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Comparative analysis of the government's role in East Asia and Sub-Saharan Africa since 1960

by
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This thesis was written as a part of themaster program. Neither the institution, the advisor, nor the sensors are - through the approval of this thesis - responsible for neither the theories and methods used, nor results and conclusions drawn in this work.

Abstract

This thesis looks at the differences in economic growth between Sub-Saharan Africa and East Asia in the time period from 1960 until today. Three major causes are assessed which all are attempted linked to the government's role; i) Structural causes; ii) Economic policy; and iii) Institutional causes. The main results indicate that Sub-Saharan Africa suffered from worse structural effects than East Asia; and that East Asia had a more favourable institutional environment. The role of economic policies remains controversial and partly unresolved, which goes especially for the role of industrial and trade policies. My main findings confirm those by a number of scholars; i) A high state capacity promoted economic growth through economic policies and institutional innovations in East Asia; and ii) Sub-Saharan Africa had a low state capacity which hampered economic growth and the state capacity was weakened even further due to increased donor involvement.

Preference

The work with this thesis has been, up until now, been the most challenging, fascinating and rewarding piece of paper I have written. At times it has been daunting to attempt to cope with such an open and large topic with so many potential pitfalls. Early in my work I had to assess which factors were more important and worth emphasising. It goes without saying that certain aspects were fascinating, but had to be dropped either due to the lack of time or due to the lack of literature. Two such factors were regional trade and cultural aspects. Apart from some factors that have been dropped, I believe so many relevant factors were assessed that a meaningful assessment could be made.

Economic growth is such a wide topic and comparing it becomes difficult not least due to the fact that scholars opinions differ so much regarding the causes of economic growth. I attempted to have a more neutral view on the debate and attempted to the best of my abilities to assess the evidence I was faced with. Of course, not everyone will agree with my conclusions. I believe that my reliance on secondary sources, and not conducting research on more primary data, is the main weaknesses of this thesis. It is more an assessment of the wide literature available rather than a field research. Thereby I become dependent on the judgement of scholars who have written the books and articles I assess. Another weakness of the thesis is its generalising nature, the countries analysed within each region are so different that it at times not gives a balanced picture. I would defend the generalising on the basis that it is the regional wide differences that are most interesting when conducting a regional comparison.

Personally, I believe that the strength of this thesis for those reading it would be the multitude of causes covered and the complexity of assessing their joint effects. Some aspects are more traditional in an economic analysis, for instance assessing the role of trade policies; others are more uncommon like assessing the role of social embeddedness. Taken all together I think the thesis gives a overview of the complexities of assessing economic growth and how controversial the role of the state continues to be in economic debates. The common perception has been that the state promoted economic growth in East Asia and retarded growth in Africa. I found that the picture is far more nuanced on both sides.

Table of contents

Introduction *5*

Chapter 1 – Structural effects *18*
1.1 Geography and demography 18
1.1.1 Climatic effects 18
1.1.2 Transportation and urbanisation 22
1.1.3 Demography 24
1.2 Other structural causes 27
1.2.1 History 27
1.2.2 Ethnic fragmentation 32
1.2.3 Primary goods dependence 35
1.3 Political aspects 38
1.3.1 Geography versus policies? 38
1.3.2 Political environment 39

Chapter 2 – Economic Policy *45*
2.1 Macroeconomic policy 54
2.2 Industrial policy 58
2.2.1 Financial system 59
2.2.2 Learning and technology 77
2.2.3 Coordinating economic policy 102
2.3 Trade policy 113
2.3.1 Home market-led development 114
2.3.2 – Export led development 119

Chapter 3 – Institutions *126*
3.1 State capacity 130
3.1.1 External influence 133
3.1.2 Internal capacity 139
3.1.3 Internal influence 145
3.2 Social Embeddedness 152
3.2.1 Conflict management 153
3.2.2 Legitimacy 162

Conclusion *169*

Introduction

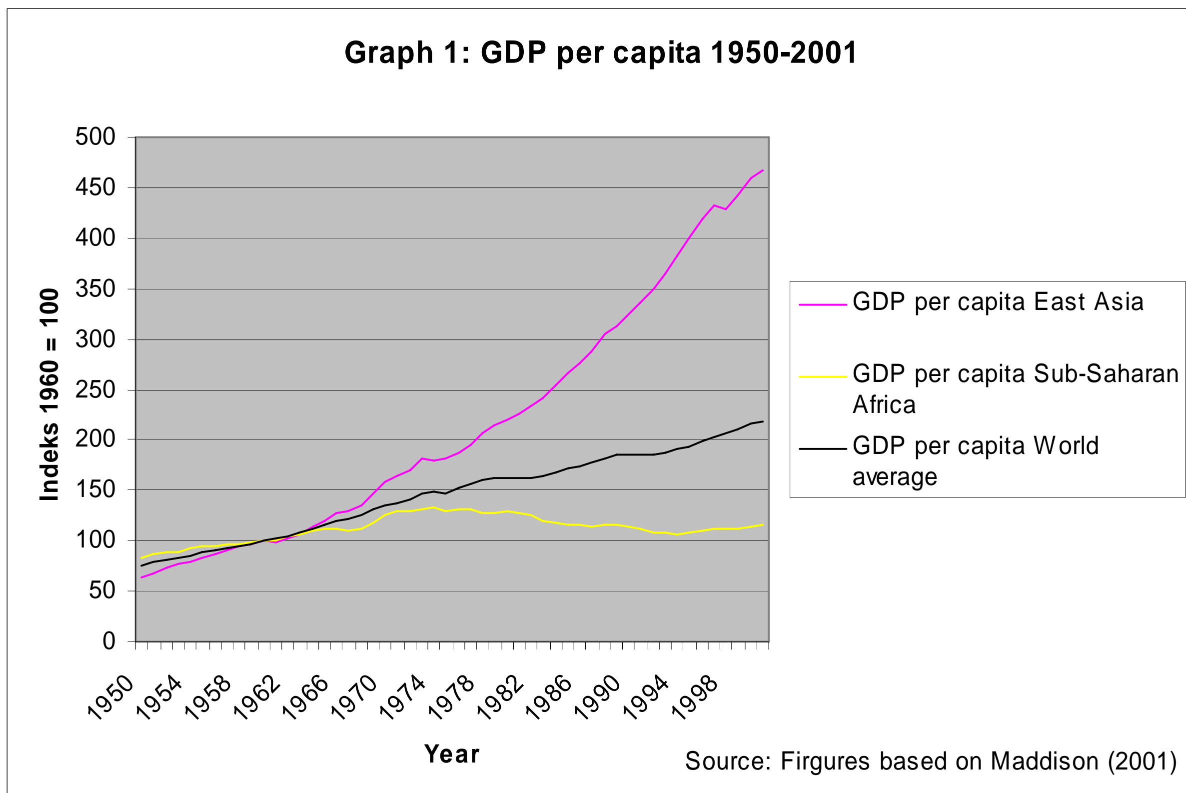
One of the most daunting questions in economic history is why some countries are rich and others poor. There are a number of reasons for why a comparison of East Asia and Sub-Saharan Africa (henceforth Africa) is a good basis for a discussion of this question.[1] Firstly, and most obviously, for the time period from 1960 to today it's the group of countries with the "*best*" economic performance compared with the group of countries with the "*worst*" economic performance, see graph 1 for an illustration. Secondly, as shown in table 1, measured by GDP per capita (PPP) the income levels were virtually the same in 1960; as a

Table 1 - GDP per capita (PPP 1990 International Geary-Khamis dollars)

	1950	1960	1973	1980	1990	1995	2001
Sub-Saharan Africa in total	***836***	***1067***	***1310***	***1289***	***1150***	***1077***	***1118***
Botswana	349	403	1119	1783	3187	3359	4552
Congo DR	570	755	836	617	525	290	202
Ethiopia*	390	439	626	642	581	550	660
Kenya	651	726	961	1028	1090	1029	1016
Nigeria	753	854	1497	1402	1161	1068	1157
South Africa	2535	3041	4175	4390	3966	3824	4208
Sudan	821	1024	780	931	743	787	1015
Tanzania	424	459	590	1048	757	664	575
East Asia in total	***664***	***1081***	***1968***	***2253***	***3313***	***4346***	***5043***
China	439	673	839	1067	1858	2653	3583
Indonesia	840	1019	1504	1870	2516	3348	3256
Japan	1921	3986	11434	13428	18789	19849	20683
Philippines	1070	1476	1964	2376	2224	2221	2412
South Korea	770	1105	2841	4114	8704	11818	14673
Thailand	817	1078	1874	2554	4629	6573	6383
Vietnam	658	799	836	758	1035	1397	1850
World Average	***2111***	***2777***	***4091***	***4520***	***5157***	***5385***	***6049***
USA	***9561***	***11328***	***16689***	***18557***	***23201***	***24484***	***27948***
Relative to the world average GDP per capita							
Sub-Saharan Africa	39,6 %	38,4 %	32,0 %	28,5 %	22,3 %	20,0 %	18,5 %
East Asia	31,5 %	38,9 %	48,1 %	49,8 %	64,2 %	80,7 %	83,4 %
Relative to the US per capita							
Sub-Saharan Africa	8,7 %	9,4 %	7,8 %	6,9 %	5,0 %	4,4 %	4,0 %
East Asia	6,9 %	9,5 %	11,8 %	12,1 %	14,3 %	17,8 %	18,0 %

*Including Eritrea
Source: Maddison (2001), for a definition of the regions, see appendix 1.

[1] When I say East Asia I also include Southeast Asia, see appendix 1 for an overview of the countries in the regions.



matter of fact East Asia had a lower GDP per capita than Africa in 1950. However, a more revealing comparison would be the period after 1960 since many African countries got their independence around this time and were therefore more able to conduct their own policies. The third reason is that both regions had a high degree of state intervention. There have been some heated debates around the effectiveness of state intervention, especially industrial policy, and this debate is central to understand the growth divergence between the two regions.

A central theme is the increased standard of living that follows with economic growth. Economic growth is assumed to be highly correlated with economic development. While economic growth measures the growth in economic activity; economic development measures the growth in the standard of living. The most important aspect is not the growth of production, but the increasing living standard of the general population. If people's lives do not improve with the presence of economic growth then what is the point? Given all this, it is imperative to understand some of the weaknesses of the GDP per capita indicator as a measure of standard of living, since it only measures the value of average production per person in a country. Some factors that are known to affect the standard of living such as life expectancy and literacy are not taken into consideration with the standard GDP per capita indicator. Another measure of standard of living is the Human Development Index (HDI)

which is an index comprised of income, life expectancy, school enrolment and literacy rates. In table 2 the HDI values and their development over time are shown. The development patterns using the HDI values are reinforced using this indicator as compared with the GDP per capita. I want to point out three trends. Firstly, the standard of living, even in the richest African countries, is lower than in East Asia. Two of the richest countries in Africa, Botswana and South Africa, have suffered from the effects AIDS recently and have had a sharp decline in life expectancy. Secondly, some African countries have according to this index had greater economic development than economic growth, for instance Nigeria and Sudan. Lastly, and most importantly for my assertion, is that it gives a comparable development pattern as when using the GDP per capita indicator, namely that the increases in the standard of living were far greater and sustainable in East Asia than in Africa. The HDI index is also not a perfect indicator. Other elements that also are important for the standard of living such as income inequality, political rights and a clean environment are not taken into consideration. Most likely there will never be an index that will objectively show how to measure standard of living. Since the HDI index gives a more or less similar picture as the GDP per capita indicator I will take a simplified assumption and say that economic growth and development both are measured by GDP per capita.

Table 2 – Development in the HDI index values

HDI ranking 2003	Country	1975	1980	1985	1990	1995	2003
			East Asia				
85	China	0,525	0,558	0,594	0,627	0,683	0,755
110	Indonesia	0,468	0,530	0,583	0,625	0,663	0,697
11	Japan	0,857	0,882	0,895	0,911	0,925	0,943
84	Philippines	0,654	0,687	0,693	0,720	0,736	0,758
28	South Korea	0,707	0,741	0,780	0,818	0,855	0,901
73	Thailand	0,614	0,652	0,678	0,714	0,749	0,778
108	Vietnam	n.a.	n.a.	n.a.	0,617	0,660	0,704
			Sub-Saharan Africa				
131	Botswana	0,503	0,577	0,638	0,681	0,659	0,565
167	Congo, DR	0,414	0,423	0,431	0,422	0,393	0,385
170	Ethiopia	n.a.	n.a.	0,291	0,311	0,323	0,367
148	Kenya	0,461	0,509	0,530	0,546	0,524	0,474
158	Nigeria	0,318	0,376	0,386	0,406	0,418	0,453
120	South Africa	0,655	0,674	0,702	0,735	0,742	0,658
141	Sudan	0,349	0,376	0,396	0,428	0,465	0,512
164	Tanzania	n.a.	n.a.	n.a.	0,435	0,422	0,418

N.a. stands for not available
Source: Human Development Report 2005 Table 2 p.223-226.

From 1960 until today East Asia has grown faster, measured by GDP per capita, than any other region in the world. Likewise, Africa has been the region in the world that has the weakest growth measured by GDP per capita. Another interesting feature is that both regions have had strong government interference in their economies. This gives fertile ground to attempt to answer two questions regarding the growth divergence between East Asia and Africa:

I. Which factors can explain the divergence in terms of economic performance between East Asia and Africa?

II. How can differences in the role of the government with regard to economic policies and institutions explain the growth divergence between East Asia and Africa?

In general, two major set of explanations have been fronted in the literature regarding the poor growth performance of Africa. The first is external and attempts to see the African growth performance as a function of factors that are beyond the African countries' control. Such causes can be geography, history and partly demography. Implicitly, if the conditions were unfavourable for Africa, they must have been far more favourable in East Asia. I will call the external causes for structural causes since they can limit or enhance the government's ability to promote economic growth. The second major explanation is internal and states that the major impediment to economic growth has been the African countries' own policies and institutions. In East Asia the debate around economic policies and institutions has been fierce. There are especially large debates regarding the industrial and trade policies of the East Asian governments and whether they promoted or retarded economic growth. Given my focus on the government's role within the two regions it's natural that I will focus most on the internal causes as opposed to the structural causes for economic growth.

There are a lot of disagreements regarding the causes of the growth in East Asia. This is made more difficult by interregional differences in the terms of population size, natural resources, timing of their take-off, and ethnically composition. Even though there are a lot of differences within East Asia there seem to be some so-called "*stylised facts*":

I. There was high government intervention in almost all countries with the exception of Hong Kong and the state intervention was especially high in Japan, South Korea and Taiwan.

II. There was a high degree of capital accumulation which most likely was related to the high savings rates in these economies.

III. There was a rapid accumulation of labour in both quantity and quality and the fertility rate declined rapidly.

IV. There was a strong focus on exports, especially of industrial goods.

V. There was a high degree of macroeconomic stability, with the East Asian financial crisis being the only true exception.

VI. The successful countries had a reasonable degree of political stability within their growth periods.

Just like for East Asia, there is a lot of disagreements regarding the causes for the poor growth performance in Africa. The causes are hotly debated and made more complex with vast interregional differences where countries like Botswana and Mauritius did exhibit sustained economic growth. In addition some countries have grown for shorter periods, but the overall picture is far bleaker. Just as in East Asia there are a number of "*stylised facts*" regarding Africa:

I. There was high government intervention, however this was qualitative different from East Asia. For instance, there was a far higher degree of public investments relative to GDP in Africa than in East Asia.

II. There was a weak capital accumulation process and savings rates were low.

III. There was s large population growth, but the educational standards were low and the quality of education declined towards the end of the period even though enrolment overall increased. In addition, the fertility rates remained high for a long period.

IV. African economies have had spells with import substitution and the export, which was often heavily taxed, was often in primary goods.

V. There was a high degree of macroeconomic instability, for instance there were adverse effects of having high debts levels such as a high fiscal burden for repayment and a loss of creditworthiness to obtain short term credit in international credit markets.

VI. The African region has become known for its political and social upheavals which have made economic growth virtually impossible.

This provides a general picture. Both macroeconomic and political stability seemed to be necessary, but by itself insufficient reasons for economic growth. To understand the economic divergence one must explain the different experiences in capital accumulation, labour force accumulation and technological upgrading. This assertion is relatively agreed upon. The role of industrial and trade policy in this process seems, however, to be far more controversial.

The thesis structure

I will divide my thesis in three parts. A greater weight will be put on the internal explanations (policies and institutions) relative to the external (structural) due to my focus on the government's role. Firstly, in chapter 1, I will look at the structural causes that have been mentioned in the literature, how they can be related to explaining the growth divergence and how they link to policies and institutions. Secondly, in chapter 2, I will look at economic policies and how the formulation and implementation of these affected economic growth. Chapter 2 will also look at some of the institutional explanations that are related to the economic policies to complement these. In the final part, chapter 3, I will look at institutional explanations for the growth divergence between the two regions. Finally, I will summarise and conclude my findings. Before I proceed I will briefly review some of the causes I'm going to touch upon.

Structural causes

The popularity of more deterministic causes of economic growth has been high. These are however nothing new. Landes (1999) gave an elegant summary of the old geography school and how it attempted to connect geographic conditions to economic outcomes. One of the

most famous deterministic explanations has been Nobel Prize winner Gunnar Myrdal's (1968) "*Asian Drama*". The arguments in his book was that Asia had a number of characteristics such as high population density and few natural resources which locked them in an "*Asian poverty trap*". Africa, however, was given a more bright future since the population density was low and natural resources were high. It reflected the time's spirit of African opportunism just after independence. History shows a different picture with East Asia becoming the most dynamic region in the world and Africa suffering from a growth tragedy; it was like putting Myrdal's wisdom on its head. Today, there is talk of "*Asian capitalism*" and an "*African poverty trap*". Many have cited Barro's (1991) so-called "*African Dummy*" which was a variable that was negative and significant that remained after accounting for other growth variables. Something that was specific for Africa kept them in a low development state. The lesson, for me, is that ideas around deterministic outcomes change over time and "*Asian Drama*" has come to stand as an ironic symbol of such an assertion. Chapter 1 looks at various structural causes that have been mentioned in the literature to highlight differences between Africa and East Asia.

The first of these is geography and demography. One geographic feature that has often been highlighted is the adverse effects of climate, especially tropics, on economic growth. Other geographic features include population density and access to waterways. Population density increases the potential for increased economics-of-scale and scope and might lead to a more advanced division of labour which would increase productivity. Access to waterways decreases transportation costs and might thus potentially increase trade which might facilitate increased division of labour and availability of technology. A last feature that will be dealt with is the demographic transition. I will comment on the effects of geography and demography in section 1.1.

Other structural causes mentioned in the literature will also be highlighted. One of these is the colonial legacies in the two regions. Another structural effect, partly linked to the colonial heritage, is ethnic fragmentation which was far higher in Africa than in East Asia. The last structural effect I will mention, primary goods dependence, is also partly linked to the colonial regime. I will comment on the effects of these other structural aspects in section 1.2.

What is important is how these structural causes affect the political environment and hence the government's ability to affect economic growth. Geography and demography are difficult

to relate to the political climate per se and I will attempt to assess how it might dominate the ability of policies and institutions to promote economic growth. The political environment is also affected by some of the structural aspects I mentioned. One of these is the colonial legacy which created imbalances in the ethnic composition and the political and economic power structure. Another structural aspect that is important is the link between ethnical groups and primary goods dependence which can raise the potential for political and social conflicts. Finally, the political life in Africa is far more dominated by ethnic issues than ethnically heterogeneous countries in East Asia. I will look how structural factors might have affected the political climate in the two regions in section 1.3.

Economic policies

The debates around the divergent growth paths have mostly focused on the issue of economic policies. The period in question saw, what could be described, as a paradigm shift within developmental economics. From 1950 to around the beginning of the 1970s import substitution industrialisation (ISI) was widely regarded as the appropriate strategy for developing countries to foster their economies from a low stage of development. This approach had three main aspects; i) A scepticism against markets; ii) A focus on capital accumulation; and iii) A desire to industrialise and produce what the rich did. The results from import substitution were disappointing in both the East Asian countries that adopted it and in Africa. Two sets of problems were especially paramount; i) Macroeconomic instability; and ii) Inefficient use of resources. The exception within the two regions during the 1960s was Japan and four other East Asian countries, the so-called Tiger economies, which pursued a strategy of export promotion and grew far faster than other developing countries. From the end of the 1970s until today the neo-liberals have dominated the mainstream. There were three main aspects according to their approach; i) Macroeconomic stability; ii) The ideal of free markets and no government intervention; and iii) Open economies. The growth in the Tiger economies was put into this framework. The Bretton Woods Institutions (BWI) started to practice these policies in Africa through the Structural Adjustment Programs (SAP).[2] The results were in general disappointing and the neo-liberals were quick not to blame their own policy "*recommendations*", but the "*lack of commitment*" of African governments. A final group of academics I will look at are the so-called revisionists, who criticise the neo-liberal paradigm and in general argue for a developmental state. A developmental state would; i)

[2] The BWIs are the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (IBRD), also known as the World Bank.

Coordinate structural change; ii) Make growth visions; iii) Manage conflicts that arise from economic growth; and iv) Build institutions that secure economic growth. The revisionists heavily criticised the neo-liberal assertion of the growth in East Asia and claimed that the market and state were more complementary in the growth process. Most East Asian countries did have heavy state intervention and used protectionist measures, although the neo-liberals question their effect. In Africa the neo-liberal policies did not work as indented and critics say the SAP failed first and foremost since they did not take the specific historical and institutional conditions of Africa into consideration. I will look at the differences in policies and academic views regarding the effectiveness of the economic policy in chapter 2. The chapter will be divided into three main parts; i) Macroeconomic policies; ii) Industrial policy; and iii) Trade policy.

In the first part I will look at macroeconomic policies. There is a near consensus regarding the need for macroeconomic stability in the process of economic growth and hence the macroeconomic policies will only be briefly touched upon. Three variables will be considered, the inflation rate, debts and exchange rates. I will comment on the macroeconomic policies in section 2.1

In the second part, in section 2.2, I will look at the industrial policies and will adapt a broad definition were I will take a comparative assessment of three major areas of industrial policy; i) Financial systems; ii) Learning and technology; and iii) Coordinating policies. The first part of the industrial policy debate covers financial systems. Financial systems have gone through two major periods; one with Keynesian inspired policies with restrictions on the movement of capital until 1980; and a period after 1980 with a higher degree of capital mobility. In the pre-1980 period both regions in general pursued a strategy of so-called "*financial restraint*" with repressed interest rates to make capital cheaper so it would increase investments. In the post-1980 era financial liberalisation to increase the effectiveness of investment went far smoother in East Asia than in Africa. I will comment on the financial systems in the two regions in subsection 2.2.1.

The second part of the industrial policy debate is centred on the need for learning and technology. A former supporter of import substitution, Bruton (1998), admitted that one of the key failings of the import substitution policies was its inability to facilitate a learning process and technological upgrading. As some neo-liberals now admit, for instance Crafts (1998), the

neoclassical assumption of universal availability of technology is quite probably false. The evolutionary approach has to a larger extent focused on the channels of technology transfer and have provided useful insight in the nature of technology transfer. I will cover the learning and technology issues in subsection 2.2.2 by looking at the role of human skills, the channels of technology transfer and especially the role of firms and state support and finally the availability of technology.

The final part of the industrial policy debate looks at the importance of coordinating policies. One argument that I found fundamentally important regarding industrial policy is that the coordination between the various policies was far greater in East Asia than in Africa. To overcome the structural hindrances associated with low development and reach a "*threshold*" level complementary investments and institutions are needed to obtain a growth take-off. Also, the coordination of policy becomes vital to maintain the momentum of economic growth once the economy as taken-off. I will comment on the coordination of policies in subsection 2.2.3

The final part of discussing economic policies I will look at trade policies. Trade policies have been almost as controversial as industrial policies and will be covered by two parts. In the first part the IS policies and the home-market led development will be assessed which had three major effects; i) The substitution of imports; ii) Overvalued exchange rates; and iii) Increased trade barriers. In the second part, the export-led development will be assessed by looking at the advantages stemming from increased exports and open economies and the debates this has produced. Trade policies will be covered in section 2.3.

Institutions

Institutions were taken back into the mainstream at the start of the 90s and have gained in popularity as a cause. But different authors seem to mean different concepts when discussing institutions. There seems to be two main institutional streams of research. The first is the new institutional explanation which is based on the rational man; sees the market as natural and hence not an institution; and sees it as the main goal of institutions to minimise transaction costs for market exchange by setting "*the rules of the game*" or institutions as "*agents of restraint*". The second is the old institutional theory which is based on the social man; does not see market as natural and just another institution; and sees the overall goal of institutions to influence human behaviour. Institutions using this approach might be better summarised as

"*social codes*". A major disadvantage of the new institutional approach is that the analysis of institutions often is conducted in isolation from its social context as they are only seen as mechanisms. Institutions, however, operate with each other and can enhance or retard the function of one and other. I believe that institutional changes and how it interacts with local institutions is of vital importance for understanding the growth divergence. Especially the concept of legitimacy is a key element to understand why some institutional innovations are more successful than others. That's why I will follow the definition of institutions as "*social code*s" since I believe it gives more analytical explanatory power and flexibility in understanding the growth divergence. There are three main institutional explanations I will focus on; i) Technology; ii) State capacity; and iii) Social embeddedness. I will look at the role of institutions in chapter 3.

The first explanation regards technological learning and might be adequately summed up by the national system of innovation (NSI) approach. There are two main levels of definitions; the narrow and the broad NSI concept. In the narrow concept the NSI comprises of; i) Private enterprises and the research institutes that they finance; ii) Governments that set the policy agenda; iii) Bridging institutions which include research councils and research institutions which act as the intermediate between governments and the users of knowledge; iv) Universities and related institutions that provide key knowledge and skills; and v) Other public and private organisations that play a role in the national innovations systems. In the broader concept of the NSI the focus is on those institutions and policies that can support the technology institutions and learning process. Such institutions and policies could include a macroeconomic stable environment, well functioning financial systems, trade policies and supporting institutions such as property rights. I will elaborate on the NSI approach in chapter 3; with an attempt to tie many of the discussions in chapter 2 together in an institutional framework.

The second institutional explanation is a focus on state capacity and how the state's capacity is linked to other political elements and its own inner structure. The political process comprises of three elements; i) Agenda setting; ii) Policy formulation; and iii) Implementation. Under the ISI era there was no real theory around the political process which meant that many of the potential pitfalls with state intervention were underestimated. With the neo-liberal paradigm the "*public choice*" models dominated the view of politics as a part of a political market, where the outcome, unlike that in goods markets, was not optimal. The

"*public choice*" argues that the state should withdraw from markets since policies can be used for opportunistic "*rent-seeking*". Not everyone agrees with this assertion, for instance Evans (1995) claims that the state should be not be completely autonomous or else it will not be able to implement its policy after intention. Evans (1995) fronted the concept of "*embedded autonomy*". I will look at three levels of political influences and politics. The first level is the international level. The second level is the internal capacity. The third level is at the national level and how domestic political powers affect the decision making process. I would look at the state capacity in section 3.1.

The final institutional explanation I will look at will look at, what I termed social embeddedness. The state is expected to fill many non-economic tasks in addition to their economic tasks. All the tasks are part of the governments overall perception even though there is no denying that economic growth and an increased living standard is one of the most important tasks the government has. I will look at two elements of the social embeddedness which are interlinked with economic growth; i) Conflict management; and ii) Legitimacy. In section 3.2 I will return to the role of social embeddedness.

The thesis

A number of studies have focused on a small set of causes and attempted to explain growth differences between countries using the variables of focus. Easterly & Levine (1997) is one example on how econometric techniques were used to estimate that differences in ethnic composition causes 28 % of the growth difference between East Asia and Africa. Also Bloom & Sachs (1998), focusing on geographical variables, attempt to find numerical values. The examples are numerous. One of the most influential has been the IBRD (1993) which has been a hotly debated contribution to the East Asian growth study by assessing the effect of industrial policies. The problem with econometric techniques as a tool for analysis is that effects are often interrelated and that another variable affects the independent variable in question. Numerical values coming from such studies, therefore, must be interpreted with caution.

With institutions, these problems are even made more difficult. Institutions are interlinked and complex mental representations which are very difficult to quantify. Sindzingre (2004) criticised the neo-liberal attempts of reducing institutions to simple variables in econometric equations. The main problem is that institutions are taken out of their social context. To be

able to analyse institutions across countries one must therefore assume that institutions function the same way in different countries. But, democracy in the US seems to work somewhat different than democracy in Zimbabwe even though both are formally democracies. Another difficulty when analysing institutions is that they have synergy effects. Private property rights as an institution might function better when there a well functioning judicial systems and democracies, where each institution reinforcing the functioning of the other.

My study uses different methods as complementary. I attempt to assess the working of structural factors, economic policy and institutions by themselves and in relationship to one and other. The sources are mainly secondary, which means that the policy implications should be somewhat nuanced. When looking at the various causes in isolation one only gets a part of a bigger picture. There are also a host of factors that might have been relevant that are not covered in this thesis. One of them is the role of regional trade patterns and how the intra-East Asian trade which has expanded greatly after 1980 compares to various failed attempts of promoting regional trade in Africa. Another theme could be cultural influence and how the presence of a Confucian heritage might have influenced the East Asian growth pattern. Not including such elements does not make them irrelevant. Still, I believe that enough different causes have been mentioned to be able to make a meaningful assessment of the growth divergence which attempts to complement traditional explanations to make a more complete assessment of the causes of growth in the regions.

Chapter 1 – Structural effects

Before turning to the main focus of the authorities it is important not to disregard many of the potent effects of the structural factors. These factors can in part limit or enhance the government's ability to promote economic growth. Thereby so-called structural features are in part interlinked to policies and institutions. This chapter looks at some of the most common structural causes mentioned in the literature and analyse how they relate to the government. In the first part I will look at geography and demography. In the second part I will look at other structural aspects such as ethnicity, history and primary goods dependence. Finally I will attempt to asses the implications for the government from the effects that are discussed.

1.1 Geography and demography

Geography is most likely the most deterministic aspect of the structural causes since it changes very slowly. To highlight the literature on geography and economic growth I will focus on three aspects; i) Climatic effects; ii) Transportation and urbanisation; and iii) Demography. A fourth aspect, which is very important, primary goods dependence, will be discussed in the second part of the chapter since it's linked to the colonial heritage.[3] I will also look at demography in this section since it in part influences the extent of potential economic growth.

1.1.1 Climatic effects

Landes (1999) emphasised the burden of climate due to for instance high temperatures, diseases and variable rainfall in the tropics.[4] The agricultural productivity in Africa has historically been weak. The agricultural productivity has often been high in East Asia, but has historically been "*eaten*" up by the increased population growth which followed agricultural innovations. Geography is thus not the entire story. But, the evidence is too strong to ignore the fact that climate has put more strains on Africa than it has on East Asia.

There are a number of effects of climate on an economy. Jeffrey Sachs is one of the most acclaimed authors that have stressed the burden of a tropical climate (see for instance Bloom

[3] Both access to water ways and population density in the African countries are also in part linked to historical aspects such as slavery and colonisation, but I will focus on them here since they are more an effect of geography per se than of history.
[4] Another important factor mentioned by Landes (1999) was the presence of catastrophes such as for instance droughts, tropical storms and flooding which have devastating economic and social costs.

& Sachs, 1998). I believe that the literature on the adverse effects of a tropical climate on economic growth can be summarised into five effects:

I. *Direct effects of the tropics on people*: The tropics often have more diseases than temperate regions such as the worm disease and malaria, this facilitates at least four effects; i) Increased costs for individuals for obtaining medicine; ii) Increased public costs for providing a public health system thereby potentially increasing the fiscal burden for countries with a large tropical zone; iii) Lost labour hours due to sickness; and iv) Direct deaths that reduce the labour stock and has adverse social effects.[5]

II. *Indirect effects of diseases on people*: There are also adverse indirect effects of a heavy disease burden, I would like to stress two effects: i) Effective labour hours is reduced by the decreased health of the working population leading to decreased labour productivity;[6] and ii) Reduced incentives to invest in education and health due to the lower life expectancy which reduces the perceived social pay-off.[7]

III. *Effects on animals*: The tamed animals available to tropical regions have usually not contributed to a higher agricultural productivity relative to temperate regions due to: i) The disease burden on cattle which made it implausible that the already tamed animals of the more temperate regions could prosper in the tropics; and ii) Animals in the tropics were more difficult to tame than animals in temperate regions.[8]

IV. *Effects on soil*: Plants are in general not as productive in the tropics as in the temperate regions and this is additionally complicated by the fact that agricultural innovations such

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[5] There is a link between health and income. The usual arguments claim that increased income leads to i) Greater access to medication due to higher purchasing power; and ii) Higher cognitive and physical capacity stems from better nourishment. Bloom & Sachs (1998), however, mention that there is a two way relationship between health and income and mentions that there were major health improvements in East Asia prior to take-off. Also, Bloom & Sachs claim that the health standards in Africa are lower than predicted given their income levels.

[6] This also goes for higher temperatures which reduces effective man hours. But people and cultures in warmer regions are in part adaptable to the higher temperatures even though there are natural limits (Landes, 1999).

[7] It needs to be stressed that this argument refers to the social pay-off for society and not the pay-off on the amount invested. For instance in Africa a dollar invested in health is very likely to give a greater relative benefit to an individual than investing a dollar extra in health in the US since the initial investment is lower and thus the "*returns*" greater.

[8] This effect might not be a burden of the tropics per se, but more of a "*fortunate*" distribution of animal species and that the northern more temperate regions were fortunate with the animal species they had around them. This is of course interlinked with population size since the higher agricultural productivity in the north allowed a higher population which meant that the natural wild life was reduced and many animal species were extinct which mainly left the animals that "*benefited*" the people (Diamond, 1997).

as the cultivations of plants do not cross well beyond climatic zones (see for instance Diamond, 1997; and Masters, 2002). To understand the effects of the tropics on soil Masters & Wiebe (2000) used frost as indicator since frost had three major effects on soil quality: i) Organic material decomposes five times faster in the tropics due to micro organisms at the top level; in temperate regions these organisms are mostly killed by the seasonal frost; ii) Frost breaks up compact soil since water expands when frost melts during the spring; and iii) Frost leads to the accumulation of "*good*" quality soil which means that there are greater possibilities for increases in agricultural productivity without the use of fertilisers and other stimulants.[9]

V. *Variable rainfall*: Landes (1999) stressed the adverse effects of variable rainfalls, which has adverse effects that are more "*disguised*" by some aggregate figures.[10] Barrios *et al.* (2003) summarised the adverse effects of variable rainfall in four arguments: i) Less investments in weather specific sectors such as agriculture; ii) Less power production from hydro-electrical power production; iii) Rainfall affects the pace and extent of the phenomenon of desertification; and iv) Direct deaths due to droughts, reducing the size of the labour force.

To see how these effects influenced the growth divergence between Africa and East Asia, the extent of these effects has to be assessed. According to Bloom & Sachs (1998) 91 % of the African land area lies in the tropics, while only 30 % of East Asia does (see table 3). This shows, on the backdrop of the previous arguments, that Africa had higher burdens of climate by having a higher degree of its area in the tropics than East Asia. Sachs puts much emphasis

Table 3: Area in the tropics

Region	Land area in the tropics	1000km coastline/ land area
Sub-Saharan Africa	91 %	1.15
East Asia	30 %	11.54

Source: Bloom & Sachs (1998) Table 2.

[9] Masters & Wiebe (2000) cited a estimate from Oldeman *et al.* (1991) that showed that the soil in Africa annually lost 660 kg/ha nitrogen (N), 450kg/ha kalium (K) and 75 kg/ha phosphor (P) from the 1960s to the 80s. During the same period the soils in temperate regions gained 2000 kg/ha N, 1000 kg/ha K and 700 kg/ha P.

[10] As the cliché goes: "*If you have your head in the oven and your feet in the freezer your average temperature may be alright, but this does not mean your doing fine*".

on the burden of malaria which he means is the main impediment for the African growth performance.[11] In Africa, of a yearly death of around 9 million people, around 1-2 million people die from malaria alone (Bloom & Sachs, 1998). In the 1960s and 70s there was a massive malaria campaign that was successful in eradicating malaria in isolated islands such as Hong Kong, Singapore and Mauritius. But in many parts of Africa the malaria campaign did not eradicate malaria, partly because the disease was harder to fight in these areas (Hammoudi & Sachs, 1999).[12] But there are also qualitative differences between the tropical areas between Africa and East Asia that can explain some of the differences with regard to economic performance:

I. Rainfall and access to sea modify some of the adverse effects caused by temperature. The tropics in East Asia both have the monsoon rain and a large part borders to the sea, especially relative to Africa (see table 3).[13] Africa on the other hand has most of its area in the interior, more than any other continent; and only small parts of West Africa experience monsoon rainfalls. In addition, there has been a decline in rainfall since the 1960s. Barrios *et al.* (2003) attempted to quantify the effect of the decreasing rainfall from the 60s in Africa and found that the reduced rainfall had adverse effects for Africa since it reduced agricultural productivity, reduced power production due to hydro-electric power production, increased the desertification process and caused a number of deaths. In addition Barrios *et al.* (2003) found that, while rainfall was a significant variable for African agricultural productivity this did not hold for any other region.

II. Much of Africa's agricultural production is not conducted in the tropics due to the adverse effects of diseases, rather, it is concentrated in half dry areas that have poor quality soil and variable rainfall, which leads to a low productivity agriculture.

III. The most fertile soil in the tropics is usually around volcanoes, which have been important for instance for the island of Java (Indonesia). In Africa these are rare, an

[11] A disease that might have more adverse effects than malaria is HIV/AIDS that also has direct and indirect effects for Africa similar to other diseases. But HIV/AIDS is a more recent phenomenon in the African countries and cannot explain the growth in the most of this period, but is likely to render future economic growth prospects more difficult.
[12] Malaria is transmitted through mosquitoes which first carry and transmit the disease when they reach a certain age. In more temperate regions mosquitoes die before they reach this age. In the tropics, however, the mosquitoes survive due to the high temperature.
[13] According to Leinbuck & Ulack (2000) the sea area in Southeast Asia was about four times the landmass.

exception is the fertile volcanic soil in the highlands of Ethiopia, but these highlands are isolated, which lowers the potential for market-based production.

1.1.2 Transportation and urbanisation

There are a number of geographic determinants other than climate. I will concentrate on two that partly could be connected to policies:

I. *Access to transportation*: Easy access to waterways, especially to sea or ocean going rivers gives increased possibilities for increased trade that potentially gives; i) Improved possibilities for division of labour which theoretically could raise productivity and economic production; and ii) Due to the increased interaction with other actors this could lead to the increased availability of technology.

II. *Population density*: An increased population density could potentially raise the level of specialisation by increasing the division of labour and producers could theoretically take advantage of increased economics of scale and scope.

In Africa the access to water way transportation through the access to the sea and ocean going rivers is weak. No continent has a smaller land area relative to the sea and there is a lack of ocean connecting rivers.[14] The picture is markedly different for East Asia where both the accessibility through the sea and ocean penetrating rivers are high. So East Asia did not have the problem of landlocked countries. Landlocked countries are not only a geographic phenomenon, but also have a historic and political dimension as pointed out by for instance Collier (1998a) and Hagen (2002). For East Asia this gave a big advantage with lower transportation costs which could facilitate increased trade. Africa had larger difficulties with regard to water transport, but there are other factors at play as well in the African case. There are three other ways transportation is hindered in Africa; i) A large distance from key markets with the historical hindrance of the Sahara desert; ii) African topography and disease climate made non-waterway land transportation very costly and dangerous, and this can explain the low exchanges between African villages and the lack of a more sophisticated division of

[14] Bloom & Sachs (1998) mentioned that there are few natural harbours that function as junctures for international trade.

labour in Africa historically;[15] and iii) The economies of Africa are not complementary in their production structure which is also a historical rooted problem partly due to colonisation and this problem is increased by the poorly developed infrastructure and other transaction costs in crossing borders in Africa such as the payment of border inspectors.

East Asia has a far higher population density than Africa (see table 4). This could be described as a potential historic advantage over Africa, but was not exploited before after 1960. The increased population density increased the potential level of internal development through the economics of scale and scope.[16] Africa with their low population density did not have the potential to increase productivity to the same degree. This argument will in the second part of the chapter be coupled with ethnic fragmentation. Northeast Asia is ethnically homogenous and these "*common-rules-of-conduct*" could have lowered transaction costs of doing business, while the ethnically fragmented African region had even less potential for economics of scale and scope due to the increased transaction costs of doing business.[17] This brings me over to the next point, urbanisation. Normally, urbanisation is due to increases in productivity in agriculture which means that labour is freed and a higher population can be fed by using less labour.[18] Urbanisation could potentially increase the division of labour and the economics of scale and scope because there is an increased population density thus

Table 4: Population density and accessibility to the coast

Region	Land Area (millions km^2)	Population (millions)	Population density (persons per km^2)	Population share within 100km from the coast or river
Sub-Saharan Africa	24	580	24	21 %
East Asia	14	1819	130	61 %

Source: Bloom & Sachs (1998)

[15] The aversion of trade due to the risk of diseases is for me a key point in understanding how Africa got so ethnically fragmented since less interaction led to increased isolation and the "*pockets of people*" over time developed their own languages, customs and this led to increasing differences. Ethnic fragmentation is a key point in the second part of the chapter.

[16] This argument is important to remember when I discuss how East Asia was able to combine import substitution and export promotion in chapter 2. My point is that the potential to do so was higher for East Asia than for Africa.

[17] This argument is based on Douglass North's discussion of how ethnically defined rules in pre-modern time reduced transaction costs since they had a higher degree of mutual trust. Personally I find this argument to be too generalising since it excludes the possibility of local institutions to handle inter-ethnically trade.

[18] I say normally since increased urbanisation could be due to increased food imports as well, for instance it's hard to claim that the virtually non-existent agriculture sector in Hong Kong and Singapore contributed to the growth of their city sizes.

increasing agglomeration effects. Urbanisation has traditionally been low in Africa.[19] In East Asia the picture in general is not that much different apart from Japan.[20] Nevertheless there are two trends are important; i) Urbanisation was traditionally higher in East Asia than in Africa, if nothing else just due to the higher population density; and ii) Urbanisation increased far more rapidly in East Asia since 1960 and has been facilitated by increases in agricultural productivity. The urbanisation in Africa, though increasing, is still lower than for other regions and is not necessarily driven by increased agricultural productivity, but perhaps the opposite, failing crops combined with a high population growth which leads to over-urbanisation since the foundations in agriculture to support urbanisation had not been laid.

Water transportation and population density could also be combined to be used as an explanation for the growth divergence. Gallup *et al.* (1999) found that a high population density close to the sea or a ocean going water way promoted trade, but that a high population density in the inlands was neutral or even negative for economic growth. East Asia has had a high population density along the rivers and the coast (see table 4). This boosted economic growth by facilitating increasing trade and the availability of technologies. Africa has the lowest population density along coasts and rivers of all continents.[21] The population density along the coastlines could have been extremely important especially after 1960 when the East Asian countries had a high degree of technological catching-up. The reason for this emphasis is that a more sophisticated division of labour and scale economics might have facilitated a process where technologies were more effectively learned and exploited than in other regions.

1.1.3 Demography

A demographic transition is a process where a society goes from having a high fertility rate and high mortality to a society which has a low fertility rate and a low mortality rate. This process is a modern phenomenon and is well documented empirically, but is not as equally understood theoretically. It normally starts with a decline in mortality rates due to for instance

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[19] According to Bloom & Sachs (1998) this is a natural consequence of the foundations of many African cities. Often cities in Africa did not emerge on the basis of being local trading centres, but rather as the administrative and political centre for the colonial powers or as a centre for support services to the mining industries. It's an interesting feature that the African countries with the highest urbanisation often have large mining sectors.

[20] Under the Tokugawa isolation period, which lasted 250 years until 1853, there was a urbanisation process in Japan with Edo and Nagasaki growing as centres for commerce and trade in a integrated national market (see for instance Mosk, 2001).

[21] A plausible explanation might be the established patterns of behaviour (read institutions) that developed as a response to slavery, the less accessible your tribe was for others, the better. However, this might only be true for weaker tribes since the slave trading tribes which sold slaves needed to be close to waterways to do business with Europeans and Arabs.

better hygiene, better medication and better nourishment due to an increased standard of living. While mortality rates fall first, the fertility rates normally adjust more sluggishly perhaps due to established customs. After a certain amount of time with mortality rates still on the decline, the fertility rates starts to decline due to decreased need to have many children since more children make it to adulthood and changing preferences due to a higher standard of living. Finally, a society ends up in a situation with a low fertility and low mortality rate which can be observed in many developed countries. Since mortality rates decline before birth rates, this facilitates an increased population growth during the demographic transition. The dependence ratio is the relative share of the non-working population, the population under 15 years and over 64 years relative to the working age population from 15 to 64 years. An increased dependency ratio is perceived to be costly for society since there is an increased fiscal burden on the working population to cover the costs for the non-working population due to for instance schooling and pensions. Both Africa and East Asia have experienced demographic transitions, but with partly opposing experiences:

- In East Asia the mortality rates started to decline after World War II leading to a high population growth. The birth rates adjusted faster than was the case during the European demographic transition and started to fall quite rapidly. This led to an increasing working population relative to the non-working population and a decreasing dependence ratio (see table 5). This led to a situation where: i) The economic growth led to a higher spending per pupil even if the percentage of GDP to schooling did not change leading to a better quality of education; and ii) A boosting of output due to the increased working population, a factor increase, without having the same increasing social costs of a increasing dependence ratio. This effect for East Asia has been termed a "*demographic bonus*".[22]

Table 5 – Population growth (Average annual growth 1965-90)

	Total	Working age	Non-Working age
Sub-Saharan Africa	2.82 %	2.74 %	2.91 %
East Asia	1.75 %	2.43 %	0.66 %
World	1.84 %	2.14 %	1.39 %

Source: United Nations (UN) – World Population Prospects: The 2000 Revision.

[22] For a useful schematic illustration see Crafts (1998).

- In Africa the mortality rates also declined after World War II which facilitated an increased population growth. But, unlike East Asia, the birth rates did not adjust as rapidly and only started to show a declining trend in the beginning of the 90s. The effect therefore was the opposite; the growth of the non-working population was higher than the working population leading to an increasing dependence ratio (see table 5). This led to a situation where: i) The lack of economic growth, especially after 1980, led to a decreasing spending per student even when the spending on education as a percentage of GDP did not change dramatically, leading to less resources per student and a decreasing quality of education; and ii) The economic growth that was achieved was often "*eaten up*" by the increased population growth, instead of boosting output the demographic transition increased the social costs by increasing the dependency ratio. To continue the analogy this effect for Africa could be termed a "*demographic drag*".

The causes for the different effects of the demographic transitions are debated. Two major explanations have been fronted. There seems to be a consensus that there is a complex link between economic growth and the demographic transition. Both are both causes and effects. Bloom & Sachs (1998) puts the emphasis on the demographic transition and claims that the demographic transition mainly was a cause for low growth in Africa and implicitly the reason for the high growth in East Asia. The reason for the lack of decline in fertility in Africa according to Bloom & Sachs is due to: i) In the absence of income, children are often the main insurance for parents for when they grow old; and ii) The special socioeconomic institutions in Africa such as for instance polygamy and other institutions that may go as far back as slavery. Collier (1998a) puts the emphasis on economic growth and claims that lack of economic growth in Africa was the cause for the lack of decline in fertility rates; while the presence of economic growth in East Asia implicitly was the cause for the decline in fertility rates creating a virtuous circle. The debate is far from settled and in part shows the lack of theoretical understanding of the demographic transition process.[23] The message from the literature seems to be that there is a complex link between economic growth and demography. Both factors are causes and effects without a universal agreement which of these factors is the main driver.

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[23] A problem with the arguments from Bloom & Sachs (1998) is that the fertility has declined in African countries like Botswana and Mauritius that did experience sustained economic growth. However, a problem with Collier's (1998a) argument is why the fertility in African countries like Cote D'Ivoire, Nigeria and Kenya did not decline in the 1960s and early 1970s when these countries did exhibit economic growth.

1.2 Other structural causes

There are a host of other important structural aspects that have limited the African and perhaps enhanced the East Asian economies potential for economic growth. I will look at three of them in this section; i) History; ii) Ethnic fragmentation; and iii) Primary goods dependence.

1.2.1 History

Historical factors affect the development of the current events; this is the idea of historical path-dependency. I will not discuss the effects of slavery on the economic growth in Africa extensively, but this does not mean that these are not paramount. Quite the contrary, institutions that developed as a response to slavery, especially the trans-Atlantic one, could have had adverse effects by for instance influencing the pattern of settlement with an increased population in the interior away from the sea. My focus will, though, be on the effects of colonisation since it's a more recent phenomenon and my focus is not on the burden of history per se.

The extent of colonialism was large in both regions from the 19th century until the aftermath of the Second World. Apart from two small countries, the whole African continent was dominated politically by European powers.[24] In East Asia, Japan and Thailand remained independent, officially so too China even though there policies were influences by foreign powers and they lost some of their land such as Macao, Hong Kong and Taiwan. The literature on the adverse effects of colonisation is diverse and different factors are used to explain the difficulties of the colonial legacy. I will look at three of these:

I. *Identity and status*: Bertouchi & Canova (1996) looked at the identity and status of the colonial power and economic growth in Africa and concluded that: i) British colonies developed better than French with the other former colonial powers trailing thereafter; and ii) Protectorates have had a more positive development following independence than pure colonies. Africa's only "*miracle*" growth country, Botswana, was a former British protectorate. The reason for the better performance of British colonies, according to Bertouchi & Canova could be: i) Their indirect rule which did not disturb the pre-

[24] The two small African countries that remained independent were Liberia and Ethiopia.

existing institutions as much as other colonial powers allowing for continuity; and ii) The superiority of the British parliamentary system compared with the French presidential system. The South East Asian countries seem in general to fit the colonial heritage pattern that's found in Africa with former British colonies such as Hong Kong, Singapore and Malaysia showing better economic development than many other former European/American colonies in the region. However, the Japanese colonial heritage in Korea and Taiwan warrants some special attention. The effects of Japanese colonisation are heavily debated, especially in South Korea. In general there are two general views; i) The colonial heritage was positive and contributed to economic growth after the Second World War; and ii) The colonial heritage was either virtually neutral or even negative and did not contribute significantly to economic growth after independence. The first school, which is most popular among non-Korean researchers, says that the colonial heritage was positive due to; i) The building up of infrastructure; ii) Increasing the human capital; iii) Creating institutions that "*obviously*" were favourable for economic growth; and iv) The establishment of an authoritarian state which could "*force*" policies through (see for instance Cumings, 1984; and Eckert, 1991). The main evidence that these scholars emphasise is the correlation between the economic growth in the pre-1945 period in South Korea and the post-1960 period and the broad similarities to the "*Japanese economic model*". The second school, comprising of mostly Korean researchers, in general argue that the contribution was not that positive and emphasise that; i) Most of the infrastructure was destroyed during the Korean War; ii) Human capital increased vastly between 1945 and 1960; iii) Most of the industry was placed in North Korea; and iv) The institutions that were favourable for economic development gradually developed after the Second World War. Jonghoe (2004) said that the Japanese colonial heritage only was marginally positive, but did have two positive side effects, namely the removal of the corrupt Choson regime in 1911; and the Japanese occupation created a sense of national Korean identity among the people in general. No matter which school one finds most convincing, the key period seems to have been from 1945 to 1960; with one school claiming that the advantages from Japanese occupation were upheld, while the other claims that they were eroded, especially during the Korean War. There can, however, be less doubt that Korea and Taiwan got a very different treatment as colonies as opposed to how Europeans treated their colonies. Many of the highly negative effects of colonisation that were present in the former European colonies were

not present in Korea and Taiwan. For instance, neither primary goods dependence nor high income inequalities were as in other former colonies.

II. *Economic structure*: The arguments based on the heritage of economic structure can be divided into two major effects: i) Primary goods dependence which I will come back to in subsection 1.2.3; and ii) Income inequality which often stemmed from preferential treatment from colonial powers to some groups in society which often generated ethnically based income differences. The effects of these I will comment in the next subsection 1.2.2 on ethnic fragmentation. Angeles (2003) attempted to link the organisation of the agricultural sector to income inequality since all colonies (apart from some city states such as Hong Kong and Singapore) were predominantly agricultural societies.[25] The result was that income inequality was highest for the colonies where the agriculture was organised in large production units that were labour intensive and had the character of a "*patronage*" system. Often these colonies had large ethnically European populations such as in South Africa, South Rhodesia (Zimbabwe) and North Rhodesia (Zambia). However this way of organisation could also be found in some former colonies without a large European population such as Belgian Congo (Congo DR), the Central African Republic, Chad and Malaysia. The income inequality was smaller for former colonies that organised their agricultural sectors with small farmers where colonial powers dictated what was being allowed to produce to what price, but where farmers were allowed to keep their profits. The majority of the population preferred working independently on the farms than to work in the mines for a higher, if somewhat more volatile, wage under harsh working conditions. Examples of such former colonies are French West Africa, French Indochina and the former British colonies the Gold Coast (Ghana) and Uganda.

III. *Institutions*: The hypothesis of Acemoglu *et al.* (2001) was that the institutional quality was linked to the mortality rates of European settlers at the time of colonisation. A low mortality rate increased the inflow of European settlers which demanded "*high-quality*" institutions such as the rule-of-law, transparency of government and private property rights such as in their home countries, African examples can be South Africa and

[25] The former Japanese colonies were also excluded due to their different character.

Zimbabwe.[26] A high mortality rate led to a small inflow of European setters which established a higher degree of exploiting institutions which in the literature often is termed "*patronage*" or "*predatory*". The examples could be numerous such as Angola, Burkina Faso and Nigeria. Africa had a higher influx of European settlers to the Eastern and Southern parts, and these parts of Africa tend even today to be richer than the Western and Central parts of Africa. The vital component of this hypothesis is the path-dependency of institutions. Colonial institutions, such as the state itself, often persisted after independence and thereby endured. This hypothesis might be less applicable to the Asian case. Englebert (2000) had another institutional explanation connected to the colonial era namely the origin of the state. The organisation of the state, especially with relationship to the existing institutions such as local customs and values is of great significance for the legitimacy of the state. In most African countries the state was created exogenously through the colonial powers and did not take the existing power structure, hegemony and ethnically composition into account. This led to the splitting up of ethnically groups through artificial borders with some groups being put together that did have nothing in common and some ethnic groups were divided between countries. In East Asia the state formation process was to a higher degree an endogenous process to the society based on local institutions and power structure. I will come back to this argument when I discuss the role of legitimacy in section 4.2.

The natural question is which of these explanations seems most plausible. Arguments based on identity and status seems easy and intuitive. The former Japanese colonies, South Korea and Taiwan pursued a similar strategy with slight deviations as their former colonial master. To what part this is attributed colonial heritage or a common Confucianism cultural base seems unclear though. I would contend that the arguments of Bertouchi & Canova (1996) are useful in identifying stylized facts, but are too simplistic. In Africa, different British colonies and protectorates fared differently; and so did the French. Both the British and French used both direct and indirect rule depending on the colony in question.

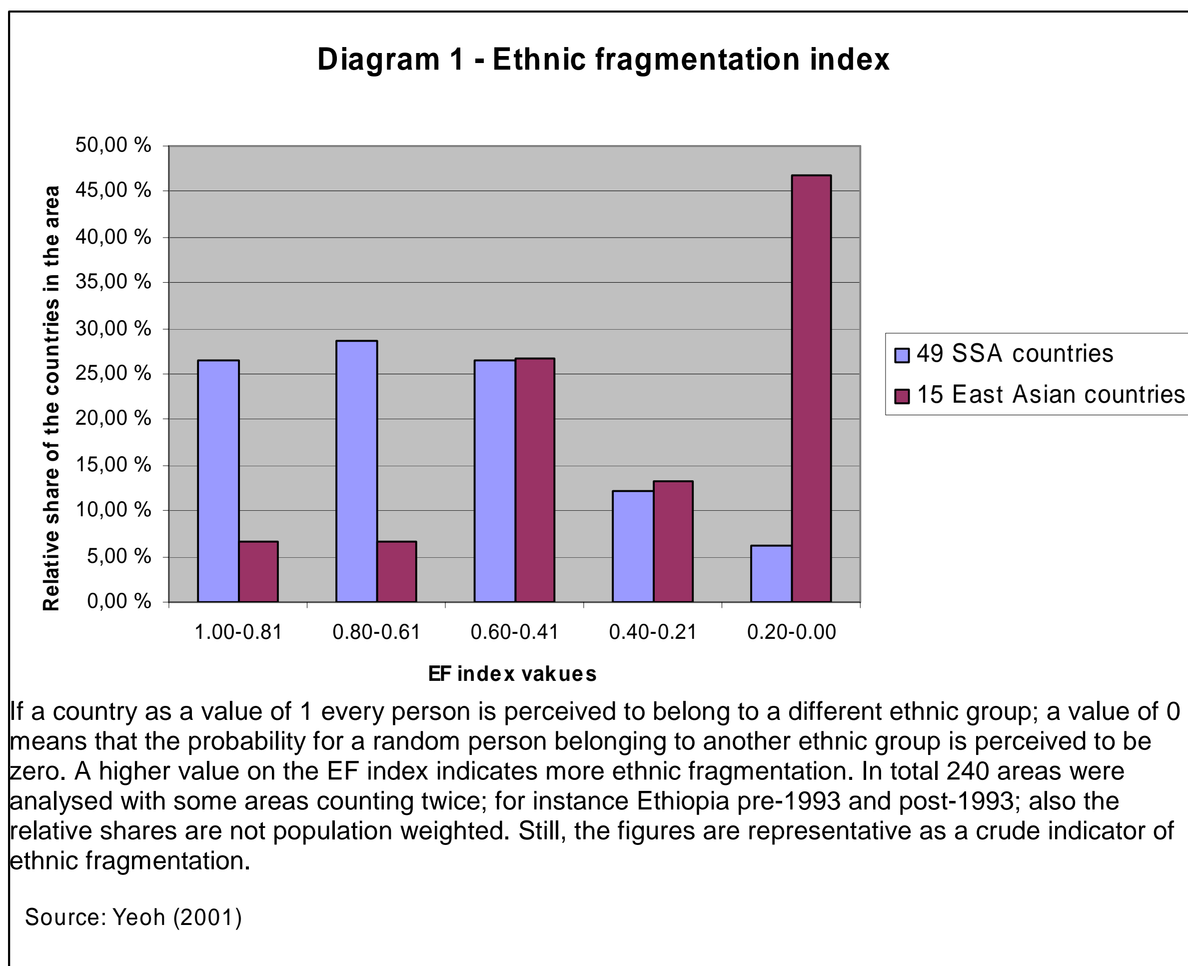
[26] The hypothesis seams to fit best with the American continents. The US and Canada with low population densities at the time of the arrival of Europeans, but with favourable climates were more populated by Europeans than Latin America. In Latin America the native population was larger and the climate less favourable and the institutions set up were to a higher degree focused on extracting resources. After independence many of these institutions remained and can be used to explain the income differences between the North and Latin America due to "*better*" institutions in North America (Acemoglu *et al.*, 2001).

The arguments based on economic structure I often found more promising. Income inequality related to the colonial period has often been a cause for social and political upheavals in the post-colonial period, especially when this is connected to ethnic groups. High social and political instability increases the risk of investment and economic activity in general and makes economic growth virtually impossible. Moreover the primary goods dependence argument, which I will elaborate on further, gives a plausible explanation for how the colonial powers disrupted the "*natural*" trade pattern. The production structure of former colonial economies often reflected the demand conditions in the markets of their former colonial master's economies rather than their own demand conditions. This, without doubt, popularised import substitution as a viable strategy after independence. Africa and many South Eastern Asian economies were left with high primary goods dependence, while the colonial legacy was slightly different in North Eastern Asia. Still, there are limitations to such a explanation since it does not explain how some countries are able to break the primary goods dependency cycle (for instance South East Asia); while others achieve successful economic growth based on primary goods (for instance Botswana); and how some countries are able to handle their income inequality better than others (for instance Malaysia). I think arguments based on economic structure have to be complemented by some institutional explanations to have more explanatory power.

Arguments based on institutions are becoming increasingly popular. Both the approach by Acemoglu *et al.* (2001) and Englebert (2000) are promising points of departure for an analysis of how colonial regimes left a devastating, more "*invisible*" heritage. Taken together they explain some of the more rooted problems of why certain African governments did not promote economic growth to the same extent as East Asian governments. I think that the three aspects of colonial heritage in part can be used a complementary explanation effects of colonial heritage. For instance, Botswana was a British protectorate which meant that the indirect rule allowed the indigenous political institutions to stay in place. This might have made the process of state formation more endogenous and since the British did not set up the same extractive institutions as in other African colonies leaving a more "*healthy*" political structure in the form of a parliamentary democracy. These institutions might help explain for why the primary goods structure did not have the same adverse effects as in other African countries.

1.2.2 Ethnic fragmentation

Ethnic fragmentation has often been treated as a major cause for the weak growth performance in Africa. There are, though, difficulties in defining what constitutes an ethnic group. As Hoetnik (1975) pointed out, there are four criteria's of ethnical groups; i) Geographic belonging (for instance home country); ii) Concepts of a common origin ("*race*"); iii) Linguistic; and iv) Religious differences. The presence of only one of these four criteria was enough to constitute an ethnic group. Hoetnik (1975) himself opposed the notion of "*ethnic*" groups since it excludes the possibility of overlapping groups and preferred the term "*socio-racial*". An additional problem is that the weighting of the differences between ethnic groups is different from country to country.[27] Yeoh (2001) attempted to construct an index of ethnic fragmentation (EF index) based on the probability that another random person was perceived as belonging to a different ethnic group. Results of this estimate, illustrated by diagram 1, shows that ethnic fragmentation in Africa is far higher than in East Asia. In fact, 31 of the 50 most ethnically fragmented countries according to this index are African.



If a country as a value of 1 every person is perceived to belong to a different ethnic group; a value of 0 means that the probability for a random person belonging to another ethnic group is perceived to be zero. A higher value on the EF index indicates more ethnic fragmentation. In total 240 areas were analysed with some areas counting twice; for instance Ethiopia pre-1993 and post-1993; also the relative shares are not population weighted. Still, the figures are representative as a crude indicator of ethnic fragmentation.

Source: Yeoh (2001)

[27] For instance religion is the main criteria in Northern Ireland; language in Belgium; and race in South Africa.

I believe that the literature on the link between ethnic fragmentation and economic growth roughly argues along three lines:

I. *Reduced incentives for public goods*: Easterly & Levine (1997) argue that ethnic fragmentation reduces the incentives to promote public goods since the perceived benefits also benefit "*the others*". According to Easterly & Levine ethnic fragmentation leads to lower public expenditure on schooling, worse financial institutions and lower spending on infrastructure and that these effects account for 28 % of the growth difference between Africa and East Asia.

II. *Social and political instability*: There is a risk of social and political instability by having social tensions due to ethnical differences. Africa has had more civil wars than any other region which needs to be seen as both a cause and effect of the lack of economic growth. A number of case studies conducted by the OECD identified ethnically income differences created by the colonial period as one of the major causes for social and political instability in Africa.[28] This does not mean that East Asia has been spared for social and ethnic tensions, for instance Indonesia, Malaysia and the Philippines have at times had social and political upheavals. These seem, though, to have become less frequent and must partly be attributed to the presence of economic growth.

III. *Transaction costs*: North's (1990) argument is that in pre-modern society's economic activities is easier within the same ethnic groups due to the lack of supporting institutions such as private property rights, rule of law and other institutions that are common in modern economies. North East Asia has large homogenous populations which could have given them an historical advantage over both South East Asia and African countries. Collier (1998b) combined the transaction cost argument with political instability and claimed that coordinating a uprising is easier with a few large ethnical groups than with many smaller ones and that moderate ethnically society's were more at risk for civil wars than highly ethnically diversified societies.[29]

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[28] Gordie & Neyepta (1999) for Southern Africa, Klugman et al. (1999) for three Eastern African countries Aram et al. (1999) for the Sahel countries.

[29] Congo DR, the most ethnically divided country on the EF index has nearly been in a constant state of civil war since 1994 and does not support Collier's (1998b) argument.

These explanations can partly be used as complementary. Easterly & Levine (1997) argument that 28 % of the growth difference is due to ethnic differences is, though, difficult to accept at face value. This is not only due to econometric difficulties with regard to measuring ethnic differences, but more fundamentally it assumes correlation as causality and it's difficult to asses how much of the public goods produced is due to ethnic fragmentation alone. Nevertheless, even though the numerical exercise is questionable, the argument still holds and can in part explain some of the difficulties with ethnic fragmentation. Also, the political and social instability argument due to ethnic fragmentation is another plausible and easily observed factor that affects economic performance. I will comment more on this in subsection 1.3.2. The transaction costs argument is based on institutional economics and gives a partly account of pre-modern economies. It could help to explain long-run differences between Africa and East Asia. Still, this argument looses some of its explanatory power when the observed income differences between Africa and East Asia first diverged on a large scale after 1950. Until 1950 income levels in the two regions was comparable, and as I mentioned in the introduction, was in 1950 even higher Africa than for East Asia. I would claim that the institutional foundations for economic growth within ethnic groups; and not only between them, need to be in place for economic growth to take place. For instance, the lack of the institutional and supporting state might have put natural strains on the growth potential of the Chinese economy.[30] Another example is Japan where the foundation for the economic growth during the Tokugawa period; and in the post-Meiji period (from 1868) also has to be attributed more favourable policies and institutions towards economic growth rather than ethnic homogeneity by itself. But, it's not difficult to agree that economic growth might have been easier due to the homogenous populations. Also, Collier (1998b) assessment of transaction costs for communicating between ethnic groups excludes the possibility for inter-ethnic communication institutions which developed as a response to the historical ethnical divisions. Nevertheless, I believe that the higher ethnic fragmentation in Africa compared to East Asia makes the political and economic climate more complex and thus increasing the potential adverse effects of ethnic fragmentation in Africa. The channels for how these potential conflicts come into being are nevertheless complicated, multi-faced and interlinked with other factors, making assessing the effect of ethnic fragmentation alone a difficult task.

[30] See also Landes (1999).

1.2.3 Primary goods dependence

As I have mentioned, primary goods dependence is linked to both geography and history through colonisation. Sachs & Warner (1995) emphasised the "*primary goods curse*" and points to the lower economic growth of those countries with a high degree of primary goods exports. I would like to emphasise four effects that the literature mentions:

- *Long-term price trend*: The Prebisch-Singer hypothesis states that there is a long-term decline in the prices of primary goods relative to industrial goods. It's likely that this differs among different primary goods with oil perhaps being the best counter example. But there seems to be a certain support for the long-term declining trend in the very long-run, see Bleaney & Greenaway (1993).

- *Price volatility*: Potentially more important than the price trend is the price volatility of primary goods. In theory positive price shocks can stimulate economies, but Collier & Cunning (1999a) points to evidence that although positive price shocks might have positive short term implications, in the long-term they increase uncertainty and increase the perceived costs of doing business. The implication is that both positive and negative price shocks can have adverse effects on economies.

- *Learning effects*: The "*Dutch disease*" literature has grown vast and diverse. The simple argument is that there are increasing potential learning effects through industrial production relative to the production of primary goods. Put simple the learning effects are higher in industrial relative to primary good production and long-term economic growth is facilitated through long-term learning and innovations. The presence of a high primary good sector will lock resources through capital and labour in the primary good sector thereby lowering the overall learning and innovation in society by partly crowding out the manufacturing sector and thereby decreasing long-term economic growth (Sachs & Warner, 1995).

- *Political and social instability*: Collier (2002) combined the ethnically division argument with primary goods. Collier mentions that a higher degree of primary goods and ethnically divisions is correlated with increased political and social instability. Primary goods can have potentially high resource rents which can lead to increased

Table 6: Primary Goods as a Share of Merchandise Export								
	1970		1980		1990		2000	
	PG	IG	PG	IG	PG	IG	PG	IG
SSA in total	87 %	11 %	87 %	12 %	80 %	18 %	71 %	25 %
Individual countries:								
Botswana	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	72 %	28 %
Congo, DR	93 %	7 %	70 %	6 %	81 %	17 %	n.a.	n.a.
Ethiopia	98 %	2 %	100 %	0 %	95 %	5 %	85 %	9 %
Kenya	87 %	12 %	88 %	12 %	71 %	29 %	79 %	21 %
Nigeria	99 %	1 %	100 %	0 %	98 %	2 %	100 %	0 %
*South Africa**	66 %	28 %	61 %	38 %	63 %	34 %	33 %	54 %
Sudan	100 %	0 %	99 %	1 %	99 %	1 %	92 %	8 %
Tanzania	87 %	13 %	86 %	14 %	82 %	18 %	66 %	16 %
E. Asia in total	34 %	65 %	26 %	72 %	14 %	85 %	10 %	88 %
Individual countries:								
China	n.a.	n.a.	52 %	48 %	27 %	71 %	12 %	88 %
Indonesia	99 %	1 %	98 %	2 %	64 %	35 %	43 %	57 %
Japan	21 %	78 %	4 %	95 %	3 %	96 %	3 %	94 %
Philippines	94 %	6 %	63 %	21 %	31 %	38 %	8 %	91 %
South Korea	25 %	75 %	10 %	90 %	6 %	93 %	9 %	90 %
Thailand	92 %	4 %	72 %	25 %	36 %	63 %	22 %	75 %
Vietnam	98 %	2 %	86 %	14 %	n.a.	n.a.	56 %	41 %

Source: Based on figures from UNCTAD; PG stands for Primary Goods and IG for Industrial Goods.
* South Africa in 1970, 1980 and 1990 stands for the South African Customs Union which are South Africa, Namibia, Botswana, Lesotho and Swaziland which are separated in the 2000 figures.

rivalry to control these rents which can facilitate social conflicts. I will come back to this argument in section 1.3.2.

Japan and the First Generation Tigers started their high economic growth before 1973.[31] The growth of the world economy and the stability in prices was greater in the period from 1950 to 1973 than the post-1973 era.[32] The characteristics of Japan and the FGT are; i) Virtually no dependence on primary commodities exports; and ii) High shares of industrial goods exports the whole period partly offsetting the volatility in primary good prices. Many analysts agree that these countries in part were lucky since they got their economic take-off in a more stable period than other East Asian countries which got their take-off later on. But East Asia as a whole has had a declining share of primary goods exports relatively to industrial goods as a share of merchandise export (see table 6). The region's export of primary goods declined from 34 % of its merchandise export in 1970 to 10 % in 2000. Countries such as Indonesia, Philippines, Thailand and Vietnam all had over 90 % of its merchandise export in primary goods in 1970. With exception of Vietnam which had 41 % of its merchandise export in manufacturing, all countries had over half of its merchandise export in manufacturing in 2000. For Africa as a whole the dependence on primary goods has declined, but very slowly and

[31] Hong Kong, Singapore, South Korea and Taiwan are often denoted the First Generation Tigers (FGT).
[32] See appendix 4 for the growth rate of world merchandise exports and its various components.

primary goods still constituted 71 % of the merchandise export income in 2000. Manufacturing goods grew faster than primary goods on world basis during the whole period and in Africa its share increased from 11 % of merchandise export in 1970 to 25 % in 2000 in Africa. The only country of the bigger African countries that has over half its merchandise exports in manufacturing is South Africa with 54 %. Nigeria, the most populous country in Africa is overly dependent on oil. Ng & Yeats (1997) reports that African countries three biggest export products constituted 36.5 % of their total export income in 1962-64. In 1991-93 the figure had risen to 62.3 % which indicates a concentration, rather than a diversification of their export structure.

How then did the different effects of primary good dependence come into force? It's difficult to relate the long-term decline in price trends for primary goods directly to Africa's growth performance. There is no doubt, however, that the higher growth of manufacturing exports compared to primary goods stimulated East Asian exports and reduced some of the potential for African countries. There seems to be more evidence for the second argument, the volatility of primary good prices. The Berg rapport assumed that all developing countries faced the same macroeconomic shocks and that therefore the internal policies not the external macroeconomic environment was to be blamed for Africa's poor growth.[33] This has been contradicted by a number of scholars which claim that there is a high correlation between macroeconomic shocks and the economic performance in Africa (see for instance Fischer, 1993; and Mendoza, 1994). Soludo (2002) claims that Africa lost 50 billions USD due to the fall in primary goods prices between 1986 and 1990; in 1986 alone they lost 19 billion USD. I think a strong case can be made that those countries which have a high income from primary goods exports suffer from greater macroeconomic instability since the price volatility often is greater for these types of goods. Africa's primary good dependence thereby increased macroeconomic instability, while East Asia's declining share of primary goods provided the countries with a higher potential to maintain macroeconomic stability.

The long-term learning effects of primary goods seem to be limited as compared to manufacturing. East Asia has been able to learn new technologies and upgrade its production structure during the period, so there seem to be some intuitive support for this argument. Not

[33] Personally, being from Norway, find this reasoning problematic. It is like saying that all developed countries suffer the same external shocks. But, the Norwegian economy reacted differently to the oil price shocks in 1973, 1979 and 1986 than other developed countries.

everyone agrees though. A study from Martin & Mitra (2001) cited by Hagen (2002) showed that the total factor productivity (TFP) growth in agriculture has been higher than in manufacturing in the period 1967-92. I am a bit sceptical to these figures though. Firstly, there will be natural limitations to increases in productivity for primary goods production, especially for agriculture. I don't think it's plausible that Africa could have had the same productivity in its agricultural sector as East Asia due to a host of geographic differences such as climate and rainfall. Secondly, an estimate such as TFP might not capture all potential qualitative differences in an economy.[34] Related to this, new and more frequent innovations make it less feasible that the whole learning curve is exploited.[35] I will come back to industrial learning in subsection 2.2.2.

1.3 Political aspects

This section will attempt to relate the two previous sections to the government. Geography and demography are difficult to relate to policies directly apart from for instance increased health expenditure on diseases in tropical environment. Rather geography will be discussed as a cause opposed to policies and institutions. Historical aspects together with ethnical fragmentation and primary goods dependence are easier to relate to the political environment and I will attempt to assess some of these effects.

1.3.1 Geography versus policies?

Bloom & Sachs (1998) argue that the whole debate around politics and institutions is overstated since up to two thirds of the poor growth in Africa is explained by poor geographic conditions. For instance climatic aspects do plausibly explain a lot of the long-run difficulties Africa has. But the message is deterministic and thereby grim. To put it bluntly, the message is "*don't live here*". Differences across time and within Africa are, though, not as easily

[34] An example illustrates my point. When a widescreen TV is produced in 2000 using only half of the labour and capital it took to produce a non-colour TV in 1950 the statistics will show a 100 % increase in TFP. The quality of the product, though, as increased by far more than the productivity figure indicates. This qualitative increase which increases the consumers well being is not taken into account in a measure such as TFP. Agricultural production seems to have less potential. It is fully possible to think of innovations in agriculture which raises nutrition and give more cost-effective production, but there are limitations to this process and to fast innovations through for instance biotechnology can give negative reaction from consumers. A potential counterargument to my point is that higher prices will reflect the increased value of the product. I would contend that this is not necessarily the case in the presence of intensive price competition, higher real wage and scale economics in research and development (R&D).

[35] New models are produced all the time. For instance when a new TV model is produced in 2000 which replaces the 1999 model it's not feasible to continue the production of the outdated model since the competitors will not do so either. This means that scale economics with regard to production not necessarily will be exploited to full effect before starting the production of a new model.

explained. One can also ask the question what the implicit message is for other regions, like East Asia. Were the aspects of a more favourable environment a necessary, but insufficient condition for growth? East Asia seemed to have fewer strains caused by geographical hindrances compared with Africa so policies and institutions were more effective and dominated geography more than in Africa. Still, there are limitations to such reasoning. It's not possible to give weights such as two-thirds to geography. One of the reasons is that geography, such as climate, is interrelated to politics, history and institutions. They interact in a dynamic way so looking at them in isolation would give an unclear representation.

Collier (1998a) disagrees with Bloom & Sachs (1998) and claims that politics and institutions explain most of the economic growth between countries. Even so, Collier (1998a) admits that geography puts more strains on certain regions compared with others. Many of the factors that Bloom & Sachs (1998) call geography are challenged by Collier (1998a) as being a result of politics. For instance the problem of landlocked countries in Africa is a result of past policies of the former colonial powers that set many of the current borders. Thus policies and history shaped this "*geographical*" problem. Another example is the transportation costs in Africa between countries that are often determined by tariffs and the poor infrastructure in the region, which both have a political cause. Another example can be the high population density in inland regions in Africa away from waterways, which according to Collier (1998a) can be seen as a result of policies that preferred inland over coastal regions.

Geography and demography provides a framework for understanding part of the growth divergence puzzle. They show that policies and institutions might naturally be more effective in East Asia as compared with Africa and that the economic potential of the former was higher than the latter due to for instance population density and access to waterways. No numerical weight will be put on geography, however, since it's interrelated to other factors that in practice are almost impossible to differentiate. Even though I agree with a lot of the arguments of the more deterministic literature on geographical strains, one has to be nuanced and remember that ideas around deterministic explanations change over time, for instance Myrdal's "*Asian Drama*" which has been proven to be wrong.

1.3.2 Political environment

Table 7: Political-economic matrix		
	Majority group in control of the economy	***Minority group in control of the economy***
Majority group in control of the state	*Pro-growth and industrialisation policies*: Kenyatta regime in Kenya	*Pro-growth and industrialisation policies*: Mauritius, Botswana, Ivory Coast, Zimbabwe (1980 to the middle of the 90s)
Minority group in control of the state	*Anti-growth and industrialisation policies*: Moi regime in Kenya	*Anti-growth and industrialisation policies*: Apartheid regime in South Africa, Tutsi regime in Rwanda
Source: Soludo & Ogbu (2004a)		

This subsection will be looking at three aspects of how structural factors affect the political environment; firstly how history together with production structure creates a tension between the political and economic power; secondly how primary good dependence is though to be linked to political instability in the presence of ethnic fragmentation; and lastly how history and ethnic fragmentation taken together form the historical political climate of how ethnic differences dominate the political live. Soludo & Ogbu (2004a) mentioned that governments are interested in two things; i) Generating income; and ii) Keeping unemployment low. Industry has the potential to generate both at the same time. So a pro-industry and hence pro-growth policy would be preferred to increase industrial production which generates income and employment. But there are difficulties when a strong private sector constituting of manufactures becomes a strong force so it gains political influence. As Mkandawire (1995) noted, governments exist in a dependency relationship to its main sources of finance. If governments generate their own revenue they are more isolated and do not necessarily choose a pro-growth policy. When governments are dependent on a few key players for their income, these key players will get a greater political influence in what kind of policy the government pursues. In Japan and South Korea the government was dependent on a strong private sector which got a great deal of influence on the policies that were initiated. Many African countries which experienced increasing debts and need for foreign aid have lost some of their political autonomy and have to meet some of the political demands of donors, see subsection 3.1.1.

Firstly, history influences the political structure through the historical distribution of economic and political power. Soludo & Ogbu (2004a) claims that a majority group in power

in Africa is likely to generate a pro-industry and pro-growth policy (see table 7). If the majority group has control of the government and the same group has control over the economy promoting this group becomes politically feasible, for instance the Kenyatta regime in Kenya. If a majority group has political power, but a minority group has control over the economy, a pro-industry policy will be pursued in so far the minority group does not pose a political threat to the political establishment, for instance Zimbabwe from 1980 until 1995 or South Africa since Apartheid ended in 1994. In 1995 white farmers started to back a political opponent of Mugabe and their land was taken by the government and given to "*more loyal*" people. The rhetoric used was the unfair legacy from colonialism which left a high income inequality between white and black farmers in Zimbabwe. Before 1995, however, the income inequality was more tolerated since the white farmers didn't pose a political threat. If a minority group has political power an anti-industrialisation will be pursued according to this framework. If a minority group has political power while the majority group has economic power, policies will go to for instance a redistribution of income, for instance the Moi regime in Kenya. If a minority has economic and political power there is no need to industrialise since it might upset the status quo, for instance the Apartheid regime in South Africa where the minority ethnically white people had the political and economic power. The cases where minorities have political power are usually unstable. As a mentioned previously, the colonial powers often left a legacy of large income inequalities. Some groups were actively promoted to support the colonial powers, while other fractions were more oppressed, which created disparities in the economic power structure. When the colonial powers left Africa, often the state was given to a preferred ethnic group as a "*reward*" for the political support. So there were also direct legacies in the political power structure as well.

This framework seemed to fit well with the African examples I mentioned. But it looses much of its explanatory power when looking at East Asia. Many countries are ethnically homogenous, like Japan and South Korea, so a pro-industry and pro-growth policy seems a natural outcome. The differences in the political environment become clear when looking at Taiwan were a small group, which were ethnically Chinese, had the political power as a minority group over the majority ethnically Taiwanese. Pro-industrial and pro-growth policies were nevertheless pursued, but the character of ownership and the industry structure was markedly different from Japan and South Korea. Because the Taiwanese government didn't want large private companies which could threaten the political power, an economic structure with small and medium-sized companies was promoted. The large Taiwanese companies were

either public or "*privately-owned*" by the KMT party, which made them de facto public. Another example is Malaysia where the political power lay with the majority Malay population, but the economic power with the ethnically Chinese. When the Chinese threatened to increase their political power at the end of the 1960s this led to mass riots and violence. Since then, an active policy favouring redistribution has been followed. But, contrary to many African experiences this ethnic redistribution has been facilitated on the backdrop of economic growth. So, it was a relative, rather than an absolute redistribution. The message I want to make with these examples is that there are large qualitative differences in how ethnics, economic and political power influenced the political environment within the two regions.

Secondly, the production structure can affect the political stability of a country. Collier (2002) found that primary goods dependence increased the potential for ethnically fuelled conflicts. One possible reason might be that primary goods normally leads to "*easy riches*" due to the potential high incomes leading to increased conflicts over the potential sources of finance. In Africa the primary goods sectors are often publicly owned since they were "*strategic industries*". Since the government themselves were in control over such a major source of finance it became more isolated and did not necessarily pursue a policy that promoted economic growth (Mkandawire, 1995). I believe that control over the state, and thereby the primary goods revenues, itself became a major source of conflict as Englebert (2000) mentioned. More than a coordinating institution which could promote economic growth the state was itself a major cause of conflicts. This could have lowered the possibilities for economic growth in Africa due to their high primary goods dependence combined with their high ethnic fragmentation which increased rival tensions which in combination increased the potential for social and political conflicts. As I mentioned, Africa has been the region in the world with the most social and political unrest the last 50 years and this has made economic growth problematic. One cannot escape the fact that poverty is one of the main causes for violence and the lack of economic growth causes poverty. Violence leads to increased social and political unrest which create increased transaction costs and thereby lowers the potential for economic growth, creating a vicious circle.

East Asia has, as I mentioned, a higher degree of manufacturing in their production structure and parts are of the region are very ethnically homogenous. Two of the potent causes of social and political upheavals in Africa, ethnical fragmentation and primary goods dependence, were

less present in East Asia which could have decreased the potential level of social and political unrest. This does not mean that conflicts did not arise or that some countries had a higher potential for conflicts. Malaysia had racial motivated riots in the 1960s when the country still was mainly a primary goods exporter. An interesting question could be whether manufacturing by itself is an industry of peace. It can also be that manufacturing is an industry that increases naturally with economic growth and higher economic growth causes a higher standard of living. I would argue that manufacturing is not by itself the cause for less conflicts, but is interlinked as both a cause and an effect of the growth process, but that the real cause for less social and political instability is due to income growth. Some East Asian countries that did exhibit primary goods dependence and high ethnic fragmentation were able to break the vicious circle of poverty and violence. Increased manufacturing production was both a cause and effect of higher economic growth which led to an increased living standard; the higher living standard created a more stable social and political environment which laid the foundations for future economic growth, hence a virtuous circle.

Lastly, historical aspects like the political history are important for understanding how institutions work and how various factors are linked to the political process. An example illustrated this point. Nigeria and Indonesia are comparable in important aspects such as ethnic fragmentation and a high income from oil exports. Chang (2001) mentioned that the way the political parties were organised determined how people voted. If a country organises its parties along ethnical criteria, the changes are far higher that voters will vote along these ethnically lines. In Indonesia, the political life was less organised along ethnical lines than in Nigeria (Ikpeze *et al.*, 2004). This meant that ethnics did not dominate the Indonesian political life as much as in Nigeria. When politics are more organised along ethnically lines, the problems of ethnically fragmentation and competition for resources gets potentially larger. My point is that the African political process in general has been more organised along ethnically lines than in East Asia and this has divided rather than unified many African countries.

I believe that all the structural aspects taken together give a comprehensive background for understanding some of the differences between Africa and East Asia. But what these explanations often have in common is that they explain why "*bad*" policies were pursued and not "*how*" these policies worked. For instance, the colonial argument of extractive institutions says that African policies are not necessarily committed to economic growth. They do not

state which policies deliver economic growth. This is an inherent limitation to such literature since it often assumes that a commitment to economic growth is all that is needed to achieve economic growth. But which policies promote economic growth is still a controversial topic as will be shown chapter 2. My main message from this chapter is that structural aspects in general gave African countries more strains than the East Asian countries. In the next two chapters I will elaborate on economic policies and institutions so a more complete assessment can be made on the government's role in the two regions.

Chapter 2 – Economic Policy

The economic profession has seen a considerable paradigm shift within the period from 1950 until today. From the start of the 1950s to around the middle of the 1970s import substitution policies dominated the developmental economics debate. From the end of the 1970s until today neo-liberal policies have dominated developing economics and the policies dictated the operational workings of the Breton Wood Institutions (BWI), namely the International Bank for Reconstruction and Development (IBRD; also known as the World Bank) and the International Monetary Fund (IMF).

Following the Second World War there was a near agreement on the need for an import substitution (IS) strategy in developing countries. One reason for this near consensus was the general believe at the time which thought that the economic challenges of the 1950s would resemble the economic challenges in the 1930s which witnessed economic hardship following the Great Depression. There were three fundamental principles behind IS (Bruton, 1998):

I. *Market scepticism*: There was a general scepticism regarding the market as a mechanism for development. These arguments did not so much go against the concept of market failures, but more the international division of labour which left developing countries producing primary goods while leaving the developed countries producing industrial goods. To break out of this pattern countries should follow a path of import substitution-led industrialisation (ISI). At the time there was also a great belief in what economic planning and the state could achieve.[36] This resulted in high state intervention and a focus on economic planning.

II. *Capital accumulation*: It was believed, with right reason, that the capital available per worker was higher in the developed countries than the developing. This was seen as the main reason for the higher production in the north relative the south. As a natural consequence the way to achieve economic growth was to facilitate a process of capital accumulation. This had at least two implications: i) An overvalued exchange rate was to facilitate increased access to capital imports by making imports cheaper. To prevent large balance of payment (BoP) difficulties there were set up a number of trade barriers

[36] In the 1950s not much was known about the economic system of the USSR and from the outside it would seem that this form of economic organisation functioned reasonably well.

to prevent imports of "*unnecessary goods*", which went especially for consumer goods; and ii) To facilitate the process of capital accumulation and investments in capital intensive industries a low interest rate was set to make access to credit lending cheaper and capital intensive investments were often subsidised or facilitated through public investments.

III. <u>*Imitation of rich countries*</u>: The underlying idea behind IS was that the goods that previously were imported by the developing countries from the developed countries would be replaced with similar products produced by domestic producers. Lewis (1954) made a dual economy model comprising of a traditional and a modern sector. Most of the investment and labour were to go to the modern sector and labour was to be drawn from the traditional sector. Over time the modern sector would "*force out*" or "*substitute*" the traditional sector. An important aspect emphasised by Lewis (1954) and Fei & Ranis (1964) was that the agricultural sector should be stimulated so the transition from a traditional to a modern economy was made through increased efficiency, not forced transfer of factors.

How did the IS function in practice? In East Asia almost all countries had a IS strategy at some stage. Countries like Indonesia and Thailand had several periods with ISI in an attempt to stimulate economic growth. The communist countries, for instance China, North Korea and Vietnam, did not follow a IS strategy and had a planned economy. But there were broad similarities between the ISI and a planned economy with a high degree of state planning, public (or collective) production and a focus on capital accumulation. The results from the ISI or the planned economy models were in general not as intended. There were some common problems with the IS and planned economy regimes such as i) Macroeconomic problems stemming from increased trade restrictions, balance of payment difficulties, increased inflationary pressures and increased public deficits which increased the debt levels; and ii) Inefficient use of resources with a ineffective manufacturing sector through the lack of competitive pressure due to lack of market competition and an inefficient agriculture. There were some countries in East Asia, however, that abandoned the ISI at an early stage, such as Japan and Singapore in the 1950s and South Korea and Taiwan at the start of the 1960s. The trigger for such a shift seemed to have been macroeconomic problems such as the inflationary pressures and BoP difficulties stemming from a faster than expected rise in imports that facilitated this shift. These countries opted for a more open economy strategy which has been

termed an export promotion strategy. Some scholars (for instance, Soludo, 2002b), however, have said that Japan, South Korea and Taiwan did not abandoned the ISI strategy, but combined it with the export promotion strategy to use them as complementary. These countries were characterised by some attributes that also were common in the countries that pursued a "*pure*" ISI strategy namely; i) High state intervention and economic planning; ii) Use of protectionism to foster or simply protect domestic producers; and iii) Focus on capital accumulation. The main difference seems to have been the active promotion of exports of industrialised goods. Japan and the First Generation Tigers (FGT) were the first of the East Asian countries that exhibit high economic growth as they got their take of in the 1960s (in the case of Japan the 1950s).[37] Given that these first mover countries grew faster than other developing countries; this gave the impression of an attractive alternative to the ISI strategy. Many East Asian countries such as Malaysia, Indonesia and Thailand shifted to an export promotion strategy during the 1970s.[38] Also China (in 1978) and Vietnam (in 1986) eventually opted for a more export-oriented economy.

Most African countries got their independence around 1960 and started to pursue ISI strategies. No other region had a worse starting base measured by the amount of infrastructure, human skills and inexperienced administrators. A number of countries did manage to achieve economic growth during the 1960s and early 70s such as Cote D'Ivoire, Kenya and Nigeria. There was a high degree of public investment and the manufacturing sector expanded. Some labour intensive sectors such as textiles emerged and even some sectors with more capital intensive production such as steel and iron emerged. But the problems that were common to those countries pursuing an ISI became evident in African economies. There was a worsening of the macroeconomic stability due to increased trade restrictions, balance of payment difficulties, increased inflationary pressures and increased public deficits which increased the debt levels. In addition, there were some problems more African in nature such as small home markets due to a low population density which dampened the potential for ISI. African domestic markets were made even smaller due to the high proportion of economic activity confined to urban areas and the lack of income in, and access to, rural areas. IS proved unsustainable and the broad decline of the viability of such a strategy came with the oil price shock in 1973 which affected most African countries negatively.

[37] The FGT countries are Hong Kong, Singapore, South Korea and Taiwan.
[38] These three countries are often known as the Second Generation Tigers (SGT).

The lack of results from the ISI and the success of more export oriented countries in East Asia contributed to the legitimacy of the neo-liberal paradigm which started to dominate the mainstream at the end of the 1970s. The new paradigm saw the state as much of the reason for the failure in developing countries. To sum up bluntly, the idea that "*policy failures*" were greater than "*market failures*" started to dominate. The new presumption was the economic planning did not work in developing countries, but that markets on the other hand did. There were three main aspects that are important and which the neo-liberals criticised the ISI for:

I. *Macroeconomic stability*: For markets to function optimally there must be a predictable economic climate. Macroeconomic stability is important since it gives this stability and makes long-term commitments such as investment feasible. If, for instance, the inflation rate is very high the price now longer can be trusted to give a correct market signal regarding the scarcity value of a resource and economic actors will be confused regarding the real value of goods and factors. This could lead to less investment and hence less economic activity thereby lowering economic growth. According to the neo-liberals at the start of the 1980s the only task of the government was to maintain macroeconomic stability so that market actors would have a stable economic environment.[39] Keeping macroeconomic stability was being called "*getting the fundamentals right*". This was according to the neo-liberals the first of three reasons why the ISI failed. Macroeconomic stability was not prioritised under the IS regime. This raised the uncertainty of doing business by raising transaction costs and thereby lowered investments and economic growth.

II. *Free market ideal*: To the neo-liberals the free market was the ideal version of economic organisation. Free markets would give neutral incentives where prices would reflect the scarcity value of goods and factors. Rational market actors will maximise their utility function given their budget constraint and the prices of goods and factors. This would give an optimal allocation of goods and resources since prices reflect their scarcity value and this will lead to a Pareto optimal allocation of goods and factors. A free market will therefore, according to the neo-liberals, give the most efficient usage of resources and will give the most efficient long-term growth rate. State intervention would disrupt the

[39] Some would also emphasise that many neo-liberals also saw the provision of public goods such as the rule-of-law, infrastructure and the military as some of the few necessary tasks of the government.

price signals and would therefore give a less than optimal allocation of resources. The high state intervention during the ISI was seen as the second of the three major reasons for why IS failed. The arguments against state intervention apart from the efficiency argument are; i) According to the "*public choice*" argument the state as a rational actor will attempt to maximise its own utility function (for instance staying in power) and will distribute "*rents*" to achieve this objective (see for instance Krueger, 1974; and Bates, 1981). Hence, those who benefit from a certain policy, the vested interests, will be able to capture the state and use it to protect their own interests. This is damaging for the economy since it for instance can generate monopoly profits for the vested interests and prevent structural change; and ii) The state will be inefficient in correcting market failure since they have less information than private market participants regarding market conditions and can therefore not take informative decisions.

III. <u>*Open economies*</u>: More open economies, which are better integrated into the international market, will have a more advanced division of labour based on international market conditions. This allows countries to exploit their endowed comparative advantages which would make economies more productive which would boost their long-term economic growth. Economies that are more open can upgrade their production structure by having better access to technology which would increase their ability to catch-up with the leading countries by upgrading their production structures to more advanced modes of production. Moreover, the increased competitive pressure from international markets could make domestic producers more efficient. Protected home markets would not be as much affected by international market forces and hence be less efficient since it relies on a smaller domestic market. The protectionist policies under ISI is the last of the three reasons why the neo-liberals criticised the IS regime. Two of the arguments that are mentioned are; i) According the "*public choice*" literature those who benefited from the protectionist policies became strong enough to defend these policies even though the society as a whole lost out due to protectionism; and ii) An overvalued exchange rate made exports more expensive for foreigners and hindered a high export growth during the ISI.

The neo-liberals took the high economic growth in South Korea and Taiwan as evidence for their views. At the start of the 1980s the neo-liberals interpreted these two countries with the following characteristics; i) Governments were able to keep a stable macroeconomic

environment; ii) Apart from keeping macroeconomic stability, there was little state intervention, citing the low levels of public investments relative to GDP compared to other developing countries; and iii) The economies were open and adjusted to international market conditions. Japan was already at the start of the 1980s known to have used high state intervention and protectionist measures and was seen as the exception thanks to the work by Johnson (1982).[40]

The IBRD (1981) issued a rapport on Africa, also called the Berg rapport, where the causes of the poor development in Africa were discussed. The rapport concluded that policies were at fault for much of the reasons I mentioned above. It was this interpretation that laid the foundations for much of the increased donor involvement from the start of the 1980s and onwards. In 1982 there was a debt crisis in many African countries and given that they could no longer obtain credit in international credit markets this led to increased loans from the BWIs. These were on two levels. On the first level, the IMF was to secure short-term macroeconomic stabilisation through the stabilisation policies. One of the measures was the scaling down of public expenditures which involved less expenditure on infrastructure, schooling and agricultural subsidies. Also it meant a tightening of credit to control the inflationary pressures and the introduction of user fees on schooling and health services to increase the state income so the public deficit was lowered. On the second level, the Structural Adjustment Programs (SAP) by the IBRD was to secure the long-term competitiveness of the African economies. This meant the privatisation of publicly owned companies, scaling down the public sector, secure a market-based interest rate, liberalise foreign trade and a scaling down of the manufacturing subsidies. This would facilitate a vision of free markets in a macroeconomic stable environment which were integrated in the international economy. This was how the neo-liberals at the time thought South Korea and Taiwan were able to grow so rapidly. Free markets were thought to work at any stage of development. The results of these donor programs, however, were disappointing. Africa had negative economic growth from 1980 to 1995. Much of this has to be attributed to political and social conflicts. But, even in those countries that were stable and reforms were implemented more successfully, the results were disappointing.[41] The BWIs, however, did not believe in the inadequacy of the SAPs. The

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[40] It is important to remember that this is a comment to mainly the American academic debate. The view of seeing South Korea and Taiwan as "*pure*" market economies was controversial right from the start in other academic forums, without it being given much attention by the American profession.

[41] The IBRD (1992) rapport was to be titled: "*Why Structural Adjustment has not succeeded in Sub-Saharan Africa*", but this rapport was withdrawn and given a less controversial title. See UNIDO (2000), p.14.

blame for their failings was not the contents, hence the policies that it facilitated, but faulty implementation by the African governments. Thus the blame was to be laid, not on the neo-liberal policies, but on the African governments. One of the major paradoxes for the supporters and the critics of the SAP alike has been the fact that the SAP would reduce the state's power in Africa. But at the same time it was the state itself that had to implement these reforms that would reduce their own power. This was an inherent contradiction which did not make sense in the "*public choice*" literature and paved the way for a more strict practice of conditionality. If a policy was not implemented, a country would not receive any more loans.

The neo-liberal paradigm has come under heavy criticism, part of which it has incorporated. It's interesting how some of the increased legitimacy of the neo-liberal paradigm came from the export-growth of South Korea and Taiwan. The revisionists first came into the fore when criticising the neo-liberal interpretation of the economic growth in these same countries. What I term revisionist are structuralist that argue for a "*developmental state*" model for economic development. In this perspective neither the market nor the state alone can promote economic growth at a low stage of development. These institutions are complementary and need to work together to develop beyond a low stage of development. A key intellectual feature is that markets are not regarded as natural nor are they automatically the most efficient mechanism for the allocation of resources. A strong state is needed not only to support markets but also enhance their workings. According to Chang (1999b) a developmental state has four functions:

I. *State coordination for change*: The state is probably the only institutions that can coordinate investments that are needed in several markets at the same time at a lower stage of development. This is the so-called complementary investment argument also known as the "*Big Push*" argument.

II. *Growth vision*: A vision of how an economy is to come from a lower development equilibrium to a higher development equilibrium. Visions can reduce uncertainty, increase the mobilisation of resources and increase government commitment to economic growth.

III. *Conflict management*: Structural changes and changing power relationships that may arise from economic growth can provoke political or social reactions. Given the

necessity of political and social stability for economic growth to take place these challenges need to be dealt with to maintain economic growth.

IV. Institutional building: In institutional theory the state is seen as an endogenous product of the society over which it presides and will therefore partly be a product of the institutions that surround. This means that any developmental state is by definition unique to the society where it exists and needs to adapt to the specific needs that specific country has. Within institutional economics the deeper causes for low economic development is that the institutions in the country are not adapted to the new technological and market opportunities that exist. It thus becomes the state's job to support and build these institutions, including markets.

The debate has been heated over the appropriate interpretation of the "*East Asian growth miracle*". Amsden (1989) and Wade (1990) showed that South Korea and Taiwan did use a high degree of state intervention and protectionist measures. The new slogan became that South Korea and Taiwan grew because they "*got the prices wrong*" and promoted sectors in which they did not have a natural endowed comparative advantage. The whole concept of a developmental state was first launched by Johnson (1982) in commenting the high economic growth in Japan. The developmental state interpretation was now being used to analyse South Korea and Taiwan as well. The reaction initially from the neo-liberals was either to ignore the evidence or to claim that the industrial policy was ineffective since the same industrial structure would have emerged had the economies been subject to market forces. The problem of accepting the presence of state intervention in the economy was not only due to the predictions of the "*public choice*" literature, but also because East Asian governments did not correct market failures in the neoclassical sense. IBRD (1993), "*the East Asian Miracle*" was an attempt to make a consensus of the viewpoints, but was able to create more smoke than light. It was unique in the sense that it was the first time the neo-liberals admitted that the industrial policy was present in East Asia outside of Japan. The rapport even claimed that some elements, such as the complementary investments and export promotion had under some conditions been successful. However, IBRD (1993), this was due to "*historical fortunate circumstances*" such as a Confucian style bureaucracy and a strong state which were not present in other countries and hence could not be emulated. Most industrial policy, the rapport concluded, had been ineffective and that East Asia grew despite, rather than because the

industrial policy. IBRD (1993) certainly did not dampen the debate, but it definitely created a new phase of the debate.

The debate is just as fierce in Africa. Stein (2000) and Soludo (2002b) readily argue for the creations of "*African developmental states*" and cite how Botswana and Mauritius have exhibited sustained economic growth using more heterodox economic policies. There are a number of factors that are criticised in the Berg rapport regarding the neo-liberal interpretation of the economies which laid the foundations for the SAP. I can mention four of these. Firstly, macroeconomic shocks were ignored as a cause for the poor African growth performance, despite the oil price shocks during the 1970s and the fact that African exporters rely heavily on primary goods. The reason given by the IBRD was that all developing countries suffer the same shocks and therefore the internal policies, not external shocks, were at fault for the macroeconomic instability. I have already commented on the infeasibility of this argument in subsection 1.2.3. Secondly, it was presumed that microeconomic inefficiency was the cause of macroeconomic crises even though there is no evidence to back such an assessment. Thirdly, the Berg rapport gave a incorrect picture of African development prior to 1980. According to the rapport the situation before 1980 was a total disaster, ignoring the economic growth that did take place in Africa from 1960 to 1973. Lastly, there was a presumption within the SAP that a scaling back of the state automatically would lead to that the private sector took their role in the economy. The private sector, on the other hand, was badly organised and weak. During colonial times there was no large accumulation of private wealth which often was discouraged by the colonial masters. IBRD pointed to the fact that there was a large informal sector which could take this role. But this informal sector is often just a supplement to a job in the formal sector to earn enough income to stay alive. To sum up the criticism against the SAP, the IBRD did not take historic and institutional conditions into consideration when forming its policy. The IBRD (1994) rapport "*Adjustment in Africa*" attempted to show that "*adjustment works*". This rapport was as controversial as the IBRD (1993) rapport in the East Asian debate and created more debate rather than to damp them. Not even IBRD (1994) own figures were able to show a consistent story and many accused the IBRD for manipulating the numbers so they would fit their own policy agenda, the so-called "*market friendly view*". However, it was the first time that the IBRD admitted that "*adjustment is not enough*".

The debate about the "*correct*" economic policy is unlikely to die any time soon. There have been differences and similarities between the economic policies pursued in Africa and East Asia. Many would claim that to understand the growth divergence one should focus on what differentiates the two regions with regard to their economic policies. Different economic policies are an important key to understand growth divergence. But there is a problem of which different policies to focus on. This problem is reflected by differences in policies within the two regions in question. For instance Hong Kong had very liberal policies and is perhaps the country in the world that has come closest to the neo-liberal ideal. While the South Korean developmental state with high government intervention, relatively high debt levels and protectionism could be regarded as a potential opposite. I will emphasise differences in general policies and how relevant they are for understanding the growth divergence. But does this mean that similar policies between the two regions are irrelevant? I believe the answer is firmly in the negative for two reasons. Firstly, every part of economic policy is part of a coherent whole and should be seen in relationship to other aspects of economic policy. Secondly, a similarity in the official policy often does not say anything about the effective policy. My point is that the implementation of policy varies between countries and this might be a key factor in understanding the growth divergence. Hence, similarities in economic policy will also be assessed in so far they contribute in the understanding of the growth divergence. To be able to assess the role of economic policy I will focus on three aspects of economic policy that have been contested and often mentioned in debates; i) Macroeconomic policies; ii) Industrial policies; and iii) Trade policies.

2.1 Macroeconomic policy

There can be little doubt that the relative macroeconomic stability in East Asia was an important aspect of the "*growth miracle*". Equally, there is little doubt that the macroeconomic instability greatly contributed to the poor growth performance in Africa. Due to this near consensus I will only briefly review the policies that facilitated these outcomes by looking at three main indicators of the macroeconomic environment:

I. *Inflation*: The inflation in East Asia was reasonably low and perhaps more important, it was relatively stable. Compared to Latin America, African countries on average did not have the same high rates of inflation, but what characterised the inflation rates in Africa

was their high volatility.[42] This led to increased uncertainty which increases transaction costs which might have put investors off and created by creating an unstable environment. An important variable that was affected by inflation was the real interest rate which was kept low in both regions during the 60s and 70s. The increased volatility of the African inflation rate intuitively spurred a more unstable real interest rate which increased the uncertainty for investments and loans. I will come back to the effects of the interest rates in subsection 2.2.1.

II. *Debt*: The debt crisis in the beginning of the 1980s was one of the most pronounced macroeconomic shocks that hit the developing countries. Debt levels in the East Asian countries were mixed with Hong Kong, Singapore and Taiwan with virtually no debt; while South Korea had very high debt levels around the beginning of the 1980s. An important question is why the debt crises didn't affect the Korean economy in the same fashion as other developing countries. There are two main explanations. The first, prompted by the neo-liberals and the main explanation in IBRD (1993), states that South Korea was more open than other developing countries and that their flexibility was the main determinant for why the short term credit was allowed to roll on. The second explanation, fronted by the revisionists, says that the neo-liberal argument does not hold water since some more open economies in Latin America did suffer from capital shocks in the start of the 80s; while more closed economies than South Korea, like India and China did not suffer the same shocks. The revisionist argument states that South Korea got the continued investors trust by being in a high growth region. Had South Korea been a Latin American country, it's not sure that investors would have the same degree of faith (see for instance Soludo, 2002b).[43] Africa did suffer a capital supply shock in the beginning of the 80s while East Asia did not (Singh, 1995). For Africa this meant that foreign currency had to come from other sources and led them to seek SAP loans (Stein, 1999). These packages, as I will elaborate on later in this chapter, did in general not promote economic growth. However they did increase the debt level for African countries even further.[44] This had a number of adverse effects, for instance; i) A high

[42] SAP with its devaluation caused the inflation to raise in the short run which in the Latin American case, due to strong labour unions, did not facilitate a decline in real wages which spurred episodes of hyper inflation. In Africa, labour unions in general were less strong and episodes of hyper inflation were in general avoided.

[43] This is a "*horde mentality*" interpretation behind investments and capital accumulation process, for a theoretical foundation see for instance Minsky (1978) and Kindleberger (2000).

[44] As Stein (1999) reported, the international debt level of Africa was 227 billion USD, which was three times the level as in 1980. This meant that every citizen in Africa owed 379 USD in 1996.

proportion of GDP went to debt serving; and ii) Increased dependence for external donor support prompting a relative loss of political autonomy (see section 4.1.1).

III. *Exchange rate*: East Asia, due to its dependence on exports, relied heavily on convertible exchange rates. During the Breton Wood gold standard system the Asian countries had stable convertible exchange rates to the USD. Japan was able to exploit this to full effect. While manufacturing was more productive in the US, the Japanese had a higher relative productivity growth compared to the US partly due to a catching-up effect which meant that the Yen was de facto devalued.[45] After 1973 the East Asian exchange rates have been either been "*realistic*" or slightly undervalued to not hurt exports. Most importantly, an overvaluation was in general avoided. An overvaluation of the exchange rate raises the prices of exports for foreigners which intuitively reduces exports. More recently, China has been the target for US criticism for using a similar strategy as the Japanese. The Chinese Yuan has had a fixed exchange rate relative to the USD which due to the higher relative productivity growth in China vice versa the US has led to an overvalued USD relative to the Yuan which is fuelling some of the trade deficit the US has with China. In Africa, on the other hand, the exchange rates were often overvalued during import substitution to make imports cheaper. But, this overvalued exchange rate made the country's own products more expensive for foreigners and thereby dampened exports. The devaluations that have followed the SAP have in general not spurred an increase in the African export performance (Kandiero & Randa, 2004). It has been suggested that one of the reasons for this failing is that devaluations only have a short term effect in affecting relative prices. Also, the devaluations seem to have contributed, at least in the short run, to increased inflationary pressures. Another factor dampening African exports has been the lack of convertibility of the exchange rates which intuitively did not promote international trade.[46]

The ISI policies deserve a mentioning here. There is no doubt that one of the main failings of the approach was that it did not prioritise macroeconomic stability as much as it should. There were increased trade restrictions on exports which limited the foreign exchange earning and

[45] In a system of flexible exchange rates the Yen would have appreciated to take into account the changes in relative competitiveness. According to Singh (1995) the USD appreciated 60 % measured in PPP relative to the Yen in the period 1950-73. One can ask oneself the question whether this was "*getting the prices right*" as the IBRD (1993) claimed.

[46] An exception to this general rule were the countries a group of former French colonies in CFA zones which used a fixed exchange rate relative to the French franc (see Hoffmaister *et al.*, 1997)

worsened the balance of payment difficulties. Also the overvalued exchange rate made imports "*artificially*" cheap and increased imports. This was also the intension of the IS strategy, the problem was that the imports increased much faster than was anticipated increasing the BoP difficulties. There were also increased inflationary pressures stemming partly from the increased public deficits. African governments were in the 1960s and 70s accused of financing part of their public deficit through increased seignorage. In addition the public deficits increased the debt levels and laid some of the foundations for the debt crisis which hit the developing countries in the beginning of the 1980s. These debt levels were partly fuelled by a high public consumption stemming from high prices on primary goods and well willing lenders of money internationally. It seems the neo-liberals were spot-on when criticising the macroeconomic policies of the IS regime. Also the "*new structural paradigm*", the revisionists, has acknowledged this fact and policies that maintain macroeconomic stability have become common ground in economics.

Macroeconomic instability was higher in Africa than in East Asia and explains a considerable proportion of the causes of the growth divergence. But they are not the entire story. At the start of the 1980s the neo-liberals claimed that by "getting *fundamentals right*" through macroeconomic stability was all that was needed to promote economic growth given that governments did not intervene beyond this. As I mentioned, the Berg rapport claimed that all developing countries suffered the same shocks and that the main culprit behind the macroeconomic instability were the internal policies. The stabilisation policies of the IMF have drawn criticism on the grounds that it only focused on macroeconomic stability from 1980 to 1985, leaving nothing for development. The problem was that an unstable international environment led to external shocks which made macroeconomic stability a "*moving target*". Long-run macroeconomic stability, say the critics, can only be achieved through long-term economic growth and therefore one should go beyond macroeconomic fundamentals and also focus on "*growth fundamentals*". There is no doubt that East Asian countries have profited greatly from governments that have chosen relatively "*sensible*" macroeconomic policies. African governments have often not done so and despite the well intensions from the IMF, it seems that external donors have contributed rather than resolved macroeconomic instability. To be fair on the IMF, they did eventually manage to stabilise many of the African economies. But, the reduced spending on higher education, infrastructure and the introduction of user fees on education and health might have dampened some of the prospects for long-term economic development. It is not so much that anybody denies that

something drastic had to be done regarding the macroeconomic instability of the African countries, but some have criticised the IMFs policies for being too contractive. The consensus that has emerged, however, is that macroeconomic stability is a necessary, but by itself insufficient condition for economic growth.

2.2 Industrial policy

Industrial policy is one of the most controversial topics in developing economics. It is also a topic that is often confusing in the sense that different authors mean different concepts when discussing industrial policy. The reason for the controversy is partly that some authors talk past each other when discussing industrial policy. One version of the concept highlights the selective element that some industries are fronted at the expense of others; see for instance IBRD (1993) and Noland & Park (2003). Another version of industrial policy highlights the deviation from free markets, for instance Lall (1996). Another version highlights a broad definition that includes elements such as interference in financial markets, labour markets, technological learning, and competition rules; see for instance Johnson (1982).

The outcome of the effect of industrial policy might partly be due to the definition chosen. That is why one should proceed with caution. Haggard (2004) attempted to structure the industrial policy debate in East Asia and highlighted market errors as the foundation for industrial policy. I will use his structure as the basis for my definition of industrial policy which includes four elements, where three of these will be discussed in subsequent subsections:

I. *Financial system*: A key argument in discussing industrial policy is the role of underdeveloped financial institutions at a low stage of development. I will look at the functioning of the financial system in the two regions in subsection 2.2.1.

II. *Learning- and technological transfer*: Difficulties in the learning process at a lower stage of economic policy has also been a key argument in favour of industrial policy. I will look at the role of learning and technology transfer in the two regions in subsection 2.2.2.

III. *Coordinating*: At a lower stage of economic development there might be certain sectors that are underdeveloped which might hinder the development of other sectors. This gives rise to the "*Big push*" argument where governments invest in a number of complementary sectors which might be difficult for private actors to coordinate. I will develop this line of argument somewhat further and highlight the role of policies and institutions in the economic take-off and the continuation of economic growth (or the lack of economic growth). I will look at this topic in subsection 2.2.3.

IV. *Agglomeration economics*: A last line of industrial policy debates is about agglomeration economics which came into being after Krugman's (1991) observation that "*national*" economies are driven by regional clusters. Even though agglomeration economics has some potential benefits in explaining the growth divergence in the two regions I feel it is of lesser relevance than the other three elements and hence will not be discussed further.

2.2.1 Financial system

The financial system is an essential part of an economy and critical to promote economic growth. In essence the financial system has three major tasks in the saving-investment-growth nexus (Nissanke & Stein, 2002):

I. Channelling funds from surplus to deficit units by mobilizing resources and ensuring an efficient transformation of funds into real productive capital.

II. The maturity transformation between savers and investors, while providing sufficient liquidity to the system as the need arises.

III. Reducing risks from the system through diversification and techniques of risk sharing and risk pooling.

The financial systems worldwide have gone through two distinct periods in the post-WWII economic area. The first period from the end of WWII to approximately 1980 was characterised by Keynesian policies with limited capital mobility and repressed interest rates. The second period from approximately 1980 and onwards has seen increasing financial

liberalisation and increasing capital mobility across borders. These impulses also affected the countries in Africa and East Asia.

Import substitution (1960s - approximately 1980)

Import substitution was based on the Harrod-Domar growth model. The reason for the higher production in the richer countries was due to the increased capital per capita (see for instance Stein, 2000 and Wange & Semboja, 2002). Thus the perceived way to achieve economic growth was to promote capital accumulation (Bruton, 1998). Two factors are worth remembering. Firstly, markets were not perceived as the appropriate mechanisms since they were prone to market failures. Secondly, there was a great belief that the governments were able to promote economic growth. These factors contributed to the idea of a supply-driven economic growth based on capital accumulation and it was thought that the economics-of-scale would automatically be achieved through bigger companies.[47] Governments, in cooperation with the private sector, should promote the financial sector by decreasing the transaction costs and increase the economics-of-scale. To promote economic growth the financial system under import-substitution should (Seemogerere, 2002):

I. *Lower the cost for investments*: The interest rate should be kept low to promote investments. Keynesian theory postulates that the interest rate is a cost for investors, by having a low interest rate it lowers the cost for investment thereby intuitively raising investment levels.

II. *Financing public expenditure*: The low interest rate can finance an increased public expenditure. The increased public expenditure could increase the investments in infrastructure, schooling and public investments to promote the rural areas.

III. *Sector limits for credit*: A limit to the amount of credit going to each sector. This would promote the allocation of credit into sectors that had a higher social relative to private benefits which would be rationed out of a purely market driven system due to the high perceived risks of investments in developing countries.

[47] This got Lewis (1955) to summarise; "*The central problem in the theory of economic growth is to understand the process by which a community is converted from being a 5 % saver to a 12 % saver*".

IV. *Increase savings*: Economic growth would increase the savings which would secure the supply of liquidity to the financial system. To increase the financial savings the operational structure of the financial system should be in place to enable the transformation of savings into financial savings.[48]

In practice, this form of financial organisation had different effects for the two regions. Hellmann *et al.* (1997) conclusion was that "*financial restraint*" as implemented in Japan, South Korea and Taiwan promoted economic growth. They also mentioned that Japan around 1973 started to liberalise its financial sector which could indicate difficulties with this type of financial organisation when countries reach a certain level of development. There are four factors that I believe have been important in these three countries:

I. *Government interference*: Chang (2004) mentioned that the government control over financial flows was more important that control over production. The financial system was important to promote industrial policy. This was done in different ways. In South Korea and Taiwan this was done through direct ownership with many state-owned banks, in both countries the bank sector was at one stage wholly state-owned. In Japan the banks were predominately private, but the post-office saving programs were publicly owned.[49]

II. *High ability to increase savings*: There is no doubt that the high financial savings in Japan and the FGT were in part a function of the high economic growth. But the countries also showed a high ability to capture the increased savings, especially in rural areas were many saving programs were launched and the authorities lowered the transaction costs for people to save financially. For instance Japan initiated so-called post-office saving programs to increase the availability of financial saving services. In the case of Japan some authors even rapport that employees in banks went physically to

[48] Desai & Mellor (1993) elaborated on six organisational principles behind the financial system under IS; i) The promotion of many financial institutions, more than one per service; ii) The promotion of a variety of organisational forms among these institutions; iii) Secure a vertical organisational structure from the local to the regional to the national; iv) Promote a high geographic concentration of field offices; v) Make financial services available to a large parts of the population – especially in rural areas; and vi) Promote a diversification and multitude of services through a horizontal diversification thereby meeting the needs of the clients.

[49] Before WWII the bank sector in Japan was publicly owned, but under American administration these were privatised. The tight cooperation between the government and the private banking sector nevertheless continued after 1953 which could indicate that the institutions changes less rapidly than formal ownership.

the clients home to collect savings.[50] Another factor that has received attention was the so-called limits on luxury consumption which have facilitated a decrease in consumption and hence an increase in savings.

III. *Increased quality of transactions*: Institutions to support the working of the financial system were set up while the economic growth was ongoing. In Taiwan the informal sector was not discouraged, but supported to increase the quality and quantity of the financial transactions. A high proportion of the total financial savings came from the informal sector (Adams *et al.*, 1993; Cho, 1990; and Shae, 1994). For instance the quality of the "*post-dated checks*", which was the most used financial transaction in the informal sector in Taiwan, was improved The government managed to increase the quality of these transactions by imposing punishments, even jail sentences for those which were not able to meet their obligations (Wade, 1990; and Shae, 1994).

IV. *Conditional state support*: Preferential loans with low interest rates were not given unconditionally. The continuation of these preferential loans was dependent on production and/or export goals and these yardsticks were forcefully implemented. This gave the companies an incentive to increase production and upgrade their production structure; I will come back to this argument in the next subsection 2.2.2.

The effects of "*financial repression*" in Africa were different than for East Asia. Some supporters of import substitution will point to evidence that the financial system was able to support the economic growth from 1960 to 1973. But there were qualitative differences with East Asia and the financial system did not function as smoothly. I would like to highlight four factors:

I. *State interference*: The negative effects of state interference were underestimated (Seemogerere, 2002). Private relationships to obtain credit became important for access to formal credit systems. The poorest therefore got "*rationed*" away from formal credit markets due to the lack of personal contacts.

[50] See Kitagawa & Kurosawa (1994) and Teranishi (1994).

II. *Problems with the low interest rate*: The low interest rate had two adverse effects for the African financial system; i) Many financial institutions went bankrupt since the low deposit rates gave them little possibilities to increase their earnings to cover the operational costs; and ii) Capital was allocated inefficiently into sectors with low profitability leading to a accumulation of non-performing loans (Inaga & Ekpenyong, 2002).

III. *Urban bias*: Most of the formal financial institutions were placed in urban areas which meant that a lot of people in the rural areas lacked access to the formal credit market.

IV. *Unconditional state support*: Preferential loans initiated by the government were often given without production and/or export performance criteria. In those instances that they were given, they were loosely implemented and had few consequences if they were not met.

The natural question that arises is what factors differentiate the "*financial repression*" in East Asia and Africa. Financial systems with "*financial repression*" had some common attributes: i) They were bank dominated; ii) Had low profitability for financial institutions; iii) There was a tight regulation of the bank sector; and iv) The financial sector was dominated by imperfect competition. There are at least four factors that account for the different experiences of "*financial repression*":

I. *Economic growth*: The economic growth was far higher in East Asia than in Africa also in the 1960s and allowed for continued liquidity to the financial sector.

II. *Rural presence*: The governments in East Asia were more competent in increasing the rural presence of financial institutions relative to Africa and this enhanced their ability to increase the financial savings stemming from economic growth.[51]

III. *Type of investment financed*: This is most likely the single most important explanation for the different experiences and three arguments needs to be stressed; i) The presence

[51] This must be set into perspective by remembering my previous argument in sub-section 1.1.2 regarding population density; the costs of having an increased rural presence in Africa might naturally be higher than for East Asia since an increase population density might allow increased economics-of-scale which would decrease unit costs.

of conditionality with preferential loans in the East Asian case promoted a more efficient utilisation of capital than in the African case; ii) In East Asia the financial system was able to promote large flows of private investments, while in Africa the financial system promoted large flows of public investments. This might have made investments in Africa less efficient than in East Asia, not because they were public per se, but because the state sector in Africa very inefficient; and iii) Investments in East Asia were often in "*sunshine*" industries that were able to promote the long-term competitiveness of the economy. The financial system was important in financing these so-called "*sunshine industries*" since they were long-term investments with high-risks which under a market-driven financial system might not have been financed; the African investments did not manage to show the same abilities in "*picking winners*" as East Asia; I will come back to this argument in the next subsection 2.2.2.

IV. Coordination with other policies: In East Asia the financial system was an integrated part of a wider vision for economic growth which was more effectively implemented relative to Africa. Some African countries, for instance Nigeria since 1970, have emphasised industrialisation, but the policies conducted towards the financial sector (and other parts of the economy) have not matched this objective. The high coordination of economic policies with the stated objectives in East Asia is something I will emphasise in subsection 2.2.3.

The traditional perception by the neo-liberals is that the financial system did not promote economic growth in East Asia since it wasn't different from other developing countries (see for instance IBRD, 1993). I don't agree with this assessment and I have to agree with Hellmann *et al.* (1997) that financial repression as implemented in East Asia seems to have promoted economic growth.[52] For me, the major difference between the East Asian and African case is the more effective implementation of "*financial repression*" in the former and the organisational and institutional failures that hindered the functioning of the financial system in the latter.

[52] For similar conclusions see Stein (1999), Stiglitz (2001) and Weiss (2005).

Financial liberalisation (from approximately 1980)

The neo-liberal based their arguments for financial liberalisation from 1980 on the McKinnon-Shaw model. The basis is a free market model as in neoclassical economics with full information and perfect competition. On the demand side the private sector will lend credit and invest the capital to maximise their expected return. On the supply side banks will asses the credit worthiness of the projects and allocate their funds accordingly. The interest rate functions as the market clearing price. If there is excessive demand for credit the interest rate will increase which facilitates two effects; i) This increases the cost of capital and thus effectively decreases demand; and ii) Increases savings since the interest rate is the reward for saving as opposed to consuming in the current period and thereby facilitating increased liquidity to the financial system which increased the supply of money. Thereby the market equilibrium will be restored. Perfect capital markets will according to this theory give a Pareto optimal expansion of economic activity and the projects with the highest profits are also the projects with highest social value.

According to the neo-liberals "*financial repression*" had a number of disadvantages which slowed economic growth (Seemogerere, 2002):

I. *Low profitability of investments*: A low interest rate will make capital "*artificially*" cheap and promotes investments with low profitability which reduces economic growth by a less than optimal allocation of capital since capital is not priced by its opportunity cost.

II. *Low savings*: A low interest rate does not encourage savings since the reward of postponing ones consumption, hence savings, is dependent on a reward of parting with liquidity which is the interest rate which was low.

III. *Burden on financial institution*: There were several burdens on financial institutions during financial repression which include: i) A low profitability due the lack of independence in setting the interest rate; and ii) The high capital requirements was an implicit tax for the financial institutions thereby reducing their profitability.

IV. *Discrimination of small agents*: Small rural agents were often "*squeezed out*" of formal financial systems due to the lack of personal contacts and the costs of obtaining information regarding loans was often higher than the utility of the loans.

According to the neo-liberals financial liberalisation would have a number of benefits that would promote economic growth (Inaga, 1995):

I. *Effective investments*: The increased "*financial deepening*" will give more effective investments which will boost the overall productivity of the economy and hence economic growth.

II. *Higher interest rate*: A market-based interest rate (normally higher than the one under IS) will promote: i) An increase in the flow of liquidity to the financial system by increasing the reward of savings over consumption; and ii) More efficient investments by allowing capital to be priced according to their opportunity cost thereby disciplining investors.

III. *Privatising*: Privatising public financial institutions will: i) Reduce opportunistic behaviour; and ii) Increase the level of competition which will give better qualities on the services that financial institutions provide.

Both Africa and East Asia liberalised their financial systems to a more market-based approach. The experiences are again mixed. In East Asia the liberalisation was more successful, but there seems to be increased volatility following liberalisation and it's not clear whether financial liberalisation and more capital-market based financial system have contributed to increased economic growth. With regard to the financial liberalisation that has taken place in East Asia there are three major points which I believe explain the more successful liberalisation in East Asia:

I. *Country differences*: The speed and nature of financial liberalisation was adapted to the needs the economy and "*one-shoe-fits-all*" solutions were avoided. In Japan the banking system started to liberalise in 1973 by removing some of the regulations on banks and a deregulation the interest rate. When Malaysia started to liberalise in the 1980s it first raised the interest rate prior to liberalisation to observe the health of their banking

sector. This allowed a more informed liberalisation process where the weaker elements of the banking sector were able to be given closer attention. The point is that this incremental liberalisation succeeded since they were country specific (Inanga & Ekpenyoung, 2002).

II. *Economic growth*: The reforms were initiated during economic growth and were a result of changing government policies rather than an economic slowdown. South Korea is a example were from the 1980s, and especially from the end of the decade, there was a growing internal pressure to liberalise the financial sector even though economic growth rates were still high.

III. *Institutional building*: Institutions were build while economic growth was ongoing to increases the governments' ability to monitor capital flows to keep macroeconomic stability and create an adequate institutional framework for a more liberalised financial setting.[53] Malaysia choose to increase the regulatory and monetary capacity of the central bank while keeping, the above mentioned, high interest rate to be able to identify some key challenges prior to liberalisation.

The liberalisation in Africa has had far worse repercussions than in East Asia. Again, the experiences are mixed. Botswana and Mauritius were able to liberalise their financial systems on the backdrop of country specific policies and economic growth, which I mentioned were trademarks for the East Asian liberalisation process. The general picture is, though, far more bleak. There are four factors that explain the weak liberalisation results:

I. *Non-tailor made solutions*: Liberalisation in Africa in general followed four types of reforms (Seck & El-Nil, 1993); i) A liberalisation of the interest rate which would increase the interest rates to market levels increasing savings and thereby investment rates; ii) Restructuring of the banks, with many of the non-performing loans being written off; iii) Privatisation of the banks, most of them were state-owned; and iv) Bank liquidations. But these reforms did not take country-specific needs into consideration. According to Villanueva (1988) and El-Nil (1990) there were different motivations for

[53] Some would claim that the liberalisation in countries like South Korea went too far in abolishing institutions that monitored capital flows at the start of the 1990s on the recommendations of the IMF. In addition, a looser regulatory framework is by many believed to be a major cause for the build-up to the East Asian financial crisis which hit the South Korean economy hard.

financial liberalisation which included; i) Increasing the monetary control system, for instance Botswana and Mauritius; ii) Increasing the mobility of savings by reforming the legislation for the banking sector, for instance Kenya and Zaire; iii) Increasing the quality of the banking system and the level and structure of the interest rate, for instance Mauritania and Senegal; and iv) A combination of these different motives, for instance Nigeria and Zimbabwe. I believe many of the reforms failed because they were not custom-made to the specific needs the different African countries had.

II. *Lack of economic growth*: The reforms were more often a result of a growth slow-down. One of the most severe implications of the lack of economic growth is the difficulty to obtain increased liquidity to the financial system since economic growth is correlated with increased savings. I believe this argument is easiest shown by looking at the financial liberalisation in Botswana and Mauritius which did exhibit economic growth and were able to liberalise their financial system relatively well.

III. *Macroeconomic instability*: As I mentioned in section 2.1 there was a high degree of macroeconomic instability in Africa during the 80s and partly the 90s. Often African countries attempted to liberalise their economies while there still was macroeconomic instability present. There is a near consensus that financial liberalisation in an unstable macroeconomic environment increases difficulties. In Nigeria and Kenya the reforms were implemented while there was instability in the banking sector and macroeconomic instability (Soyibo, 1994). One of the results was a capital flight from Nigeria between 1986 and 1994 (Lewis & Stein, 1997). In other countries, such as Zaire and Zambia there was stability in the banking sector, but there was still macroeconomic instability. The reason why macroeconomic instability has such adverse effects is that even rational market participants want to place their money in activities with a rapid pay-off such as imports or speculation since the long-run situation is uncertain.

IV. *Institutional weakness*: The banking sector and the regulation-institutions were often weakly development. In addition, the banking sector was often in disarray when liberalisation started as I mentioned. Another key failing, I believe, is the lack of institutional building that followed with the SAP. Stein (1999) mentioned that financial institutions should be tailor-made since they need to co-exist with the existing

institutions, such as informal markets which are large in Africa. I will comment on this further later on.

A comparison between the two regions shows a number of key points for why the financial liberalisation was more successful in East Asia than Africa:

I. In East Asia financial liberalisation was to a greater extent custom-made to the needs of the economy, while the SAP more often dictated "*universal*" solutions for African countries bypassing country-specific needs.

II. The presence of economic growth in East Asia facilitated a continued inflow of liquidity to the financial system thereby "*fuelling the machinery*". The lack of economic growth in Africa meant that the saving rate did not increase and this decreased the liquidity and eventually led to the drying up of investments.

III. The relative macroeconomic stability gave investors in East Asia the possibilities to make long-term investments due to the higher perceived pay-off than in Africa where macroeconomic instability led to a capital flight in many countries.

IV. East Asia was able to build the institutions which helped the transition to a more liberalised financial system, in some countries such as China, this process is still ongoing, in Africa the institutional weaknesses were not remedied before liberalisation leaving a at time battered financial system worse off.

The controversy

A host of scholars, which I dubbed revisionists, do not agree with the neo-liberal assessment of financial liberalisation. The theoretical underpinning is often a more Kenysian perspective, such as the promoters of import substitution, but the international capital mobility make a similar solution implausible. There are number of theoretical and empirical arguments that the revisionists have criticised the neo-liberals for:

I. *The link between interest rates and savings*: There is a weak theoretical and empirical support for the notion that savings increases with a higher interest rate. On a theoretical level a higher saving rate does promote postponing ones consumption and hence

savings, hence a substitution effect. But at the same time the higher interest rate has a welfare effect which indicates that one would to prefer to consume today rather than postponing ones consumption. These are opposing effects. It is clear that the McKinnon-Shaw model assumed that the substitution effect strongly dominated the welfare effect, but the empirical proof for this relation is weak.[54] It's not the interest rate that determines the level of saving, but it might determine the level of financial savings. Thus a higher interest rate might only increase the saving rate up until overall savings equals financial savings.

II. *The link between real income growth and savings*: The link between the increase, not necessarily the level, in real income and savings seems to be far more robust (see for instance Hoff & Stiglitz, 2001). When real income increases the established consumption pattern adapts more slowly, there is a so-called lag, meaning that consumption not necessarily rise as fast as real income thereby increasing savings.

III. *Determinants of investments*: There seems to be two major determinants for investments; i) The availability of profitable projects; and ii) The availability of finance. From the perspective of the company the demand for finance is determined by the company's willingness to be indebted to make future income. From the perspective from the bank the demand for finance is the willingness of a company to get indebted and the finance supply is the bank acceptance of the company's ability generate future surplus value.

IV. *Externalities*: Stiglitz (1994) is one of the neoclassical economists which have claimed that externalities are far greater than neo-liberals like to admit and they are especially paramount in financial markets. There are at least seven market failures worth mentioning; i) The solvency of a bank is a public good which leads to undersupply of the good and a possible misuse of the good by users; ii) Externalities are present in the monitoring, selection and the loan functions. The presence of one or two bad banks will make it increasingly difficult for other banks to obtain credit; iii) There are major externalities present connected to bank liquidations where the social costs far outweigh the private costs; iv) Financial markets are imperfect through risks and information

[54] Warman & Thirwall (1994) mentioned that with empirical tests of the McKinnon.Shaw model there is normally little effort made to differentiate between total and financial savings.

problems which leads to problems such as moral hazard and adverse selection problems which reduces the markets ability to handle such phenomenon; v) Financial markets often have multiple participants where banks have information regarding their one customers that other banks do not have. This means that the new customers become more risky projects and the "*exit*" option a customer normally has, is reduced; vi) Financial markets left to market forces will not be Pareto optimal. A higher interest rate will increase the possibility for insolvent loans. It is therefore in the interest of the banks to hold the interest rate artificially low, something that leads to a oversupply for finance which leads to a situation where banks are able to choose the most preferred projects. The interest rate will not always give a good indication of the quality of the investment since a maximisation of profit not always is equal to the social contribution, for instance investments in real estate; and vii) Even if full information regarding all relevant market conditions was available, it would be impossible for humans to process it all due to limited cognitive capacity. These seven market failures are severe in developed countries. In developing countries, however, they add to problems such as macroeconomic and political instability and institutional weaknesses.

V. *Institutional underpinning*: The McKinnon-Shaw model lacks an understanding of institutions, still institutions remain crucial for the financial sector (Stein, 1996). This can be seen on two levels. The first level relates to the regulations and controls that need to be in place to promote a smooth functioning of the market such as property rights, institutions that secure macroeconomic stability and institutions that correct some of the market failures of financial markets. The second level relates to the micro level and involves the banks, credit institutions and other financial institutions. Institutions need legitimacy to function as intended and some economies do not have traditional banking habits. These might need time to develop which might require an environment of participation and availability (Stein, 1999).

The neo-liberals and revisionist disagree regarding the success of the financial system in East Asia. The revisionist point out three factors regarding the growth in East Asia:

I. Park & Patrick (1994) shows that the interest rate did not have any large effect on the savings rate in Japan, South Korea and Taiwan. The interest rate was low, but positive

and fairly stable. The main determinant for savings seemed to be the high economic growth in these countries rather than the interest rate.

II. The neo-liberal argument was that the low profitability of the financial system indicates it ineffectiveness. This argument presumes that the private pay-off reflected the social pay-off which is not necessarily the case (Chang & Singh, 1993). Projects that have a large social pay-off often demand a long-term commitment and involve high risks, such as investing in a new technology. As pointed out by Chang (1998), the Anglo-American capital market driven financial systems are more profit-seeking with a more short-term perspective. Moreover there is a greater divide between the financial and the real economy in the Anglo-American model than in bank-based financial systems. One of the attributes of the East Asian financial systems was their ability to provide long-term loans in risky new investments such as investing in more technology-intensive sectors.

III. The neo-liberals created a myth that financial market driven financial systems are the norm and that East Asia was deviation from this norm. The truth, however, is the opposite. It's only in Anglo-American countries and former British colonies that normally have capital market driven financial systems. The norm, for both developed and developing countries, is to have bank based financial systems (see for instance Zysman, 1983; and Cox, 1986). Another myth is that there is an "*East Asian model*" for financial systems. It's true that most of the financial systems were bank-based, but there were large differences between countries. In China banks are mostly state-owned; the same was true previously for South Korea and Taiwan. In Thailand, however, banks were by and large privately-owned. Japan had a mixture with private-owned banks, but publicly-owned saving schemes.

The controversy is especially large regarding two major episodes in East Asia:

I. <u>The Japanese banking crisis</u>: Japan liberalised its financial system far earlier than other Asian countries, the process started already in 1973. The financial liberalisation was incremental and started with a deregulation of the interest rate and less regulations for banks. The increased competition within the banking sector led to a decline in the banks "*franchise value*" and prompted an increased investment in high profitable sectors such

as real estate.[55] The bubble finally busted in the end of the 80s and led to a crisis in the Japanese banking sector. For the neo-liberal academics this was the "*proof*" that financial systems with repressed interest rates led to weak financial systems that did not tolerate increased market competition. Hellmann *et al.* (1994) did not agree with this explanation since Japan started liberalising long before other Asian countries and the process was caused more by faulty liberalisation rather than "*financial repression*". According to Hellmann *et al.* there were two major causes for the banking crisis; i) No increased capital requirements which decreased the "*franchise value*" due to the increased competition which prompted the need for increased income which was obtained through real estate speculation; and ii) No model for liberalisation, but a pragmatic step-by-step liberalisation which led to half-solutions.

II. <u>*The East Asian financial crisis*</u>: In 1997/98 the East Asian financial crisis came more unexpected than other financial crisis' since it was driven by private, rather than public capital streams as in Latin America. The crisis prompted a lot of criticism from the neo-liberal profession towards East Asia, for instance; i) "*Crony capitalism*" due to selective industrial policies and personal contacts led to unsustainable investments which hampered long-term economic growth; and ii) Financial repression hindered the development of high-quality domestic financial institutions, it was more preferable with capital-market driven, rather than bank-driven financial systems (Mishkin, 2001). These interpretations of the deeper causes of the crisis are controversial. A number of arguments have been raised; i) According to Singh (1997) there is still no clear-cut evidence that capital-market driven financial systems give more productive investments; and ii) Three out of four countries that were affected most badly by the crisis, Indonesia, Malaysia and Thailand, had earlier been hailed as good examples for other developing countries since they relied more on the market than their North-Eastern counterparts (see for instance IBRD, 1993). The last of the four major crisis countries that was affected was South Korea, which since 1980 had been liberalising its economy (especially after 1990). The so-called developmental state and industrial policy were largely absent in the build-up to the crisis. The counterargument to the neo-liberal interpretation was that the East Asian financial crisis was more one of excessive and uncritical liberalisation rather than industrial policy failure (Chang, 1998).

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[55] The speculation in the real estate sector led to increased prices which eventually did not longer represent their fundamental value and thus created a "*bubble*".

In Africa the financial reforms that followed the SAP have been highly controversial. IBRD (1994) admitted that the financial reforms had not delivered much success and cited three reasons for it's failings:

I. *Lack of commitment*: There was a high resistance against the reforms from the state-level since the financial system provided much of the finance for the state which the ruling elite was depended upon. An implication of these reforms would mean that they would lose some their financing and hence their commitment to do so was limited.

II. *Sequence*: There was a faulty sequence of reforms, something that McKinnon (1993) criticised the SAP for.[56] For instance, Nigeria opened it economy for capital flows when it's banking system and macroeconomic environment still was in disarray.

III. *Institutional support*: There was a lack of supporting institutions to monitor and support the financial system.

IBRD (1994) was not very nuanced and in limited degree questioned the policies of the SAP. Implicitly, if the above problems were solved, the results would be as the McKinnon-Shaw model had predicted. The revisionists didn't agree with this assessment and point out to a number of arguments:

I. *Increased interest rates and a decline in savings*: The increase in interest rates due to the SAP and the reduced credit due to stabilisation policies to control inflation decreased the availability of capital and increased its cost. Both private savings and private investment decreased during the 1980s as a result.

II. *Increased urban bias*: One the arguments of the neo-liberals was that "*financial repression*" led to a urban bias since people in rural areas did not have personal contacts to access formal capital markets. Under the SAP, however, the urban bias became even more pronounced. The requirements of having rural presence were abolished to allow

[56] The optimal sequence according to McKinnon (1993): i) Inflation control; ii) Interest rate liberalisation; iii) Privatisation and commercialisation; iv) Full convertibility of the exchange rate; v) Trade liberalisation; and vi) Opening of the economy for international capital flows.

more freedom for the banking sector. It was not cost-effective to have many of the banks in rural areas and they moved to urban or semi-urban areas with a higher population density since the agglomeration effects allowed a higher economics-of-scale and scope with falling unit costs. This meant that people in rural areas, which had been squeezed out of the formal financial system under import substitution, were even more squeezed out of formal capital markets under the SAP.

III. *High risks*: African economies are predominantly agriculture-based. The agriculture sector in Africa is a high risk sector where low population density, variable rainfall and poor transport facilities makes investment in such sectors risky. After liberalisation, the poor started to be squeezed out of formal capital markets even further due to high perceived risks which banks often were not willing to finance.

IV. *Informal sector*: The SAP attempted only to restructure the formal economy, but much of the finance, especially in rural areas, came from the informal financial sector (Stiglitz, 1993). This informal sector uses direct rationing to solve supervision and implementation problems in those cases where there is information about the borrowers and sanctions can be imposed to collect the loans. The professional lenders in this market give rewards to those who are able to meet their obligations and they actively collect information regarding the credit worthiness of their clients. Given these direct mechanisms these kinds of market solutions are only available to small pockets of the population. The problem in the formal sector is that interest rate is only the market-clearing price up to a certain point. Due to the increased insolvency due to the increasing interest rates banks want to keep their interest rates "*artificially*" low. Another argument against the SAP was that an increase in the interest rate only will increase financial savings if the savings from the informal sector were idle. If not, the increased interest rate will simply mean a redistribution of savings from the informal to the formal sector (Simmons, 1992). Some, for instance Solis Fallas & Owen (1989), claim that such a transfer would be preferable since a transfer to the formal sector would make investment more effective. The problem with the argument is that it does not address the problem that formal financial markets do not clear.

V. *No institutional strategy*: IBRD (1994) blamed the lack of institutional support for the failing of the financial reforms of the SAP, but did not have adequate institutional

building policies included in the SAP to support the build-up of these. According to Stein (2000), a shock therapy financial liberalisation is unlikely to succeed since not only the institutions need to be in place to support the financial system, but also the legitimacy and the banking habits that go with it need time to develop. The solution, according to Stein (2000), would be to have transformative institutions as a bridging link between the new and old institutions were these transformative institutions are laid close the local ones. An example could be how the Taiwanese government encouraged the informal capital market and increased the quality of these transactions before they became formal.

The debates are for a large part unresolved. I believe a strong case can be made that the East Asian financial crisis was driven not by faulty industrial policy, but by faulty liberalisation. Financial liberalisation was far less in Taiwan than in South Korea prior to the East Asian financial crisis. The use of industrial policy was comparable in both states with Taiwan having less direct intervention, but a higher state ownership. Still, the South Korean economy was hit far harder than countries that did not liberalise their financial systems as much such as China and Taiwan which passed the tremors of the financial crisis surprisingly smooth. If industrial policy was the cause, it's likely to have been reflected in other countries as well, with Taiwan as the best example.[57] I think a strong case can be made that capital restrictions are good in preventing the spread of financial crisis, but might hamper economic efficiency in normal times. Liberalisation thus has its dangers. Still, Japan and South Korea started to liberalise their financial systems, as China is doing presently indicating that there are major benefits from financial liberalisation in terms of effective investments. What has come out of the debates so far is the need for institutional control. The institutions that govern financial markets were for a large part lacking in their functioning in both Africa and East Asia at the time of liberalisation. Should economies foster their institutional framework by keeping restrictions on financial flows until the institutional framework is in place? Restrictions on capital flows are made more difficult today due to the pronounced role of foreign direct investment (FDI) which makes a fully financial repression strategy implausible. The evidence, on balance, is mixed. I believe that fully liberal capital markets do not function as optimally as their proponents claim and involve high risks. At the same time, a certain degree of

[57] Even some neo-liberal authors have changed their mind regarding the causes if the East Asian financial crisis such as Radelet & Sachs (1998), Feldstein (1998) and Stiglitz (1998); even though the last was the least a surprise.

openness is needed and too high capital restrictions will make investments less effective. So the conclusion might be that a sort of middle way which might be preferable, but where this middle way is set might be different for countries and stages of economic development.

2.2.2 Learning and technology

There is a near universal consensus regarding the vital importance for learning and technological upgrading for the long-run sustainability of economic growth. Bruton (1998), one of the former proponents of IS, said that the IS approach failed mainly because it wasn't able to secure this long-term learning and technological upgrading. The main channel for technological upgrading during the IS was to be through capital imports which would facilitate a process technological through for instance reverse engineering. In East Asia industrial policy was more successful, as acclaimed by the supporters and sceptics of industrial policy alike, since there was conditional state support which provided incentives for technological upgrading. There was no such process present in Africa, with the lack of human skills and weak developed technological institutions making the situation even worse. In the IS period technological upgrading was not as easy as anticipated. Bruton (1998) criticised the neo-liberals for not learning two very important lessons from the IS era. The first was the difficulty of policy implementation which meant the policy that was formulated was not always the same as the policies implemented. The second lesson was the difficult nature of technology transfer.

The neo-liberal case for technology learning is rooted in neoclassical theory. In its simplest form, the standard neoclassical model and the Solow model, technology is presumed to be universal where companies without costs and risk can attain a given technology. Government intervention to promote technological learning in such a world would only distort the price signals leading to a less than optimal allocation of resources and hence damping long-term economic growth. In the more relaxed version with learning curves and economics-of-scale a case could be made for infant industry support even though this would be only regarded as a second-best solution since capital markets would be the preferred option. Moving away from the more idealistic standard models is the new growth theory that does operate with learning- and technology externalities. In these models state intervention could in some cases be justified depending how much rigidities there are presumed to be in the learning process. State intervention to promote industrial learning is, nevertheless, usually not recommended by the

proponents of such models given the dangers of policy failures. The usual recommendation from the neo-liberals is therefore not to use state intervention to promote the learning process, even though opinions differ about the effectiveness of the market in stimulating the long-run learning and technological upgrading.

The criticisms against the neo-liberal interpretation of the "*catching-up*" process are vast. Perhaps it's the technology attainment argument where neo-liberals have the hardest time arguing against industrial policy; partly because some of their own models do not give a conclusive answer that developing countries eventually will catch-up using free markets. The evidence against the easiest presumption, the universal availability of technology, is vast.[58] It's not so much that anybody doubts that a lot of the knowledge and technology are public goods and relatively freely available. The problem first arises if one starts assuming that all knowledge and technology is freely available. Many neo-liberals admit that the neoclassical presumption of the universal availability of technology is most likely false, see for instance Crafts (1998). To support the learning process of firms some neo-liberals are instead arguing for functional, rather than selective industrial support that will help companies in a neutral way. In this way the price signals do not get blurred and the market mechanism is not as much disturb. In practice it's almost impossible to differentiate between functional and selective industrial support. If the government supports the attainment of tertiary education, which is important for building strong learning capacities in companies, the government favours sectors that are more skill intensive and discriminate against sectors that are more labour intensive and uses fewer skills. The neo-liberals tend not to argue against industrial support as such, but rather against "*government failures*". Firstly because selective intervention can create rents favouring some over others and this can create a situation where the state eventually will use this mechanism to gain support to stay in power such selective intervention is dangerous. The best way to prevent unfavourable rents is to avoid selective state support from the outset. Secondly, the state does not have enough information about the

[58] There is also an inherent contradiction within the "*pure*" neoclassical model with regard to long-term learning. If technology is universally available and there is full information, why should anyone care to innovate? An innovation will immediately spread to other market participants and the benefit from one's own innovation will be limited. This is the criticism Schumpeter had against the neoclassical learning process and he argued that it's through imperfect competition that the long-run innovation process best can be upheld trough scale economics in the learning and technology process. Many neo-liberals might disagree with this assertion, but will have more difficulties in explaining why the most innovating and dynamic sectors in the world economy are dominated by just a few large companies.

market conditions that private market participants have and should therefore not intervene since it cannot make informative decisions.[59]

The message from the neo-liberals is partly confusing. They acknowledge that it's not certain that free markets will facilitate increased technological learning. At the same time they acknowledge that all of today's rich countries have used industrial policies themselves at an earlier stage to stimulate the learning process. Still, because of weak states today's developing countries should not do the same. Does this mean that they should accept their fate and let the market decide their outcome? If one accepts the idea of rigidities in the learning process and the concept of "*getting the prices right*" is to promote increased learning and productivity growth in the long run there needs to be a different definition of "*getting the prices right*" than the one given by free markets (see for instance Stiglitz, 1987; Cheney & Srinivasan, 1988; and Amsden, 1989). I believe that looking at the neo-liberal theory alone will not give a complete understanding of the learning process in the two regions that are being compared.

Another approach is the evolutionary theory which draws more on the bounded rationality concept of Herbert Simmon and looks more at the channels for technology transfer. Lall (2000) mentioned that capabilities are needed as well as capacity to exploit the technology available. Capability is unique to the company and is the institutional knowledge that individuals have obtained where the knowledge has accumulated over time. The total capabilities are though not a mere accumulation of knowledge as such, but a process where there are a number of synergies between individuals and between individuals and the company. Technological learning does not only confine itself to the technological frontier, but involves a wider perspective where companies get access to, implement, absorb and build on the knowledge attained in the production process. There are a few key points following this approach: i) Technology cannot be transferred to developing countries like a physical product since it's effective implementation requires important co-defined knowledge; ii) If learning costs, uncertainty and leakages are high some technology will not be learned even if it is more profitable to do so; and iii) Learning needs of specific sectors and even specific companies is

[59] As a response to this "*lack of information*" argument Deraniyagala & Fine (2001) said:"*If governments are less well-informed than the private sector (and less able), does it follow they should do nothing? The answer is resoundingly in the negative and should not come as a surprise. For the implication is that we should leave the generals and the military industrial complex to make defence policy since they know more about waging war and the true costs and capabilities of weapons. Alternatively, to be topical, chemical companies should be allowed to make policy on genetic engineering.*"

often unique and some state support to facilitate the learning process therefore by definition at times needs to be selective.

The approach I will use later on myself to create an institutional framework for understanding the technological learning in the two regions is called the National System of Innovation (NSI) and is in part an extension of the evolutionary approach. I will come back to this framework in chapter 4, but will discuss vital elements that are important to that framework in this subsection and tie the threads of these arguments together in the start of chapter 3.

The different approaches, neo-liberal and the evolutionary, have some common ground. I will use this common ground to elaborate on the learning- and technology process in the two regions in the rest of this subsection. The consensus is that:

I. Human skills play a crucial role in the long-run learning of economies.

II. Learning is mostly done at the firm level. The role of state support is however more controversial, as I will comment on further.

III. Most technology is generated internationally and access to this technological pool becomes imperative for technological upgrading.

Skills

There is a near consensus for the need for human skills to promote economic development. I will look at the human skills present in the region at the outset of the period in 1960; and how the development proceeded over time.

The basis with regard to human skills seemed to have been favourable in East Asia. I would like to stress two points:

I. *High levels of human capital in 1960*: Rodrik (1994) showed that the East Asian countries had a large stock of human capital relative to their income level in 1960. It goes without saying that Japan had high levels of human capital compared to others in the region due to universal primary education in the post-Meiji era (from 1868). The American administration, which lasted until 1953, also made secondary education

Table 8 - Gross enrolment ratios									
	Primary education			Secondary education			Tertiary education		
	1960	1980	2000	1960	1980	2000	1960	1980	2000
Sub-Saharan Africa									
Botswana	36	91	102	1	19	73	n.a.	1,2	4,0
Congo DR	72	92	50	n.a.	24	18	n.a.	1,2	1,0
Ethiopia	6	36	60	1	9	17	n.a.	n.a.	7,0
Kenya	47	115	94	2	20	31	n.a.	0,9	3,0
Nigeria	37	105	103	3	16	36	0,1	2,2	n.a.
South Africa	82	85	106	82	n.a.	85	28,0	n.a.	15,0
Sudan	25	50	58	3	16	32	0,4	1,7	7,0
Tanzania	24	93	64	2	3	n.a.	n.a.	0,3	1,0
East Asia									
China	n.a.	113	118	n.a.	46	65	n.a.	1,7	10,0
Indonesia	59	107	110	6	29	57	n.a.	3,6	15,0
Japan	103	101	101	79	93	102	9,5	30,5	48,0
Philippines	91	112	113	26	64	77	12,9	24,4	31,0
South Korea	96	110	100	27	78	94	4,7	14,7	78,0
Thailand	136	99	96	7	29	83	1,9	14,7	36,0
Vietnam	101	109	106	11	42	67	0,9	2,1	10,0

South: UNCTAD (1974), (1984), (1997) and UNCTAD online database.

II. mandatory which increased levels of human capital even further. Japan's colonial legacy also left relatively high levels of human capital in South Korea and Taiwan. While Hong Kong and Singapore got influxes of human capital to their city states; Hong Kong got a mass influx of high quality human capital after the communist take-over in China in 1949. But even countries in Southeast Asia such as Indonesia, Malaysia and Thailand had higher levels of human capital relative to other countries with the same level of income in 1960. Without a shadow cast of a doubt this was a major advantage the region possessed which raised the potential for economic growth. But this goes only for the potential for economic growth, not growth by it self. The Philippines had one of the best educated labour forces in the region in 1960, but their economic growth has been very disappointing.

III. Informal institutions: A number of countries were able to increase the levels of human skills using non-formal institutions. For instance, in South Korea the government was able to increase the literacy rate from 22 % in 1945 to 71 % in 1961 using informal public institutions (Chang, 1998).

East Asia was able to exploit the early advantage by building on their favourable skill base from 1960 and onwards. Regarding the skill formation I want to emphasise four elements:

I. *Increase in formal enrolment*: Governments managed to increase the formal education level (see table 8). There are two points I would like to make; i) This was not done by increased relative spending on school; the percentage of GDP going to education was about the same as for other regions (Thomas & Wang, 1997), but the economic growth allowed a higher absolute spending on education thereby increasing the quality of formal education while the period proceeded; and ii) Governments showed a high willingness to invest in rural areas and raised the education level of the general population.

II. *The role of job training and informal institutions*: The role of job training and informal institutions was very important in improving on the human skill base. Job training is often more relevant than formal education. Also the organisation of work can enhance learning. Chang (1998) took the example from Japan where employees are given more decision making power than is usual in western companies. This is done to promote learning at all levels of the organisation. In South Korea there was set up a number of public training institutions and the training of employees was made mandatory in the 70s for larger companies. Some of these companies outsourced this job training to the government to not overspend resources on these activities (You & Chang, 1993). In Singapore the government in the 1980s launched a number of programs to increase the quality of the labour force as for instance "*Basic Education for Skill Training*", "*Working Improvement through Secondary Education*" and "*Core Skills for Effectiveness and Change*" (Ashton & Green, 1996).

III. *Emphasis on "core" education*: The focus on "*core*" education such as maths, engineering and chemistry is often more relevant for the industrial sector than more social educations such economics, sociology and psychology. IBRD (1993) focused on primary and secondary education and claimed that the social pay-off from these was higher than from tertiary education. Singh (1995) did not downplay the importance of primary and secondary education, but claimed that it was not feasible to compete in high-skill sectors on the world market without high quality tertiary human skills. In East Asia the government showed a high ability to prioritise higher education, and not least, its direction. Tertiary education in the so-called "*core*" areas was subsidised by the government, while tertiary education in more social oriented studies were given by private institutions.

IV. *Ability to educate the entire labour force*: The governments in East Asia recognised the importance of educating the whole labour force and not just small technocratic elite at the top. To achieve this primary and secondary education were made mandatory. Chang (1998) goes further and claims that the type of secondary education was important to promote economic growth. In Japan and South Korea the secondary education was organised after the German model with a high focus on vocational training. This was according to Chang (1998) a reason for why these countries had a higher level of human skills than the countries in south and Southeast Asia which modelled themselves more after the Anglo-American model of education with little focus on vocational training. For instance, in South Korea basic engineering is given at the secondary level. This does not make them specialists in the field, but might increase, in general, the labour force's production and learning ability. Chang's (1998) view might be regarded as a harsh criticism of the Anglo-American system and critics might point to the higher stock of human capital in Japan and South Korea at the outset of the period which explains some of the differences. But still, studies that measure the quality of education by conducting tests across countries often find that the highest scores are obtained from students coming from Japan, South Korea and Taiwan which in general score higher than their counterparts in developed countries (Lall, 2000).

V. *Coordination with other policies*: As Lall (2000) pointed out, the capability and skills have to come together with the appropriate technology to function efficiently. The process of skills development through formal education and job training is complex. One problem, for instance, is that the need for a certain type of skill is not known before it arises, but it takes time for a certain education is completed by new students. These "*lags*" means that the supply of a certain type of worker with the right educational background does not always match the demand and vice versa. Which education to promote might be easier for countries attempting to catch-up with leading countries since they can choose a pre-existing technology that has not so far been applied previously within the country. Many analysts have pointed out the underlying concept behind this idea, that the East Asian countries were far better in "*using*" rather than "*creating*" ideas. To be able to exploit the appropriate technology from abroad the human skills to do so need to be present. The East Asian governments showed a high ability to correlate their educational policy with the need of their industries and the

direction, in form of economic structure, they wanted to pursue. In some instances the human skills needed were absent and this led to the hiring of expatriate expertise. For instance the promotion of foreign skills in the educational system in Singapore in areas where local skills were inadequate (Lall, 1992; Page, 1994). Many developed countries are today concerned with regarding to the quality of their educational system which might indicate difficulties with choosing educational policies at the technological frontier.

With regard to human skills present Rodrik (1994) showed that Africa had a lower stock measured by formal education than any other developing region in 1960. I would like to stress three points:

I. *Low levels of human capital in 1960*: The education level measured by schooling enrolment was low. This is a legacy of the colonial period. In Africa the colonial powers were not interested in educating the broad masses since they might revolt.[60]

II. *Educational inequality*: Ethnic inequalities increased since it often was a "*preferred*" ethnic group that received educational privileges. The colonial powers often educated small local elites to be "*puppeteers*" for the colonial masters to increase the legitimacy of colonial rule. This might have contributed to increasing the problems of ethnically income inequality which I discussed in section 1.2.2. A higher education might have meant higher income and increased productivity for those groups which were privileged. This might have maintained ethnic income inequality.

III. *Social studies focus*: The small elite educated were mainly educated in social tertiary science rather than technical subjects. There was no desire to industrialise the colonies since they might compete with the colonial powers home market. Instead, it was more desirable to education them within social sciences so they could help the administrators keep control over the broad masses. These policies might have backfired somewhat after World War II when African states started to demand their independence.

[60] This was summarised by a quote of Lord Lugard in Nigeria: :"*(the expansion of missionary schools in southern Nigeria) seems to have produced discontent, impatience of any control and an unjust assumption of self-importance in the individual.*" (quoted in Oyelaran-Oyeyinka (2004a))

African skill formation has improved during the period, but this development has been far slower than in East Asia. There are four elements that have been worrying:

I. *Increased enrolments, but…*: Enrolments at all levels have increased since 1960, but are still lower than for any other developing region. The process of increased enrolments, especially at primary levels, did suffer a setback in the 1980s due to a host of factors which included; i) The high population growth which increased the financial strains of the government which suffered from the weak growth performance; ii) The cutback of social spending, partly due to the SAP which clammed down on government expenditure;[61] and iii) IMF's introduction of Anglo-American style intuition fees for primary education which raised the costs of schooling and thereby effectively excluding the poorest from obtaining education.[62]

II. *Continued emphasis on social sciences*: The structural composition of tertiary education since colonial times has been remarkably stable with most students still enrolling in social sciences. This is despite the increased need for technical skills and a declining demand for social oriented labour (Fabayo, 1996). Lall (2000) reported that 60 % of all studying choose more social oriented studies, while only 40 % choose more technical subjects.

III. *Declining quality of education*: Clark (2000) reported that the quality of African education is below the world average and that students from Africa score low on international tests. The expenditure on education has shifted character since 1980 due to the SAP with more funding going into primary education and there has been reduced spending on secondary and especially tertiary education. There have been attempts to set

[61] In appendix 5 there is a graphical illustration of the development of enrolment levels in Sub-Saharan Africa in the period 1960-95; a graphical illustration of spending on schools from 1970 to 1996 which saw a dramatic decline from 1990 and onwards (partly due to the more effective implementation of the SAP due to the end of the Cold War, see section 3.1.1); and finally how spending per education type developed from 1970 to 1995 showing the largest decline in the financing of tertiary education.

[62] In addition there is the phenomenon of "*Brain Drain*" where leading intellectuals and highly educated labour migrate from Africa, often to the Western world. According to Udogo (2004) there are a number of both pull and push factors affecting this development. Among the pull factors that attract people emigrating from Africa are; i) Higher incomes; ii) Better standard of living; iii) Better working conditions; iv) Better research facilities; and v) Better career opportunities. Among the push factors which wants them to leave are; i) Pessimism about ones own future; ii) Under exploitation of ones profession; iii) Economic hardship; iv) Bad working conditions; and v) No confidence in the policies conducted. But according to some, for instance Darko (2003), the "*Brain Drain*" problem is over focused since the skills that are present in Africa are underexploited.

up informal institutions to increase the literacy of farmers, but these were often of poor quality (Clark, 2000).

IV. *Decreasing state support*: The state institutions that were supposed to support job training and capability formation have experienced declining funds since the initiation of the SAP. This has limited their functions and has meant that the African firms' capabilities have suffered further strains. To be fair on the IBRD, the state-driven support institutions did function as smooth in Africa as they did in East Asia and some only gave preferential support to some "*preferred*" segments before the 1980s. Still, the declining funds due to the cutback of government expenditure has decreased the development of appropriate skills even further and have led to a decrease in the competitiveness of African firms since there was a lack of support for human skill developed at the company level. Several studies, for instance Wangwe & Semboja (2002) have emphasised that the African companies that were able to compete most effectively on world markets had entrepreneurs with a higher formal education and skill base within the company. However, most African companies do not invest in job training and most job training in companies operating in Africa comes from multinationals. The typical African company has entrepreneurs with a low education, a low educated work force and no strategy no method how to upgrade the technological capacity of the company.

Technological institutions

For an economy to be able to master and diffuse technologies it's dependent on its National System of Innovation (NSI). This analytical framework, partly the result of the evolutionary approach literature, attempts to capture the nature and the channels of technological learning and upgrading. It emphasises the role of a number of interrelated institutions which broadly can be divided into five categories (OECD, 1999): i) Private enterprises and the research institutes that they finance; ii) Governments that set the policy agenda; iii) Bridging institutions which include research councils and research institutions which act as the intermediate between governments and the users of knowledge; iv) Universities and related institutions that provide key knowledge and skills; and v) Other public and private organisations that play a role in the national innovations systems. To get some useful insights in this increasingly popular framework see for instance Adeoti (2002) and Edquist (2001). I will come back to this approach in chapter 4. For now the focus is on two levels which are

widely mentioned in the industrial policy debate; i) Firm capabilities; and ii) State support. Both the neoclassical and the evolutionary approach stress the role of learning at the company level since firms are the dominant mode of production and learning in an economy. State support is at the heart of the industrial policy controversy since its effect, especially in promoting specific industries over others, is hotly debated.

The support from the state can come from a number of sources. In the case of East Asia the involvement from the state in the technology learning process was in general high. But there were major differences. State interference was without doubt highest in Japan and South Korea; with also Malaysia and Taiwan having high levels of state support. China and Vietnam are a bit more difficult to asses given the different nature of their economies, but had in general high levels of state support. Hong Kong, and partly Singapore, had more liberal regimes even though Singapore did attempt to direct the nature of structural changes. Indonesia and Thailand relied more on the markets than for instance Malaysia and Taiwan, but did not have as liberal policies as the city states. I would like to emphasise three elements regarding the state support in East Asia:

I. *Direct support*: East Asian governments often gave direct support to certain industries over others through tax incentives, subsidised loans and other measures.[63] The support given to manufacturing was normally conditional on a set of production and/or export demands. This disciplined companies by giving them incentives to increase production and facilitate technological upgrading for continued state support. The effectiveness of this state support is often at the heart of the controversies when discussing industrial policies.[64] Econometric studies attempting to measure the profitability or productivity of preferred industries over non-preferred industries often conclude that industrial policy not always was effective; see for instance IBRD (1993). Normally these are the arguments that the neo-liberals support. But, the picture is bigger than that. I would like to emphasise four arguments that make simple econometric analysis difficult. Firstly, there are certain industries that have a higher degree of backward and forward linkages than other industries and the lack of promotion of such "*strategic*" industries might have dire implications for the emergence of other sectors. Given such key industries, it's

[63] Direct subsidies were normally not used for manufacturing support, but were normally used for promoting agricultural production and other "*sensitive*" industries. I will come back to their role in section 3.2.2.
[64] For some, for instance IBRD (1993), this is the very definition of industrial policy.

doubtful to measures the sector's contribution to the economy be measures such as productivity or profit gives a good indicator of the industries social contribution. Complementary investments are mentioned in section 2.2.3. Secondly and partly related to the first argument, is the fact that some industries do exhibit externalities in production such as higher technology intensity which can have externalities through for instance increased job training which might benefit other sectors as well. Rodrik (2000a) mentioned that selective industrial support could promote economic growth if sectors that were more technological advanced, were more interlinked with the rest of the economy and had higher surplus potential were promoted over industries that did not exhibit the same potential. This does not mean that mistakes were not made. In Japan the biotechnology sector never got a real foothold and was an example of failed industrial policy. But the presence of "*bad*" industrial policy does not mean that all such support is unwanted. Another example from Japan is the information technology (IT) sector which is an industrial policy success story. Thirdly, it's very difficult to separate one policy from another in such a fashion as in IBRD (1993). The conclusion in IBRD (1993) was that industrial policy in general was not favourable, but that the export promotion strategy was. But sectors were promoted on the basis of their export potential and thus industrial and trade policy could in many cases not be separated (Chang, 1999a). Lastly, there is a lack of historical evidence of countries that have grown into today's rich countries without using selective industrial policies at some stage.[65] This debate is likely to remain unresolved for some time to come. Measuring all the effects that I mentioned will be near impossible and will allow for multiple interpretations. The whole question boils down to whether the East Asian countries, particularly Japan, South Korea and Taiwan, would have grown as fast without this direct support or not? I believe they wouldn't and my argument is not only based on the East Asian experience, but also the past experience of Western Europe and the USA which all, contrary to what many Western governments often recommend today's developing countries, did use direct support and protectionist measures themselves to grow rich.[66] But this debate is not likely to die any time soon since empirical results are mixed.

[65] Perhaps Hong Kong is the only exception so far. The problem is that Hong Kong is such a special case due to its nature as a city state and also a number of attributes in 1960 such as a well developed financial system and high levels of human capital that make their case less relevant for other developing countries.

[66] This argument is adequately summed up in Chang (2001):"*Kicking Away the Ladder*". Lall (2000) makes the point that the only country without a real active direct scheme, Hong Kong, is the only economy that has experienced a deindustrialisation during the whole period, but has managed to grow due to its close ties with the Chinese mainland. According to Lall (2000), the reason for why Indonesia, Malaysia and Thailand still have not

II. *Role of universities*: The universities provide at least two key elements to companies and other institutions such as the state sector; i) The provision of human capital; and ii) Conducting knowledge generating activities. In East Asia universities have been able to fulfil both these role to high effect. I already commented on the high levels of tertiary education and the high quality of this education in northeast Asia. In addition, universities were able to play a research generating role for the industrial sector. One of the best examples comes from Taiwan and how universities linked themselves with firms to provide increased research for companies which they often could not manage themselves due to the low size of the average Taiwanese company.

III. *Public research institutions*: Public research institutions also played a vital role in generating knowledge. Often, these public research institutions are the antenna of a NSI which are able to catch up the latest trends within technology. This allows the government to make more informed decisions regarding its technology policies and support private companies willing to investment by giving them access to information. In East Asia these institutions functioned well, an example is from South Korea were the "*Korea Institute for Science and Technology*" (KIST) played a prominent role.

IV. *Connection between the various research institutions*: Just as important as the functioning of each of the components of the NSI are the linkages between the various elements. I have already commented on the tight linkages between universities and firms in Taiwan. A number of studies confirm that networking among companies and among companies and research institutions is higher with the presence of large quantities of human capital. The high presence of highly skilled labour might thus have increased the linkages between firms and research institutions even further.

V. *Wider institutional support*: Part of the so-called broader NSI framework is the general institutional support for economic activity (see chapter 3). Evans (1995) mentioned the importance of small and medium enterprises (SME) support institutions in all East Asian economies to promote learning. Some important institutions include secure property

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been able to upgrade their production structure successfully beyond labour intensive production is the absence of successful state support since active state support is needed to get beyond a "*simple*" to a more "*advanced*" industrial structure of the type found in the developed countries and in Japan, South Korea and Taiwan.

rights, competition policies and transparent government through the rule-of-law. I will comment on private property rights and the rule-of-law in subsection 2.2.3. I will comment on competition rules in this section since it might have helped promote increased efficiency in East Asia. Three points are worth mentioning regarding the East Asian competition rules; i) Governments often promoted oligopolies and at times even monopolies if the scale economics were thought to be significant. Estimates regarding increased welfare from price competition are often not more than 1-2 % of GDP, while costs saved through scale economics can be as much as 30-50 % of GDP (Chang, 1999). In North East Asia governments often used "*administrative guidance*" to increase economics-of-scale.[67] Secondly, governments were afraid of excessive competition. Overcapacity becomes a problem when one is dealing with "*specific assets*" where assets such as specialised labour and investments have a irreversible part see Williamson (1985) where much of its productive value is lost with an alternative usage. Bankruptcies will then have large social costs and support was given to so-called declining industry, see subsection 2.2.3. Finally, antirust laws were "relaxed" in those cases where scale economics were thought to be significant. That's how the Japanese conglomerates known as the Keiretsu system. In South Korea there was no anti-monopoly law before 1981 and the Korean conglomerates known as the Chaebols grew large especially during the 70s.

Firms in East Asia had in general a relative high capability and were able to learn new technologies. I believe there are at least four main reasons for this development:

I. *Favourable state support*: As I mentioned, the state support along the criteria I mentioned above, were all favourable to the East Asian development. The support for learning and technology by the government by financial and institutional support increased the capabilities of firms to exploit more advanced technology over time. The strategy was different, though, from country to country. In Japan and South Korea large companies were actively promoted. A lot of the research effort in South Korea was conducted within these large conglomerates, the so-called Chaebols. Today South Korea has the largest private R&D expenses in the world (Lall, 2000). In Taiwan a large

[67] In Taiwan and in South Africa the car manufacturing sector had around 10 producers each which produced a few thousand cars each. This was in a sector were the minimal efficient scale lies at around 300 000 cars (Chang, 1999a). The same may go for the highly fragmented Chinese car manufacture sector.

support network for SME was established to cut the costs of attaining new technology. Most of the research was conducted not by private companies, but by the state.

II. *Competitive pressure and incentives*: Just as important as state support is the role competitive pressure and incentives for technological upgrading. I have already mentioned the conditionality attached to financial support. Conditionality in the form of production and export targets led to increased discipline since the continuation of such support was dependent on that the targets were met. This provided the incentive to upgrade the production structure and become more effective over time. Such state support was often temporary and companies were opened up to international competition when they were thought be ready for it. This is how trade policy got linked to the technology policy in what is often referred to as the "*infant industry argument*".

III. *High skills*: The abundance of cheap and highly skilled labour proved to be one of the major assets that East Asian companies had. It's hard to overstate the importance of human skills in the East Asian development. Higher skills allowed companies to become more productive, to achieve higher learning abilities and increase their linkages with other technologic institutions.

IV. *Access to finance*: Financial resources are needed to build the capacity to exploit the potential capability. One of the attributes of the East Asian financial systems, as I mentioned in subsection 2.2.1, was their ability to give cheap long-term loans to finance investments in sectors with new technologies..

V. *Organisation*: The organisation of the job itself often enhanced the learning capabilities of firms. There are two elements of the organisation that were emphasised by Chang (1998); i) The role of the high decision-making power of employees at all levels of the production hierarchy. People at the "*ground level*" were given more decision power since they often had more information regarding operation-specific issues at this level and might be more knowledgeable on how to increase the productivity of these operations; and ii) The departments were often well integrated. Instead of making the engineers develop products that the market department had to sell, there was a tight cooperation between the various departments making which reduced the time of making new products and increased their potential market value. This tight integration managed

in general to avoid products that would become "*engineering dreams*", but would have low marketing value.

African state support for the technological process has varied. I would like to emphasise three elements:

I. Changing paradigms: Under import-substitution state support for industries was, at least on paper, favourable. Financial resources were made available through the financial system, but these were often directed at selective groups. Under SAP, the policy changed dramatically. State support, under the neo-liberal paradigm, was seen as unwanted and distorting and was to be abolished. Direct support for industries has declined in Africa, especially from the end of the Cold War around 1990. Gibbon (1996) thought that IBRD (1981) had a minimal understanding of the complex realities of Africa. The "*true*" private sector in Africa normally comprised of one-man companies or family businesses that conducted activity for survival purposes. There were several structural hindrances that limited the further development of these companies such as a primitive technology, difficulties in obtaining credit, competition with other one-man enterprises for income sources and poorly developed infrastructure. Most of what was called the private sector in Africa was very dependent on state connections for subsidies, access to credit and factors, state contracts and the protection from domestic and international competition. The state is therefore a dominant economic actor in African countries were there exists a complex two-way relationship (Ogbu & Soludo, 2004a). Simple neoclassical models that differentiate between private and state ownership are likely to meet a lot of so-called "*grey zones*" in Africa.[68]

II. Role of universities: Universities in Africa have not provided the technical skills needed for industrialisation and the quality of the human skills coming out is often weak. Also, the research conducted at African is often little relevant for African firms and does not match the needs of the economy. Part of the reason is the declining funds that universities in Africa have received following the initiation of the SAP programs, which

[68] Botswana in the 1980s was one of the few African countries that went the other and conducted some selective support which proved to be quite successful (Owusu & Samatar, 1997). The main concern with selective state support in developing countries is whether companies will be able to compete when the support stops. Most of the companies were able to maintain there production after the state support was abolished, something which indicates that the state support was successful and that companies managed to achieve cost effectiveness.

meant that the resources available declined. Oyerlara-Oyeyinka (2004b) conducted case-studies in Nigeria, Kenya and Zimbabwe and found that the funding of research as measured by the gross academic expenditure (GAE) had declined. For instance, the funding of university research in Kenya in 1993 was only 40 % of the level in 1986.[69]

III. *Public research institutions*: Public research institutions in Africa were often set up after independence and were modelled after the institutions in rich, often European countries. Their functioning has not been as intended (see for instance Oyerlara-Oyeyinka, 1996; and Adeboye, 1997). Oyerlara-Oyeyinka (2004a) mentioned two main reasons for its failings. Firstly, there was a lack of human skills to operate these institutions, which was a part of the colonial heritage. Secondly, it's important to remember that the European institutions not were the result of a fixed model, but were the result of an evolutionary path were the institutions in question adapted to the changing environments and technological demands. Implementing the result of such an institutional evolution without having gone through the same process this led to the lack of relevance of these institutions within the African context. Adeyinka (2005) looked at the role of R&D institutions in Nigeria.[70] The funding of R&D had experienced a slight increase during the 70s, but fell by almost 2/3 between the mid 70s until the mid 90s. The RDIs have performed poorly measured by their ability to support production and support the creation of new markets.[71] Enos (1995) attempted to measure the impact of the SAP on the science and technological effort and found that the resources were being drawn more towards areas that were prioritised by foreign rather than domestic interests. According to a number of scholars, what they call the anti-state attitude of the BWIs, has led to a situation today where few African countries have a science- and technology policy. According to Abiodun (1998) only 0.004 % of the regional GDP went to R&D.

[69] 80 % of the funds go to wages alone.

[70] In the 70s a federal body named the National Council for Science and Technology (NCST) was established to coordinate various sector specific R&D institutions. In 1977 the body was replaced by the National Science and Technology Department Agency (NSDTA), which was replaced by the Federal Ministry of Science and Technology (FMST) in 1979 which merged with the Ministry of Education in 1986.

[71] The reasons for the failing were according to Adeyinka (2005); i) Poor infrastructure support for research; ii) Inadequate or low funding leading to involvement in revenue-generating activities at variance to their research mandates; iii) Human capital shortage both in quality and quantity;; iv) Inadequate database to guide research; v) Poor extension liaison services; vi) Poor linkages between research institutes, universities and end-users; and vii) Lack of continuity in policies, and particularly frequent changes of the agencies, actors and structures for supervising the R&D system.

IV. *Connection between the various research institutions*: The link between the various institutions was in general weak in Africa. I already mentioned how the universities conducted research which was less relevant for firms; and I also mentioned how public research institutions were exogenously imported institutions rather than endogenous created institutions which limited their links with other elements of the economy. Several studies by Oyelaran-Oyeyinka have confirmed that the linkages between firms and technological institutions are weaker in Africa than for other regions. For instance Oyerlaran-Oyeyinka & Lal (2004) where e-business technology adoption was compared between Nigeria, Uganda and India; where the adoption of e-business technology was far higher in India due to the higher linkages between the research institutions and firms. A higher level of human skills within the firm seems to promote increased linkages with research institutions.

V. *Wider institutional support*: The wider institutional support was weak in Africa. Measured by property rights, competition rules and rule-of-law the African states did sometimes not have the capacity and sometimes did not have the willingness, or sometimes both, to promote such institutions. Competition rules also promoted large companies in Africa just like in East Asia. The major differences are i) The larger potential economics-of-scale in East Asia due to the higher population density; and ii) More importantly, there were production and/or export requirements for East Asian companies that African companies often lacked.

Firms in Africa have not shown the same capabilities as East Asian firms. I believe that there are at least four developments that can explain this discourse:

I. *Varying state support*: As I mentioned, the direct state support was varying over the period. Under import substitution there was state support, but this was not readily available for all. Under the SAP the direct state support declined, leading to increased difficulties in building up capacity for African firms in the light of increased competition and more volatile conditions. In addition, I mentioned how the technical support through universities and public research institutions was weak and got worse under the SAP. All these came in addition to the weak wider institutional support and the macroeconomic instability which all made economic activity very difficult and all of

these factors did not promote a wide scale improvement in the capacity or capabilities of African firms.

II. *Varying competitive pressure and incentives*: Import substitution did not have any "*real*" provisions for production and export goals for obtaining state support. This led to a situation were firms did not have competitive pressures and hence no incentive for a technological upgrading or expansion of their production. The SAP changed the situation and the competitive environment became far higher, but without the direct state support to manage to compete. Many manufacturing firms were simply out-competed after import liberalisation. I think the "*carrot-and-stick*" analogy of Rodrik (2000a) is rather fitting in this context. To be able to compete efficiently firms need a certain amount of support ("*carrot*") and a certain amount of discipline through competitive requirements or production targets to efficiently exploit resources ("*stick*"). In East Asia both the "*carrot*" and the "*stick*" was given to firms. In Africa, there was plenty of "*carrot*" during the ISI period, but little "*stick*". During the SAP there was plenty of "*stick*", but little "*carrot*". Both approaches seemed little balanced in this respect.

III. *Low skills*: One of the main reasons for the weak capabilities of African firms is their weak human skills. These findings are confirmed by a number of studies such as Oyelaran-Oyeyinka (2004b) where higher skills where linked i) A higher learning process; ii) Increased links with research institutions; and iii) Higher profitability.

IV. *Lack of access to finance*: The weak access to finance, both during the financial repression and after liberalisation, is putting major strains on African firms. I already commented on the financial system in subsection 2.2.1.

The contrasts between the two regions with regard to technological learning capabilities and support is vast. I believe that the differences can be bluntly summarised as:

I. The state support for technological learning was higher in East Asia relative to Africa due to i) Better and more consistent direct support for firms; ii) More effective use of state support resources for firms through various learning and technology institutions; iii) Higher relevance of the human skills and research provided indicating a more

integrated NSI; and iv) The ability to create and maintain a general supporting institutional environment for economic activity;

II. Firms capabilities were higher in East Asia than in Africa due to; i) Better overall state support; ii) Better incentives through production targets and/or competitive settings to exploit resources more efficiently and facilitate technological upgrading; iii) Better access to human skills; and iv) Better access to financial resources.

Availability of technology

So far I looked at the learning and technology argument of industrial policy economies from the inside by looking at internal elements such as finance, skills and technologies as the result of internal policies. Technology, though, is most often generated internationally and countries and industries need to access this technology. This can be done through various methods. One of the forms of technology transfer most mentioned in the literature is through foreign direct investments (FDI), this form therefore warrants some special attention.

The neo-liberals normally attach three properties to FDI (Lo, 2004b); i) FDI gives a higher access to financial resources above the saving rate of the country; ii) FDI gives higher access to foreign exchange than the domestic country's own export sector can produce; and iii) FDI can give technology transfers which can facilitate an increase in productivity in the recipient country due to access to better technologies, better organisational practice or information about the international market. The revisionists do not deny these advantages, but also claim that these need to be put into perspective by looking at two potential disadvantages of FDI (Lo, 2004b); i) FDI, especially from large multinationals may out-competed local producers since the large multinationals have far greater economics-of-scale. Some of the most dynamic sectors in the world economy are dominated by imperfect competition and they can lower the level of competition in recipient countries; and ii) FDI, again especially form large multinationals, can disturb the domestic economic structure by competing for scarce labour and capital. The presence of large multinationals might prevent the development of domestic "*upstream*" activity.

The main research on the effects of FDI has been within the neoclassical tradition. Variables such as exports, profit and productivity are being tested to see whether they are correlated with FDI. The general result from this literature is that there is a "*crowding in*" effect of FDI.

Also within the revisionist tradition it has become increasingly popular to do research on FDI. Normally variable such as local capital formation are considered and the conclusion in general is that there is a "*crowing in*" effect of FDI which leads to a more efficient utilisation of the local capabilities. Both traditions might have the fundamental problem of differentiating between correlation and casualty. There are studies that indicate that certain types of FDI might be more efficient than others, I will come back to this later.

In East Asia the strategy how to access foreign technology differed substantially from country to country:

- In Japan and South Korea there was a very low dependence on FDI as a means for technology transfer. The usual mechanisms were to a higher degree reverse engineering through the use of capital imports, licensing and turnkey contracts. All these methods required a high quality technological institutional framework to spread the knowledge to end users, which these countries possessed.

- Hong Kong, Singapore and Taiwan to a larger extent relied on FDI as a mechanism for technological upgrading; this goes especially for the city states. While Hong Kong adopted a more "*laissez-faire*" approach and did not discriminate against foreign investors, Singapore attempted to affect the pattern or FDI coming in. This was done to upgrade the technological intensity of their production structure over time. Taiwan used FDI in their so-called export zones and often promoted joint-ventures to be able to learn the technologies more efficiently. The technological infrastructure was strong in Taiwan and they were able to learn technologies through a host of other means as well, just like Japan and South Korea.

- The Second Generation Tigers (SGT), Indonesia, Malaysia and Thailand, also used FDI as a primary channel for technology transfer. The technology institutional infrastructure in these countries, however, might have been less advanced than in Japan and the FGT. This led to a higher dependence on foreign technology and the learning and diffusing of technologies might have been less in the SGT. The SGT have a dependence on FDI coming from Japan, and to lesser extent, the FGT.

- China has received a increasing share of the region's FDI and many countries in East Asia fear a "*crowding out*" effect since China is a like a "*black hole*" sucking foreign investments to it due to it's immense gravity which is also increasing. Especially during the 1990s, FDI to China increased dramatically. The effects of FDI in China have been subject to much research. Lo (2004b) found that FDI stimulated the Chinese learning capacity in the capital intensive home-market oriented Shanghai region to a larger extent than the labour intensive export oriented Guandong region. This a deviation from what neo-liberal theory would predict due to its focus on export-led growth and comparative advantage. China is thought to be more effective in its labour intensive industries. As in Taiwan, the usual practice in China used to be to actively promote "*joint-ventures*", but wholly-owned companies are becoming increasingly popular as an entry mode for foreign investors. Hu & Jefferson (2002) found that the FDI going into China has different effects on different sectors and in the short and long run. Another source of technology upgrading in China has been through capital imports.[72] Zhao (1995) looked at the specific channels of technological upgrading in China in the period 1960-91 and found that the imports of more technological advanced products was positively correlated with; i) Domestic R&D expenses; ii) Investments in technological upgrading; iii) Value-added in the heavy industry sector; iv) Exports from the heavy industry sector. Zhao (1995) concluded that the imports of technology intensive products affected economic growth by upgrading the domestic production structure.

African countries also attempted to access foreign technology through much of the same means as the East Asian countries, but did not have the same access to foreign technology:

I. <u>*Capital imports*</u>: Many African countries had high levels of capital imports, but this did not facilitate increased technology upgrading in the long-run. I believe there are at least three reasons for this failure: i) Africa did not have the adequate amount of human capital or technological institutions in form of a well developed NSI to access the foreign technology;[73] ii) Protection from foreign and domestic competition lowered the

[72] Lo (2004a) found that the Chinese export was negatively correlated with economic growth; but that imports was positively correlated with economic growth. The exports, according to such a view, merely provided the finance for the imports.

[73] Intuitively, one needs a certain level of skills, capabilities and technological know-how in society to be able to access high-technological goods through reverse engineering, for instance computers and TVs.

Table 9 – Average "inward" FDI 1970-2004 (Regional share on world total; Country share of the regional FDI)

	1970-79	1980-89	1990-99	2000-04
SSA share of world inward FDI	***4,2 %***	***1,4 %***	***1,2 %***	***1,6 %***
Country share of regional FDI:				
Botswana*	3,5 %	8,9 %	0,2 %	1,8 %
Congo DR	6,5 %	2,7 %	0,0 %	2,0 %
Ethiopia	1,1 %	0,1 %	1,1 %	2,9 %
Kenya	3,5 %	5,0 %	0,7 %	0,9 %
Nigeria	35,5 %	4,3 %	41,0 %	16,5 %
South Africa	7,1 %	0,9 %	13,7 %	15,6 %
Sudan*	0,2 %	0,7 %	1,2 %	7,7 %
EA share of world inward FDI	***7,4 %***	***9,4 %***	***18,0 %***	***12,7 %***
Country share of regional FDI:				
China	n.a.	17,7 %	40,2 %	46,7 %
Indonesia	24,4 %	4,3 %	4,0 %	-1,1 %
Japan	8,1 %	3,8 %	4,1 %	6,9 %
Philippines	4,2 %	1,5 %	2,0 %	0,9 %
South Korea	7,3 %	3,2 %	3,2 %	4,5 %
Thailand	4,9 %	5,3 %	5,5 %	2,0 %
Vietnam	0,0 %	0,1 %	1,9 %	1,2 %
Developing country's share	***26,3 %***	***26,0 %***	***31,3 %***	***12,9 %***

n.a. stands for not available
***No figures for Botswana 1970-73 and Sudan in 1971.**
NB: East Asia includes five high-income countries; Africa comprises of soley developing countries..
Source: Own calculations based on data from UNCTAD (2005)

incentives for African manufactures to exploit the technology efficiently and reduced the incentives for continued technologic upgrading due to the lack of competitive pressure; and iii) Technological institutions and the government failed to match the technology need from the manufacturing sector with the supply of technology through imports.

II. *International competition*: International competition has increased in Africa. Especially import competition were foreign companies compete with indigenous African companies for market shares. As studies from Deraniyagala & Semboja (1999) and Latch & Robinson (1999) have shown, there is little evidence that increased competition has facilitated an increase in the availability of technologies for African companies. The lack of state support, human resources and finance has made the exploitation of potential better technologies either too expensive or companies were unwilling to invest.

III. *Foreign Direct Investments*: There have been increasing absolute flows of FDI to Africa, even though less than to other developing regions. The access of technology through FDI has, however, been weak for Africa. This not only due to the fact that FDI inflows are weaker than for any other region. It's also due to the fact that most of the FDI is in primary goods which are not thought to have the same learning potential as FDI in manufacturing. In addition, the oil rich nations of Angola and Nigeria; together with regions biggest economy, South Africa received 64.5 % of the regions inflow of FDI, leaving very little for the rest of the region.

IV. *Other transfer mechanisms*: As Wangwe & Semboja (2002) have said, donors often attempted to make technology available through other means such as turnkey contracts, joint ventures, contracts and licences. The problem has been the exploitation of this increased availability of technology. The institutional infrastructure has been too weak to exploit these technologies to increase the technological innovation, adoption and assimilation process which continue to be at a low level

The main difference between the availability of technology between the regions seems to have been:

- There was less technology available in Africa than in East Asia through FDI (see table 9 measured by FDI inflows). [74] Most of the FDI in East Asia was is in manufacturing while most of the FDI in Africa was is in primary goods. In addition, East Asia had Japan as a primary investor in the region which thereby was able to spread the technology and make other countries "*climb up the technological latter*" in a pattern known as "*the Wild Geese Flying*". Africa did not have a Japan, even though South Africa as the most advanced economy has recently attempted to invest abroad.[75]

- The governments in East Asia were far more able in coordinating their technology policies with the needs of their economies. The technologies pursued, whether through

[74] I am aware about the difficulties of measuring FDI and that flows and stocks can different outcomes. But, I merely wanted an indicator showing the perceived relevance of a region and inward FDI for that purpose seemed a useful indicator.

[75] This is however controversial. Some would claim that although the political structure in South Africa has changed, the economic power still lays with the minority white people. The export of FDI to other African countries and hence indirectly the South Africa economic structure, has by some been accused of "*exporting apartheid*".

capital imports, licensing or FDI were part of a larger agenda where the technological needs of the manufacturing sector more often were met than in Africa. In Africa, the government was not able to meet the purchase of technology as good to the need the economy had. This is especially relevant for developing countries since they often have scarce reserves of foreign currencies and the long-rung sustainability of the economy is dependent on matching the technology need of the society with the supply. In Africa technologies were often chosen more on the basis of what status this would give the nation internationally, for instance the steel industry in Nigeria which is heavily protected and highly inefficient, but regarded as a "*strategic industry*" by the government.

- The internal capacity grew more sophisticated due to the economic growth process in East Asia allowing more investments in the technological infrastructure and a higher availability of highly educated labour force. This increased the amount of technology that was available to the countries. The economic growth process in turn was partly driven by the technological upgrading of the production structure, hence creating a "*virtuous circle*". In Africa the internal capacity declined over the period leading to a lesser ability to support technological learning which again dampened growth prospect, creating a "*vicious circle*". But, I have to agree with Wangwe & Semboja (2002) in asserting that the main problem in Africa has not been the availability of technology, but the lack of exploitation of the technology that was availability. The availability of technology is in part a function of economic growth since governments can invest in better a more sophisticated technological infrastructure and firms increase their capabilities and hence their learning capacity.

Learning and technology summarised

There is a agreement that the human skill divergence between the two regions is a key factor explaining the growth divergence, even though the nature of the underlying reasons varies somewhat. Another key factor seems to have been the lack of institutional support for learning and technology in Africa; while this was present in East Asia. Again the nature of this assertion is mixed as neo-liberals are more sceptical to a large role for the state in the learning process. Those supporting the evolutionary approach will make the case that learning and technological upgrading from a low development stage might be implausible without state support, especially through well functioning universities and public research institutions. The

selective promotion of some sectors over others is even more controversial and is often at the heart of the industrial policy debate. I think a strong a strong case can be made that the counterfactual, East Asia without selective intervention, would not have exhibited the same phenomenal economic growth. The effects of these interventions are more on the economy as a whole rather than on the individual sectors in question. Selective intervention in Africa, however, failed. This shows that selective intervention in certain sectors, even though it sometimes might succeed. There are no guarantees that it always will and the measuring of its effects is very difficult due to the complex linkages with the rest of the economy. When it comes to the availability of technology it was higher in the case of East Asia than for Africa. This was in part the result of the economic growth that was taken place. But, there seems to be a strong case that the main reason for the lack of learning and technology upgrading in Africa has not been the availability of technology, but rather their underdeveloped technological structure and weak human skills in exploiting the technology available.

2.2.3 Coordinating economic policy

The complementary investment, or "*Big push*" argument, states that some markets are missing or underdeveloped at a lower stage of economic development which requires governments to coordinate investments in various sectors at the same time. This goes especially for sectors with high backward and forward linkages and thus is important for the emergence of other sectors. As I have highlighted under financial systems and under technological learning, economic growth can create virtuous circles and the lack of economic growth can create vicious circles. Thus achieving a certain threshold development so that economic growth will take-off thus becomes imperative.[76]

I will go further than the usual investment arguments and highlight that the institutional conditions are as least as important for economic take-off. Also, the role of agriculture as a supplier of labour and a strategic industry is hard to overstate. These are issues that are important in increasing our understanding regarding the differences in the nature of the African and East Asian take-off.

[76] The role of complementary investments was accepted by the IBRD (1993) as one of the few "*legitimate roles*" of the government in promoting economic growth in East Asia. This was a change of heart in comparison with IBRD (1981). Still, such policies were not recommended other developing countries since they had weaker states than those in North East Asia.

It also highlights another stylised fact. Most developing countries have only had minor growth episodes. What makes the East Asian countries so unique is that they as a geographic group have been able to continue their economic growth over a long sustained period. I agree that the continuation of economic growth might be easier when growth is taken place, but most countries have not been able to keep this dynamic going. Also, it's important to know what accounts for those countries that in long periods have not attained economic growth such as in Africa. In this subsection I will highlight the prospect of general policy coordination as the main explanation for take-off and the continuation of growth (or non-growth).

There are four factors that I whish to emphasise regarding the take-off in East Asia:

I. *Variations in take-off*: The nature and the timing of the take-offs were different for the East Asian countries. Earlier I mentioned how Japan started their economic surge in the 1950s; the First Generation Tigers (FGT) in the 1960s, the Second Generation Tigers (SGT) in the 1970s, China from the 1980s, while other countries like the Philippines and Vietnam have perhaps taken off in the 1990s.[77] The nature of the take-off was also different. According to Rodrik (1999), the economic growth in South Korea and Taiwan was not triggered by a surge in exports, but high investment levels. In Hong Kong and Singapore the trigger seems rather to be increased exports.

II. *Agricultural preconditions*: There was a major increase in agriculture value-added in East Asia compared to other regions prior and during take-off (Hammouda, 2004). A number of countries had extensive land reforms such as China, Japan, South Korea and Taiwan. The goals for the land reforms were often not mainly economic, but political such as lowering the potential problems stemming from income inequality, for instance combating communist sympathies, I will comment more on this in subsection 3.2.1. I believe that two aspects of the agricultural policy should be mentioned. Firstly, rural sectors were prioritised with investments in for instance financial institutions, infrastructure and schooling. This led to more dynamic rural areas by increasing the integration of national markets, giving rural people more readily access to credit and increasing the quality of human skills; all enhancing productivity. Secondly, there was a

[77] Following the analogy one could argue to call the Philippines and Vietnam; perhaps together with Cambodia and Laos as Third Generation Tigers. The sustainability of their economic growth is the best indicator whether the growth is a mere spur or a shift in their economic paradigm. In time some of these countries may be termed along side the other successful East Asian countries; so far it might to early to tell.

large state interference in determining the prices for agriculture and providing protectionist policies. The prices were usually kept "*artificially*" low, but high enough for re-investment to take place. Later on, with the emergence of more modern industry, agriculture could also benefit from more efficient machinery and methods to enhance their productivity. These policies, I would claim, have been successful in promoting the agricultural sector. The development in the agricultural sector had at least five major implications; i) Urbanisation increased since the increases in agricultural productivity released labour. This insured a steady increase of cheap and well-educated labour for the manufacturing sector. Wages in the industrial sector were in general higher than in agriculture and the increased presence of schools in the rural areas increased the general level of skills in these areas; ii) The countries managed to attain food security which meant that the foreign exchange did not needed to be used on food imports, thereby increasing the surplus on the balance-of-payment. Also, food security was a strategic goal since it allowed more self-determination and hence increased political autonomy; iii) Agricultural reforms were used to fight income inequality in some countries such as Malaysia were income inequality along ethnic lines had caused difficulties thereby enhancing social stability, more on this in subsection 3.2.1; and iv) The increased income of the rural sector increased the size of the domestic market and helped the economy since domestic producers could sell their products to the domestic market thereby increasing their income and potential for obtaining economics-of-scale and scope more independently from the international market.

III. *Visions*: The role of growth visions has often been understated by the neo-liberals, but was important in mobilising national forces around economic growth. There are at least two major reasons for this significance; i) Visions showed the intension of the government which reduced uncertainty and might have increased the commitment of investors and the direction of the investments. Hence they were able to coordinate the investments needed to overcome structural hurdles and the state invested in those sectors that were perceived to being to risky by private actors; and ii) Mobilisation of national forces around economic growth by playing on national pride connected to economic growth. In South Korea Park came to power in 1961 and started to signal his commitment to economic growth. His five year plans were not so much detailed economic objectives, but rather loosely defined visions to steer the economic policy after. Another example is how China after 1978 has increased their national pride due to

the economic growth and how nationalism has been able to mobilise Chinese around a common cause. The effects of such a national mobilisation might have been more committed investors, higher labour productivity and a feeling of common identity with economic growth which made policy implementation more effective. The extent of such a national mobilisation and the quantitative contribution are hard to measure. I will come back to this point in subsection 3.2.2.

IV. Institutional innovations: Before the growth took off there was always a short period with numerous institutional innovations (Rodrik, 2000a). An important aspect of these institutional innovations is that they seldom were fixed solutions imported from abroad, so called "*best practice institutions*". Rather they attempted to adapt institutional change to the local context by given them a "*local flavour*". This point is for me vital to understand the successfulness of institutional innovation in East Asia. Roland (2002) (cited in Haggard, 2004) called this the "*evolutionary institutional perspective*". There are number of reasons for why this was important; i) It increased the legitimacy of institutional change by making it more social acceptable and thereby increased the working and durability of such changes; ii) Institutions were more adapted to the specific needs the countries had as opposed to pre-fixed; thereby enhancing the effectiveness of the institutions for the countries in question by being more attuned to the domestic needs; and iii) It promoted national pride by enhancing the belief of self found paths to economic growth, like the "*Japanese economic model*", "*the Taiwanese economic model*" etc. This could have been important for raising the national mobilisation around economic growth even further.

The continuation of economic growth is what differentiates East Asia from other developing regions that have had short spurs of economic growth. I would contend that the qualitative foundations of the East Asian take-offs were vital for the continuation of economic growth in the long-run. In addition, there were a number of important government related factors that were vital in sustaining economic growth in East Asia.

I. Coordinating institutions: The East Asian countries all had methods to coordinate their economic policies in a coherent manner. The most obvious might be institutions as the Ministry of Internal Trade and Industry (MITI) in Japan and the Economic Planning Board (EPB) in South Korea. These institutions comprised of technocratic elites that the

authority and the legitimacy to go across various departments and make the economic policy more coherent. The coordination of economic policy was very important in East Asia since there was a focus on "*the bigger picture*". To meet the stated objectives there was a need to coordinate for instance the financial, educational, technological, macroeconomic, and trade policies. In Japan, South Korea and Taiwan there was a large focus on creating so-called "*focal points*" so private market participants were able to observe the intentions of the government (see Renshaw, 1986; and Chang, 1998). Both through white papers and the coordinating institutions the governments were able to get the private investment into the sectors it wanted. Okimoto (1989) provides an example from Japan where governments through the usage of preferential treatments decreased the perceived risks in investing in the new IT sector which has become one of the biggest Japanese success stories. Another example is the semiconductor industry in Taiwan. Private market participants found it too risky to invest in this new sector so the government instead invested in this "*strategic industry*". After several public companies had emerged several private companies started to be spun of these. This was a process of market building.[78] One example is how governments in South Korea promoted labour intensive exports on the basis of their earning potential well into the 1980s (Chang, 1998). This despite the declining comparative advantage that this sector had as compared to other East Asian countries such as the SGTs. The foreign exchange earned was used to purchase more capital and technological intensive imports which due to the strong emphasis on increased educational and technological know-how were able to be used to increase the technological know-how of their manufacturing sector. To finance certain sectors with higher knowledge intensity these sectors were given preferential loans by the governments. This example shows how industrial, educational, financial, trade and technological policies were combined. Therefore, assessing the effect of only one of these, for instance industrial support, becomes an ever more daunting task (Chang, 1998).

II. Governmental learning: East Asian governments were able to strike a balance between long-run flexibility and short-term discipline. The short-term discipline meant that exports and production targets had to be met and avoided so-called "*stop-and-go*" policies. This decreased uncertainty and thereby reduced transaction costs by increasing

[78] Contrary to the neo-liberal view of seeing markets as natural constructs, in developing countries these might be underdeveloped or non-existent. This process is what Wade (1990) called "*Governing the market*".

transparency. In the long-run, however, governments changed their policies if it proved to be faulty. Governments did make mistakes, they did promote certain industries that did not succeed and finally had to be abandoned.[79] This meant that East Asian governments were "*learning-by-doing*" and had a very incremental and pragmatic approach towards managing the economy. Bruton (1998) called this a process of "*government learning*" rather than "*government minimising*". An important part of this process was the consultation with the private sector. In Japan this was done through the so-called deliberation councils where representatives from the government, the private sector and third parties such as academics met to discuss the economic policy. This gave the policy makers a feedback mechanism so they could attune their economic policies so they would meet the needs of the private sector.

III. Dealing with structural change: After take-off a virtuous cycle of high investment – high exports – high savings emerged (Rodrik, 1999; see also Akyuz *et al.*, 1999; and Weiss, 2005). But the continuation of economic growth also inevitably led to structural changes and dealing with these is challenging. In East Asia governments not only gave support to so-called "*sunshine industries*", but also to "*declining industries*". The critics of industrial policy said that the support of declining industries hindered structural changes and leads to a less efficient allocation of resources and this will eventually lead to a declining growth rate.[80] "*Declining industry*" support in East Asia often fell into two categories; i) Short-term industrial support due to market fluctuations that will not be long-lasting. Support from the government was given due to the lack of financial means through less developed capital markets and because they in capital markets perhaps would not get the funding. For instance in Japan there were the so-called "*recession cartels*", see Dore (1986) and Chang (1994a); and ii) Long-term industrial support to the real declining industries was given to facilitate a more smooth transition.

[79] In the industrial policy debate hardly anyone ever mentions that private investors make mistakes all the time and often go bankrupt; private investments are often prone failure as well.
[80] Most famous is Krugman's (1994) argument that almost the entire growth process in East Asia was simply an accumulation of capital and labour; leaving almost nothing for productivity measured by total factor productivity (TFP). Given the declining marginal productivity of these factors economic growth would not be sustainable if there wasn't an increase in productivity. Thus, the East Asian economic growth was according Krugman unsustainable in the long-run. Krugman's arguments have been hotly disputed, for instance Nelson & Pack (1999) argue that an estimate like TFP underestimated East Asia's dynamism and efficiency. They also point to that South Korea and Taiwan grew far faster than given by their investment levels. I would add that a key to understanding the continued growth are structural changes and that capital and labour is released from depressing sectors to more booming sectors. To maintain growth in the long-run such a process becomes vital. There is an attempt to avoid a situation were declining industries become "*nursing homes*" and lock resources that eventually will depress the long-run efficiency of the economy and hence economic growth.

Support was given conditionally with restructuring demands, cost demands and demands for the upgrading of the production structure. Time was given to either restructure the enterprise to become more cost efficient; or to go into more profitable sectors. Another example from Japan are the so-called "*cartels for structural-depressed industries*", see Dore (1986), Renshaw (1986) and Chang (1993). Such support might have made structural changes more acceptable thereby reducing the opposition to structural change.

IV. Binding institutions: The tenants of new institutional theory would emphasise the role of binding institutions to overcome problems with regard to commitment and time inconsistency associated with government involvement. Governments in East Asia were able to commit themselves to economic growth and gained a more favourable reputation as a reliable partner because of that. Reputation alone, however, is not enough. There is a need for institutions to constrain government power to show credible commitment. One such an institution is through clearly defined and secure property rights. There is a consensus in the literature that property rights are a fundamental institution that needs to be in place for economic development to take place. Clearly defined and secure property rights secures that market actors can enjoy the fruits of ones own labour and hence increase incentives innovation and production; it also binds the government since some sovereignty is given to market actors to control their own resources and protects them from exploitation.[81] Another institution is the rule-of-law rather than the rule-of-men. East Asian government have been moving towards an increased rule-of-law during the period. To compensate an at times inadequate legal framework other guarantees were

[81] There is a near consensus that clearly defined and secure property rights are needed for economic development to take place. At the same time there is no disagreement on the fact that the economic growth in East Asia for a large part was driven by private investments. Neo-liberals have seen this as the superiority of private formal ownership. This might, or might not be true. A number of scholars have a more nuanced approach and point out at least three moments; i) It's not given that formal ownership gives full control over a property, at the same time certain informal mechanisms can give larger controls than formal. In many countries one has to seek permission to build houses on one's own property, which indicates that property rights not yields full control; ii) It plays on the strong anti-state attitude of the neo-liberals which states that public ownership should be avoided. Even though public ownership in East Asia was low it did play a part in for instance complementary investments in Taiwan as I mentioned. In Taiwan the three largest companies; and seven of the ten largest companies are publicly owned (Fields, 1998). In South Korea the publicly owned Pohang Steel Company is known to be one the most efficient and technological advanced within its industry (Amsden, 1989). In Singapore there are a number of publicly owned companies within shipbuilding and some high technology sectors (Chang, 1998); and iii) China is an interesting case since the formal property rights are vaguely defined with a multitude of owners Often, however, the property rights de facto are very clear which means that informal institutions control the property rights (Nolan, 1996). This shows that in some society's informal institutions can be as clear as formal ones. There is no doubt that Anglo-American cultures have an obsession with formal rules, something that's reflected in the US judicial system.

sometimes given to show commitment to economic growth. For instance, in China foreign investors were given more favourable tax incentives than local private entrepreneurs in the special economic zones. Also in South Korea there was a strong pro-business bias from the 1960s to the 1980s with the leading Chaebols profiting the most.

In Africa some countries did experience short periods of economic growth, while others did not. Contrasting with the take-off in East Asia, I want to emphasise four points:

I. *Different experiences*: There are at least three groups of countries in Africa with regard to economic growth. The first one group of countries has had a economic take-off and has managed to sustain growth over a long period; only two countries qualify for this group, namely Botswana and Mauritius.[82] The second group of countries are countries that have had growth spurts, but have been unable to maintain these, for instance Cote D'Ivoire, Ghana, Kenya and Nigeria. The third set of countries has not had growth spurts and has been caught in the various vicious circles during the entire period, for instance Angola and Congo DR.

II. *Lack of real visions*: Many would contend that African leaders did have visions after independence, quite a lot of them actually. But, these were often political and did not have a realistic economic entrepreneur vision attached to it. To me, the most important thing about the visions in Africa was that the policies that were conducted often did not match it. Complementary investments were often ill planned, lacked consistency and were subject to frequent reversals. Nigeria is a good example of how different government since 1970 have stated that Nigeria was to become an industrialised nation. But still, 99 % of the export income in 2000 was in primary goods despite at least 40 years of different attempts of industrialisation.[83]

III. *Institutional change*: There have been many and frequent institutional changes in Africa, or at least attempts of. This is closely connected to frequent regime changes in the

[82] Some would want to put Uganda from the end of the 80s here as well. The problem is that it's to early to tell whether their growth is sustainable, just like countries as Cambodia and Laos.

[83] From around 1960 to around 1970 the manufacturing did grow and there was a pro-industrialisation policy and at times rapid economic growth in Nigeria. But around 1970 large reserves of oil were discovered and the oil price shock a few years later led governments to prioritise the extraction of this natural resource despite much of the pro-industrialisation rhetoric.

region and shifting policies. Intuitively, this increased uncertainty and hence increased transaction costs leading to fewer investments given the uncertain environment. There were a number of reason for why institutional changes often were ineffective and unsustainable: i) Lack of local contents, often institutions were pure copies from abroad and not suited to the local African needs, for instance some of the technological institutions I mentioned in subsection 2.2.2; ii) Lack of consensus around policies and institutional change which rendered many of the changes unsustainable due to the frequent reversals, more on this in section 3.1; and iii) Rather than achieving their goal of increased certainty, institutional changes increased uncertainty both due to the frequency of changes which increased the danger of future reversals. In 1987 Zambia halted their SAP driven policies and started to undue some of the liberalisation which had taken place. The same goes for Nigeria which had been liberalising their economy since 1986, but a military regime reversed much of these policies in 1994 by for instance a appreciation of the exchange rate to facilitate increased public consumption for the military regime.

IV. *Agricultural developments*: Under the colonial administration policies varied from colony to colony on how the agricultural sector was treated, as I mentioned in subsection 1.2.1. In general, the authorities set a fixed price for agricultural goods to keep up the supply of cheap food to urban areas, not least since it was in urban areas the potential for a revolt was the largest. After independence many of these policies were continued. The farmers in Africa thereby received a low, but stable income which often was not enough to upgrade their production structure to allow for increases in productivity.[84] Policies towards the agricultural sector were not that different as in East Asia which also had low fixed prices. The main difference for me is the low public investments in rural areas going to infrastructure, schooling, health and institutional expansion such as financial institutions. One of the main objectives of the SAP was to allow for higher farm incomes. It was thought that a liberalisation of the prices and allowing for foreign trade would achieve higher prices. But, the prices did in general not increase in one of the most "*distorted*" world markets of them all with prices being

[84] A question that remains unanswered is how large income African farmers should receive to allow for a productivity increase. The geographic conditions in Africa are harsh and whether the income of farmers need to be higher than in other regions to allow for increased wealth remains to be seen. It is not clear whether or not policies or geography alone were at fault in lowering African agricultural output, but the two in combination were devastating.

depressed by developed world farm subsidies. The prices did, however, become more volatile. The result was that farmers now got a low and volatile income with no social safety net to allow them to cope with the increases in volatility. Liberalisation proved to lead to more adverse outcome than the previous situation. The reason seems to be that the SAP abolished the old system without putting a new system in place. Once African countries had food security, but the African countries today are unable to feed themselves, needing food imports. Hammouda (2004) summed up the development of the agricultural sector during the two policy eras as the "*failure of development experiments*". The results of the agricultural policies in Africa were; i) Urbanisation not due to increased agricultural efficiency, but due to hardships in the countryside leading to over-urbanisation since the economic fundamentals were not in place which have facilitated high unemployment; ii) Increased food imports which has locked much of the African foreign exchanges and increased the balance of payment deficit. Also, the food dependence has led to a increased dependence on foreign countries leading to a increased loss of autonomy; iii) Since most poor people are in the rural areas and the largest sector is agricultural most poor people are farmers. The hardships endured by African farmers have led to increased absolute numbers of poor people which might have increased social tensions and hence increased political and social instability, more on this in subsection 3.2.1; and iv) The rural areas did not become a market for urban production due to the low income and accessibility thereby lowering the potential for home-market led economic growth in Africa.

Normally, take-offs, when achieved did not proved to be sustainable. There were also a number of reasons for why the lack of growth continued:

I. <u>Lack of coordination</u>: African states have a unclear distribution of power within the state sector. The responsibility for the formulation and implementation runs across various departments. Many of the departments have stayed afloat on the backdrop of previous attempts of industrialisation which did not succeed. For instance, there are three different industrial departments in Nigeria where all of them see themselves as responsible for the industrial policy formulation for the country as a whole. This has often resulted to a lack of coherence between various political goals due to a contradiction between different departments. This has contributed to making policy formulation and implementation a more difficult process. Both the tenants of the IS and

SAP approaches claimed their policies failed due to implementation difficulties, not their own policy recommendations. The SAP policies might have been even more difficult to implement due to the lack of popular support in many African countries which made such policies subject to reversals and ineffective implementation, I will return to these issues in section 3.1.

II. <u>*Stop-and-go policies*</u>: I have already mentioned some of the arguments regarding the damages of constant policy reversals. There was a more long-term commitment to IS than to SAP; but still the policies failed. I would claim that the short-run policy reversals and lack of discipline in the short-run in keeping production and export targets were at the heart of the problem. This was combined with preferential treatment of some actors over others and led to a decrease in government transparency which increased transaction costs and often made the government an unreliable partner. The process of "*government learning*" was not present in Africa not least due to the unstable political climate. Under the SAP policies the new slogan was "*government minimising*" since the government in Africa was the main reason for the lack of economic growth in Africa according to the neo-liberals. This process of scaling down the government led to a decreased state capacity which furthered reduced the state's capacity to promote economic growth. Most important was due to the lack of real consultation during the SAP.[85] This increased the danger of policy reversals due to lack of a consensus around policies, something than also characterised the IS period. I will come back to these issues in section 3.1.

III. <u>*Structural drag*</u>: The ISI left many African countries with a legacy which has proven hard to overcome, namely a large state owned manufacturing sector which is highly inefficient. One major problem of the manufacturing sector in Africa is their high dependence on imports for continued production. The development in for instance Kenya followed this pattern where a manufacturing sector developed with a high dependence on imported capital goods and factors; there was a high uncertainty in the export markets in the surrounding countries and a relative small home market, all setting limitations for increases in efficiency (Oyejide, 2002). The SAP policies, however, created their own structural legacy as well. Ghana was one of the few truly "*successful*"

[85] Some would disagree and say that the concept of "*local ownership*" attempted to consult the African countries. But this was often more rhetoric than real; see subsection 3.1.3.

implementers of the SAP and liberalised their foreign trade in 1983. Although there was an initial expansion of manufacturing production until 1987, it dropped until 1993. The companies that expanded their production were normally small, with a low productivity which directed towards the home market (Oyejide, 2002). Also the SAP, with its import liberalisation, led to a high increase in imports. The export sector in Ghana and Uganda, the countries with the most consistent implementation of the SAP, have a high dependence on imports and can only be hold afloat by increases in foreign aid. They have been unable to generate the foreign revenue to pay for the imports themselves. Thus, both development strategies left African countries with an economic structure which is highly dependent on imports and hence foreign exchange, which is partly caused by foreign aid.

IV. *Binding institutions*: The reputation of the African states was as an unreliable partner for economic cooperation. This reputation is partly due to the frequent and rather turbulent changes in leadership and partly the lack of institutions that guarantees economic and political actors a certain amount of rights. These two are interlinked and the political instability is also reflected of how these problems do not find their solutions through political institutions. For economic actors the property rights often have been uncertain and have contributed to the low investments. A sudden and drastic change in property rights is known to decrease the trust of investors in a economy for a long time. In Uganda Idi Amin seized power and drastically took the property of Indian businesses to fight the income inequality in the country. Another example is Robert Mugabe seizures of white farmers land in Zimbabwe. There was an attempt by the IBRD to implement certain "*best practice*" institutions such as formal private property rights in some African countries. These did often not have the intended effect. I will comment on the reason of this failing in the start of chapter 4. The rule-of-law is another institution that increases the transparency of the government and decreases transaction costs. There was a lack of stability in the application in the rule-of-law which led to a high perceived risk in African investment.

2.3 Trade policy

The debate regarding trade policy has almost been as heated as for industrial policy. The export performance of East Asia has been increasing during the whole period. East Asia's

Table 10 – Regional share of worlds exports; and Country share of total regional exports					
	1960	***1970***	***1980***	***1990***	***2000***
EA total share	***9 %***	***10 %***	***13 %***	***18 %***	***24 %***
Individual country share of regional exports:					
China	22 %	7 %	7 %	10 %	16 %
Indonesia	7 %	4 %	9 %	4 %	4 %
Japan	34 %	62 %	51 %	45 %	31 %
Philippines	5 %	3 %	2 %	1 %	3 %
South Korea	0 %	3 %	7 %	10 %	11 %
Thailand	3 %	2 %	3 %	4 %	5 %
Vietnam	1 %	0 %	0 %	0 %	1 %
SSA total share	***5 %***	***4 %***	***4 %***	***2 %***	***1 %***
Individual country share of regional exports:					
Botswana	0 %	0 %	1 %	3 %	3 %
Congo, DR	8 %	7 %	3 %	3 %	1 %
Ethiopia	1 %	1 %	1 %	0 %	1 %
Kenya	2 %	3 %	2 %	2 %	2 %
Nigeria	8 %	11 %	33 %	20 %	22 %
South Africa	35 %	29 %	33 %	34 %	32 %
Sudan	3 %	3 %	1 %	1 %	2 %
Tanzania	3 %	2 %	1 %	0 %	1 %

Source: Own calculations base don data from WDI indicators (2005)

share of world's exports was 9 % in 1960; in 1980 it was 13 %; while it constituted almost a quarter of world trade in 2000. Africa's export performance has seen an opposite trend. In 1960 Africa's share of world exports was 5 %; in 1980 it was 4 %; while the share dropped to around 1 % of world trade in 2000. This is especially worrying since the regions' two biggest countries, Nigeria and South Africa since 1980, have had over half of this share leaving the rest extremely marginalised.

The trade policy debate has been marked by what, at times has seemed to be, two extremes; i) Home-market led development; and ii) Export-led development. From the 1950s until around 1980 import-substitution home-led development was within the mainstream. From around 1980 the neo-liberal ideas started dominating the mainstream and an export-led economic development started to be the main recommendation for developing countries. This development was related to the economic growth in South Korea and Taiwan.

2.3.1 Home market-led development

Import substitution was based on the idea around home-market led economic development. With regard to trade policy there were three major effects:

I. *Substitution of imports*: The whole concept of import substitution reflexes the replacement of imported foreign produced goods with the country's own goods. In this way the country started to produce manufacturing goods which up until then were produced in developed countries. Thereby the international division of labour was broken up.

II. *Overvalued exchange rate*: An overvalued exchange rate would facilitate increased access to capital and would make imports cheaper which would facilitate technologic upgrading.

III. *Increased trade barriers*: Trade barriers increased based on two arguments: i) So-called "*consumer goods*" since the overvalued exchange rate made all imports cheaper and this could facilitate an increased import of "*unnecessary*" goods; and ii) Protection of home industry would make it possible to build up the domestic industrial capacity.

For many developing countries primary good exports would give the necessary foreign exchange to finance the import substitution strategy at the outset. The model of import substitution differentiated between the first and second generation import substitution. During the first generation import substitution agriculture and simple labour intensive industry such as textiles should be promoted to give the necessary basis for further industrialisation. During the second generation import substitution more advanced industry which was more capital intensive should be promoted. Finally developing countries would have a industrial structure similar to those found in developed countries and they could start to open up their economies. To put it bluntly, the infant industry argument was now used for the economy as a whole.

African countries pursued such a home-market led development through an IS strategy. Initially this strategy seemed to work quite well and a number of African countries did achieve high growth rates. Countries like Kenya and Nigeria at times recorded growth rates of 9 % in GDP per capita. However, the growth did not prove to be sustainable and certain problems that were common for those pursuing an ISI strategy also became obvious in Africa. In addition, Africa had some problems that were specific for the region:

I. *Standard macroeconomic problems*: I have already mentioned some of the difficulties with such a strategy earlier. With regard to trade policy the IS created three main effects: i) Increased BoP difficulties stemming from a faster than expected rise in imports; ii) An overvalued exchange rate which created an export bias since goods were priced higher for foreigners; and iii) Imports of capital goods increased.

II. *Standard efficiency problems*: The ISI, as I have mentioned previously, led to a high degree of state ownership in Africa and a high degree of economic planning which both proved to create inefficient manufacturing sectors. One of the reasons was the lack of competitive pressure, in the absence of conditionality such competitive pressure could have been provided by the international market, but this was also not present in the African context. Industries were often protected, often enjoying monopoly status in their home markets.

III. *Specific African problems*: There were a number of problems with the ISI that were more specific for Africa; i) Domestic markets were small and often fragmented. This lowered the potential for an ISI since economics-of-scale could not be as much exploited; ii) Africa had inexperienced administrators at independence and policy implementation proved to be difficult. Some ISI proponents claim that, even though the IS did fail in Latin America; it did not fail in Africa simply because it was never really tried due to implementation difficulties (see for instance Riddel, 1990). Such a view says that only a handful of the larger countries such as the Cote D'Ivoire, Nigeria and Kenya did implement a milder form of ISI, but that smaller African countries did not have a real strategy.

East Asian economies until the beginning or mid 1970s could be divided into two categories based on their trade policy pursued; i) The first mover countries with Japan and the FGT; and ii) China, Vietnam and the so-called Second Generation Tigers (SGT) which comprises of Indonesia, