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Strong Institutions Support Market Oriented Policies

Successful implementation of policy depends on three connected facets of public institutions: interest groups, the state's representative and bureaucratic structures, and political leadership. This policy brief is based on research* that reviews problems of change in African economic policy and assesses institutional quality.

Sub–Saharan Africa (SSA) is the world's poorest and most politically fragile region. In recent years, African governments have attempted to liberalize and restructure their economic and political systems but with some difficulties. Reforms can succeed only when effective institutions exist to support them. In 1998, through the EAGER Project, USAID sponsored a study to assess institutional quality and to review how institutions have stifled change in African economic policy.

SSA governments often engage in activities they should not pursue, or fail to engage in activities they should pursue. In the 1980s, international financial institutions such as the World Bank and the International Monetary Fund believed that African governments could improve government performance by implementing a reform strategy known as structural adjustment. Structural adjustment calls for reducing the scale of government, increasing the role of markets, and integrating domestic and global economies. International donors promise funding as long as governments adopt prescribed market-oriented policies. However, by accepting structural adjustment loans, African governments have grown dependent on development assistance. Assessments by the World Bank reveal that few African countries have experienced success with structural adjustment. Even if leaders possess the political will to implement austerity measures, reforms often fail because the administrative capacity of the state is too weak to support them.

It is now clear that much of Africa's economic difficulty is due not only to mistakes made by governments but the failure of governments to take on responsibilities. Creating effective markets requires more than removing barriers to trade so prices will obey the law of supply and demand. Markets cannot exist without institutions that support buying and selling, and savings and investment. Institutions are stable, recurring patterns of behavior that determine the policies that are accepted and the way that these

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policies are executed. In Africa, many public institutions whose stated purpose is to provide public goods actually funnel public resources for private use. The successful implementation of policy depends on three connected facets of public institutions: interest groups, the state's representative and bureaucratic structures, and political leadership.

Interest Groups

An interest group is an association of like-minded people who band together to press a specific issue, usually one that promotes the group's own material well being. While economic growth benefits society as a whole, specific policies cause incomes to rise for some groups and to fall for others. Groups that expect harm from a policy tend to mobilize to protect themselves by either stopping or crippling legislation supporting such policy. However, groups that stand to benefit from market-oriented policies rarely mobilize to support policy implementation. The reason is that groups feel actual losses more acutely than potential gains. Furthermore, individuals tend to discount the benefit of a proposed change as too small, too uncertain, or too distant to be worthwhile. With economic liberalization, losing groups tend to be merchants and industrialists with access to rationed foreign exchange, public employees whose salaries depend on deficit spending, and the urban poor who rely on social welfare programs. Winners are often agricultural producers, for whom the terms of trade improve upon the removal of controls.

Liberalization is frequently against the interests of the dominant political coalition in a country. By issuing licenses, quotas, and other privileges to friends and followers, government officials create economic rents that they use to remain in power. Well-placed political actors contribute to the state's rent-seeking behavior by lobbying or paying bribes to safeguard their privileges. Such patronage constitutes a dilemma in SSA governments by creating a basis for political power but simultaneously undermining the capacity of the economy to continue generating rents. While liberalizing the economy promises to correct budget deficits and recession, it cannot do so without eliminating some opportunities for rent-seeking. The result is that, to stay in power, African governments often concede the minimum amount of reform to receive funds from international donors while simultaneously preserving the status quo in order to remain in power.

Sometimes, however, coalitions do emerge that seek broader collective interests that can break the logjam. There may be a "reform bargain" or deal among political leaders, technocratic civil servants, and private economic actors who agree to experiment with liberalization even in the face of opposition. The issue is why these particular outcomes are not more common. What is it about African countries that causes them to have such difficulty breaking through the existing political and economic impasse? The character of African state institutions is part of the explanation.

The State's Institutions

African political systems are "soft states," or systems that defer or reverse controversial policy decisions. In soft states, both citizens and leaders ignore government edicts since policy outcomes differ from policy intent. State softness is often attributed to political illegitimacy and instability, but those explanations are less than convincing for Africa. While deep and fragmented ethnic divisions do characterize African countries, violent changes in political regimes occur no more often in Africa than in other developing regions of the world. Furthermore, the average chief executive in Africa has a longer term in office than does the average ruler in Asia or Latin America. Lack of legitimacy and stability are problematic in other regions, and therefore fail to explain why Africa's governments are markedly less successful on average at managing their economies. However, there are additional differences in African states' institutions, both representative and bureaucratic, that are salient.

