

Solving the Mystery of African Governance

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Introduction

There is a wide consensus in academic and policy circles on the idea that good governance is a prerequisite to sustained growth and economic development. Starting with North (1990) and Shleifer and Vishny (1993), many researchers have argued that the economic performance of nations can be severely hampered by malfunctioning government institutions that reduce incentives and opportunities to invest and innovate. Yet, good governance is difficult to define rigorously and in a way that commands universal acceptance.

Good governance generally ‘relates to political and institutional processes and outcomes that are deemed necessary to achieve the goals of development [...] the process whereby public institutions conduct public affairs, manage public resources and guarantee the realization of human rights in a manner essentially free of abuse and corruption, and with due regard for the rule of law.’ (United Nations 2007, p. 1) The World Bank has defined good governance as ‘predictable, open and enlightened policy making; a bureaucracy imbued with professional ethos; and executive arm of government accountable for its actions; and a strong civil society participating in public affairs; and all behaving under the rule of law.’ (1994, p. vii). Empirical research has attempted to measure good governance and quantify perceptions of progress toward its goals. Perhaps the most authoritative and rigorous approach is that of the Worldwide Governance Indicators (WGI) project, which is based on perception surveys. It attempts to capture the evolution of governance along six dimensions: voice and accountability; political stability and absence of violence; government effectiveness; regulatory quality; rule of law; and control of corruption. It defines governance as consisting of ‘the traditions and institutions by which authority in a country is exercised. This includes the process by which governments are selected, monitored and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the

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institutions that govern economic and social interactions among them.² But despite its comprehensiveness, even the WBI approach does not address the theoretical difficulties of identifying the elements of governance in a consistent manner across countries, institutional settings, political contexts, cultures of power, and administrative structures. Neither does it provide a blueprint for the operationalization of good governance.

The dominant view of good governance as a pre-condition for economic success is therefore misguided. By focusing on the search for the determinants of some global governance standards that often reflect particular political, ideological and philosophical conceptions of power, the traditional literature on governance has so far yielded few results: it has failed to offer a set of actionable policies that poor countries could implement to foster inclusive growth in a pragmatic and incentives-compatible way. This paper acknowledges that governance problems are indeed major impediments to economic growth. But contrary to conventional wisdom, it argues that they are often correlated with the level of economic development. Seen from that perspective, the well-known governance problems in African countries and many developing countries today are mainly the reflection of their low level of development, and the results of failed state interventions and distortions originating from erroneous economic development strategies.

The remainder of the paper is organized as follows: Section 2 highlights the conflicting conclusions from various waves of research on the main pillar of good governance, which is generally seen to be a situation of low levels of corruption. Section 3 highlights the correlation between economic development and institutional development, and suggests a change in the approach to the fight against 'bad' governance. Instead of posing 'good' governance as the main prescription and a prerequisite for sustained growth in African countries, development economists should design policy frameworks that offer the maximum likelihood of success because they are consistent with comparative advantage while providing minimum opportunities for rent-seeking and state capture. The dynamic development of competitive firms and industries eventually leads to institutional development.

The elusive quest for governance

² See <http://info.worldbank.org/governance/wgi/index.asp>.

Since the United Nations Commission on Human Rights identified transparency, responsibility, accountability, participation, and responsiveness to the needs of the people as key attributes of good governance (Resolution 2000/64), the fight against corruption has become the most revealing and the most widely discussed aspect of governance. However, the academic pendulum on the subject has shifted from praising the economic efficiency effects of corruption to stressing its many economic, sociopolitical, and even moral costs to societies.

Initial theoretical work on corruption underlined its positive role in the development process. Renowned scholars such as Leff (1964) and Huntington (1968) argued that corruption may allow businessmen to be more efficient by allowing them to circumvent bureaucratic procedures and therefore avoid the burdening effects of red tape. Similar arguments were made in subsequent studies: Lui (1985) developed an equilibrium-queueing model to show that corruption allows the queue to be reorganized in a way that leads to an efficient allocation of time, giving those for whom time is most valuable the opportunity to move to the front of the line. The same efficiency argument can be found in Lien (1986), who even suggested that corruption actually helps ensure that contracts are awarded to the most efficient firms, those that stand to gain the most from the payment of bribes.

A second strand of the literature has attempted to invalidate these previous analyses, arguing for instance that beyond possible changes in the order in the queue, bribes may actually allow civil servants to reduce the speed with which they process business transactions in the queue (Myrdal 1968), or that bureaucratic procedures should not be seen only as causes of rent-seeking activities but as their consequences (Tanzi 1998). Boycko et al. (1995) also stressed the higher degree of uncertainty and costs due to enforceability problems created by corruption. Others have argued that even taking at face value the suggestion that the most able economic agents in corrupt societies are also engaged in and benefit from rent-seeking activities, such reallocation of talent cannot be economically efficient. Rose-Ackerman (1975) for instance observed that, once corruption is entrenched, it becomes so pervasive that it cannot be limited to areas in which it might be economically 'desirable.'

A third and most recent strand of research has focused on the negative effects of corruption (and bad governance more generally) on economic growth. Murphy et al. (1993) suggested that increasing returns on rent-seeking may eventually crowd out productive investment. Romer (1994) made a similar point, emphasizing the idea that corruption imposes a tax on ex post profits, which

may reduce the flow of new goods and technology. Mauro (1995) offered some empirical evidence that the prevalence of perceived corruption may negatively affect economic performance and pioneered econometric work on the subject. His conclusions were confirmed by Keefer and Knack (1997) and Poirson (1998), who also observed that corruption significantly reduces economic growth rates. Such problems are said to be even worse in natural resource rich countries—especially those in Sub-Saharan Africa—where opportunities for rent-seeking activities are typically very high.

Despite the insights from all these various waves of research, the problems of corruption and governance and their implications for economic development remain unresolved. Empirical demonstrations of the impact of governance on economic growth are often based on subjective perception indices, the limitations of which are well known. Policy makers in African countries still have few actionable prescriptions on how to design policies to achieve their economic and governance goals. Moreover, a traditional recommendation for improving governance often involves curbing the power of political leaders—some of whom are not democratically selected. Yet the social sciences literature does not provide an incentives-compatible mechanism for political leaders to improve governance and eliminate corruption. For African countries, a potentially more fruitful approach to tackling the problem would be to examine the possible determinants of good governance, and infer from there which policies would limit the opportunities for rent-seeking while contributing to the realization of political leaders' personal goals.

An incentives-compatible policy framework for governance

Most studies on the determinants of 'good' governance go back to arguments similar to those made by either Becker (1968) or Krueger (1974). The former analyzed corruption first and foremost as a purely illegal activity and suggested that criminal offenses must be viewed as 'economic activities' with external effects and punishment conceived as a form of taxation. From that general framework, he conjectured that the probability of committing a crime depends essentially on the penalty imposed and on the probability of being caught. Furthermore, the deterrent value of the penalty depends on the willingness and capacity of the authorities to enforce laws and regulation, and also on people's level of acceptance of the country's institutions. This implies that effective corruption enforcement rules and good governance in general can only take place in country environments with political stability and transparency of rules.

In Becker's insightful analysis, corrupt agents expend resources to steal and society, the victim, is said to experience negative external effects. Using the Pigouvian solution to negative externalities—which is to introduce fees or taxes on the externality-generating activity—he suggests that prohibition rules combined with fines or other punishment constitute such a fee system.

Unfortunately, that kind of after-the-fact remedy to corruption may arrive too late. Or it may be ineffective in countries where the externality-generating activities (i.e., corruption) are not easy to identify due to prevailing social norms and practices; or they may be costly to curb. In almost all poor countries, the costs of running a well-staffed, well-equipped and well-functioning national judicial system are often well beyond what the public sector can afford. The problem is compounded in many African countries where corruption is embedded in societal, economic and power relations (Monga 1996) and virtually all state institutions, including the judicial system, are caught in the low-equilibrium dynamics of what Joseph (1998) called 'prebendal politics'.

However, 'corruption isn't just something that happens to poor countries' (Glaeser and Saks 2004: 1). Christian Wulff, the President of Germany resigned after prosecutors asked the parliament to strip him of his immunity while they investigated allegations of financial impropriety. The former French President Jacques Chirac was found guilty of corruption and given a two-year suspended prison sentence for diverting public funds and abusing public trust. In Japan – a non-Western, high-income country with old democratic traditions – many high-ranking government officials have been forced out of office throughout the postwar period amid corruption scandals (Mitchell 1996). The problem has extended well beyond the political sphere and into a bureaucracy often considered one of the better managed in the world (Johnson 2001).

An important difference between high-income and low-income countries is the fact that institutions generally work in the former and officials caught violating the laws are systematically prosecuted by a relatively independent judiciary. However, looking at corruption in historical perspective, it appears that today's high-income countries also went through the same—or even worse—episodes of bad governance that can now be observed in Sub-Saharan Africa. A good example is that of the United States. According to Glaeser and Goldin (2006): 'Conventional histories of nineteenth and early twentieth century America portray its corrupt elements as similar, and at times equal, to those found in many of today's modern transition economies and developing regions. Nineteenth-century American urban governments vastly overpaid for basic services, such as street cleaning and

construction, in exchange for kickbacks garnered by elected officials. Governments gave away public services for nominal official fees and healthy bribes.'

Figure 1: Governance and Economic Performance, 2010

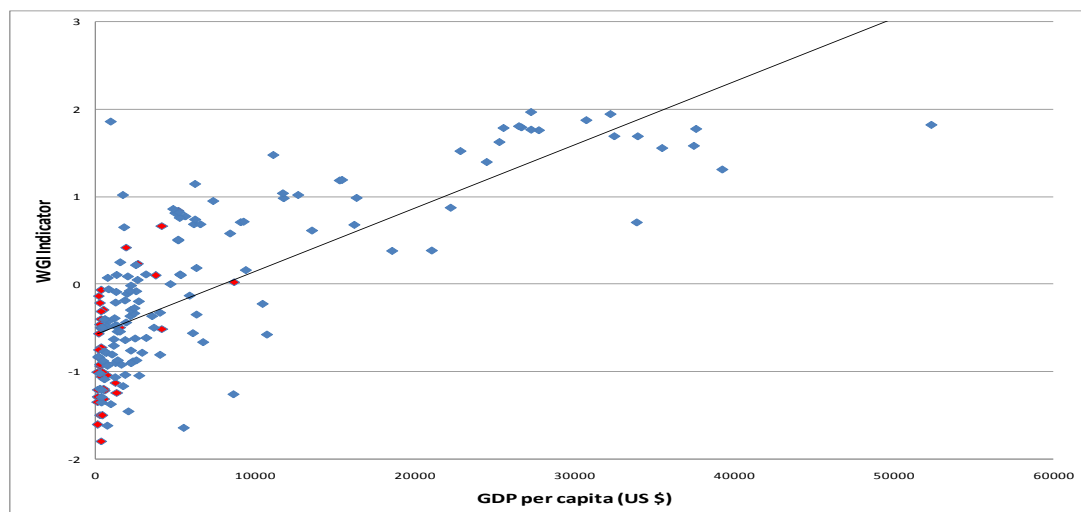


Figure 1 plots WGI indicators in 2010 against GDP per capita for a large selection of countries (with African countries in red dots). It shows a clear correlation between the two variables. However, the observation that the generally low quality of governance in Sub-Saharan African countries (at least as measured by available perception indicators) is not correlated to their level of economic development may be a first step in solving an apparent mystery. If that is the case, then what is crucially needed to fight corruption and improve governance in low-income countries is a development strategy that offers few opportunities for state capture and rent-seeking activities. In other words, the main solution to corruption is to create a policy environment where there are few opportunities and gains for such externality-generating activities.

Following the type of policy-oriented approach suggested by Krueger (1974), the empirical literature has identified the following factors as the main causes of corruption: (i) trade restrictions, which make the necessary import licenses very valuable and encourage importers to consider bribing the officials who control their issue; (ii) poorly targeted government subsidies that are appropriated by firms for which they are not intended; (iii) price controls, whose purpose is to lower the prices of some goods below market value (usually for social or political reasons) but create incentives for individuals or groups to bribe officials to maintain the flow of such goods or to acquire an unfair share at the below-market price; (iv) multiple exchange rate practices and foreign exchange allocation schemes—differentials among these rates often lead to attempts to obtain the most

advantageous rate, although that rate might not apply to the intended use of the exchange, and multiple exchange rate systems are often associated with anti-competitive banking systems in which a particular bank with strong political ties makes large profits by arbitraging between markets; (v) low wages in the civil service relative to wages in the private sector, which often lead civil servants to use their positions to collect bribes as a way of making ends meet, particularly when the expected cost of being caught is low; (vi) natural resource endowments; and (vii) sociological factors such as ethnolinguistic fractionalization (Mauro 1997).

Given that virtually all governments in the world—including those in successful, democratic countries—regularly intervene in their economies and set various types of regulations, the important question is to understand which particular policy circumstances provide the best incentives for good governance. New Structural Economics (NSE) attempts to articulate such an approach (Lin 2012). Leaving aside the last two factors identified by Krueger, the NSE specifically recommends policies and safeguards to ensure that the essential responsibilities of any state be carried out in a way that mitigates such risks of state capture and rent-seeking. It suggests the lifting of trade restrictions, price controls, and multiple exchange rates. It advocates carefully targeted incentives (of limited amount and time), which are allocated in a transparent manner to compensate for the externality generated by pioneer firms—even in industries that are consistent with comparative advantage. Such a framework ensures that the opportunities for corruption are minimal. It only favors government interventions in industries where firms are viable in open, competitive markets, and their investment and survival do not depend on protection, large budgetary subsidies, or direct resource allocations through measures such as monopoly rent, high tariffs, quota restrictions, or subsidized credits. In the absence of large rents embedded in public policies, there will not be distortions that easily become the targets of political capture. The likelihood of the pervasive governance problems observed in many African countries would be much reduced by government facilitating the development of new industries that are consistent with the country's changing comparative advantage determined by the change in its endowment structure.

The goals of the political leaders in Africa and elsewhere are typically to stay in power as long as possible and to have a good legacy in history if their staying in power is not under threat. Most of them understand that promoting economic prosperity in a good governance environment is the best way to achieve these goals. Development policy based on the NSE can reduce the opportunity for corruption and bring dynamic growth in a country. Therefore, it is an incentives-compatible way for

political leaders in developing countries, including those in Africa, to address challenging governance issues.

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