'Explaining African Economic Growth' project (Growth Project) of the African Economic Research Consortium (AERC). For an epitomised version, see Fosu and O'Connell (2006).

democratisation might provide an avenue for reducing the level of corruption and for channelling resources into more productive projects for improving growth and development in the region.

Arezki and Gylfason find additionally that the likelihood of conflict is higher for more democratic countries. This finding seems to contradict results in the extant literature that the risk of ethnic conflicts is attenuated by greater democracy (e.g., Collier, 2000). However, Arezki and Gylfason further observe that less democratic governments are more likely to redistribute a portion of the resource rent to the public in order to quell the masses. If so, then democratic governments would do well to adopt a similar strategy by redistributing a part of the resource rents in order to buy peace,³ if the long-term objective of maximising social welfare is to be achieved.

5. Addressing the natural resource curse: an illustration from Nigeria

Nigeria presents a good illustration of the resource-curse challenge. Despite the huge rents that have flowed from oil over the last 50 years, there has been little economic development; instead these rents have served to undermine the quality of institutions and to lower growth (Sala-i-Martin and Subramanian, 2013). Indeed, the long-run effect of improved barter TOT on GDP growth has been negative in Nigeria (Fosu, 2011).

Although higher quality institutions could lower the risk of the resource curse, institutions themselves can be corroded by resource rents. For instance, countries with large oil deposits become less democratic with time (Ross, 2001), and politicians tend to undermine institutional rules in countries where substantial public revenues emanate from natural resources (Collier and Hoeffler, 2009). Hence, attaining the requisite institutional structure for minimising the risk of the curse might be rendered infeasible by these rents, to begin with. A potential solution to such a quandary, then, is to reduce the rents in the hands of government authorities. It is such a solution that is prescribed by Sala-i-Martin and Subramanian, using Nigeria as an illustrative study. They propose directly distributing all the oil revenues to the public.

The above Sala-i-Martin and Subramanian proposal seems theoretically sound, especially if the implied subsequent taxation meant that politicians were now subjected to significant accountability towards taxpayers.

³ For an exposition of how redistribution can buy peace in African economies, see, for instance, Azam (1995).

Besides, these political agents could no longer use the rent for buying votes to undermine the democratic process. The proof of the proposal's efficacy, though, would lie in the implementation process. Would politicians agree, or be sufficiently compelled, to surrender the authority derived from controlling the oil revenues? That seems quite unlikely. An alternative and perhaps more feasible solution might entail strengthening the process of democratisation (Fosu, 2011), given that a more democratic institution would exhibit less corruption from the resource rent (Arezki and Gylfason, 2013).

Indeed, Nigeria has since about 2000 become more democratic, with improvements in the executive and legislative indexes of electoral competitiveness as well as in XCONST (Fosu, 2011, Table 1). Since 1998, furthermore, there have been improvements in various measures of institutional quality, especially in 'voice and accountability'. Changes in 'government effectiveness', 'regulatory quality', 'rule of law' and 'control of corruption', although not statistically significant, have also all been in the right direction (Fosu, 2011, Table 6). Such institutional improvements bode well for addressing the oil resource-curse problem, provided the momentum can be maintained. Unfortunately, though, the country's 'political stability and absence of violence' has deteriorated significantly since 1998 (Fosu, 2011, Table 6), consistent with the above observation that greater democracy may be associated with a higher risk of conflict (Arezki and Gylfason, 2013).

6. Institutions and job growth in African manufacturing

Low 'effective' employment is a particularly vexing problem in African countries.⁴ Unfortunately, unlike other developing countries, the transformation of the economy away from agriculture in African economies has not brought with it significant transfers of labour into more productive sectors. Instead, labour emigration from agriculture has been associated with productivity stagnation (Thorbecke, 2013). Meanwhile, the manufacturing sector, which has historically constituted the main basis for structural transformation around the world, has constituted a relatively miniscule feature in the region's economies.

But as African countries strive to improve the manufacturing sector, what are the implications for employment? Manufacturing firms have indeed evinced strong employment growth in recent years, though from a low

⁴ By 'effective' employment, I mean employment with a liveable wage. In some sense, this definition is similar to the ILO's of 'decent' work, though this latter term includes other job characteristic beyond a liveable wage.

base (Fox and Oviedo, 2013). What has been the role of institutions, especially employment protection regulation (EPR), in this growth? Fox and Oviedo explore this question using recent data for twenty African countries. EPR has been found to be, on balance, detrimental to employment growth in the OECD and other regions of the world. For African economies, however, Fox and Oviedo find that the effect of EPR is non-existent in the short run, while the evidence for a possible adverse effect in the longer run is weak. Instead, they uncover that it is the overall regulations of doing business that are consequential. While greater difficulty in doing business in a country does not seem to matter in the short term, in the longer term it tends to significantly limit manufacturing employment growth.

7. Conclusion

The current special issue presents ample evidence in support of the view that institutions indeed matter for African economies. The recent transformation in many African countries towards greater democratic dispensation seems to have paid dividends in terms of increasing growth in both agriculture and the general economy. This evidence is consistent with the predictions of NI. However, the extant literature also suggests that the relationship is non-linear, with the likelihood of decreasing growth at the initial stages of the transition. Therefore, there is the need to design and implement policies for minimising such risks.

Additional evidence supports the view that Africa's economic growth record has essentially been productivity-driven, with TFP deterioration explaining much of the growth troughs and improvements in TFP accounting for growth resurgence. Furthermore, anti-growth policy syndromes characterising the policies of many African countries have been blamed for the historically dismal growth of these economies. A potential antidote to the syndromes appears to be an institutional structure that effectively limits the power of the executive branch of government. Thus, it behooves stakeholders of African development to ensure the design and enforcement of mechanisms intended for limiting the overwhelming power of the executive that prevails across the region.

A large number of African economies are dependent on natural resource rents for development. More recently, Africa generally has embarked on democratisation. Thus the current evidence that more democratic regimes are less prone to the corruption induced by resource rents is good news. However, it also appears that less democratic countries are better able to reduce the risk of conflict, presumably by employing a part of the rent to quell potential

fomenters of conflict. If so, then there is an imperative for resource-rich African democracies to provide for special provisions that will ensure that there is sufficient redistribution to buy peace for the longer term.

A potential solution to the resource-curse problem, strongly recommended by Sala-i-Martin and Subramanian, is to distribute all the resource rents to the public. This recommendation is conceptually appealing; however, its implementation seems impractical. That Nigeria has recently begun to evince signs of increasing democratisation, coupled with the above finding that more democratic countries tend to be less susceptible to corruption from resource rents, suggests that the most practical solution is to deepen democratic consolidation in Nigeria. We must, however, also guard against the potentiality of increasing the risk of conflict that could arise from the democratisation process. Of course, the Nigeria case is only illustrative; it is likely to be applicable to many of the resource-rich countries across the continent.

As African countries strive to expand the manufacturing sector, what institutional arrangements would foster robust job growth for the sector? In particular, does EPR matter? EPR apparently does not matter in the short term, and the evidence for its adverse long-term impact is weak. What seems to matter, though, is the overall regulatory environment governing the difficulty of doing business, which tends to adversely affect job growth, especially in the long term. African governments should, therefore, take note and invest in further reforming the regulatory environment of doing business, that is, if the employment challenge is to be met head-on.

Note

Except for the introduction written by the guest editor(s), all the papers included in this special issue were subjected to a normal refereeing process.

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