• **Representation.** Economic liberalization is more successful in democracies than in dictatorships. Since the late 1980s, the international financial institutions have imposed "good governance" requirements on their structural adjustment loans. Good governance consists of a pluralistic polity limited by the rule of law and administered by an impartial, professional bureaucracy. Democracy and a market-oriented economy are linked because liberal economic reforms facilitate multiparty competition. At the same time, political opposition and participation create pressure for economic growth, which in turn produces a stronger social base for democracy.

Approximately half of Africa's states are emerging democracies. However, democratization in Africa is centralized and occurs from the top down, with political participation rarely extending outside the capital city. In addition, peaceful transfers of power through elections rarely occur in Africa. Although international donors make democratic reform a condition of aid, the political systems of many African countries remain oligarchies where private sector organizations are closely linked to high-ranking officials.

• **Bureaucratic Capacity.** Africa's bureaucratic capacity is ineffective because civil servants pursue some activities opposed by political leaders and fail to pursue other activities supported by leaders. Many factors contribute to the unproductiveness of African bureaucracies. The centralized, hierarchical structures imposed by colonial powers left public administrators with a tradition of legalistic and unresponsive practices. Bureaucrats tend to be conservative when change threatens established power structures and demands the mastery of new tasks. In addition, the civil service in African countries acts as an informal network of alliances based on personal, family, and ethnic loyalties. Finally, the bureaucracies themselves are too undisciplined to implement policies precisely.

Because SSA administrations are technically and managerially weak, policy reforms need to be modest in scope and speed of implementation. Supporters of "shock therapy" believe that rapid change gives losing groups limited time to mobilize resistance, creates a sufficiently large impact to change the behavior of public and private actors, and minimizes the likelihood of reversal by creating a self-reinforcing aura of credibility. When applied to weak administrations, however, shock therapy may actually undermine the institutions it is trying to remold. Proponents of incremental reform, on the other hand, suggest that bureaucracies gain experience and confidence by first tackling easily solved problems. They believe that demonstrated success will build support for higher-profile and strategically important reforms in the future.

The Role of Leadership

An essential requirement for sustainability of a reform program is "policy ownership" by political leaders. When national leadership is committed to reform, they are less likely to reverse reform in the future. However, leaders are committed first and foremost to their supporters. Broadening the scope of participation assures international donors that African leaders will not sacrifice economic reforms to protect their political allies.

Corrupt leaders threaten the success of

economic liberalization. Political corruption is the abuse of public power for private ends. The three forms of corruption are embezzlement or theft of state funds, bribery or the demand for political payments in exchange for a favorable decision, and nepotism or the placement of family members or other supporters into important positions. Corruption often reaches excessive proportions in Africa and permeates all levels of government. High-level officials, such as Mobutu in Zaire, bankrupt their states in order to amass large personal fortunes while minor functionaries demand "speed money" to do their jobs or accept gratuities to overlook rule infringements. The international financial institutions recognize that eliminating high-level corruption is an important factor in creating democracy. However, local commitment to rid the political system of petty corruption is also necessary.

Conclusion

While more private investment and greater competition have proven to be useful approaches to the generation of income and wealth around the world, investment will not grow and living standards will not rise without a market-enhancing institutional environment. African countries have a weak base of public institutions because leaders are often predatory, bureaucracies are poorly managed, and neither is beholden to the electorate's demands. Although institutions evolve slowly and elites strive to preserve the status quo, government failures in Africa can be reversed by including more diverse interests in policy decisions and electing leaders who can spearhead institutional innovations. Until SSA institutions are stronger and more capable, market liberalization will not achieve its theoretical promise.

***This policy brief is based on EAGER Discussion Paper Number 7, *Institutions and Economic Growth in Africa*, 1998, by Arthur Goldsmith [agoldsmi@hiid.harvard.edu], Harvard Institute for International Development, Cambridge, Massachusetts; University of Massachusetts, Boston, Massachusetts.**

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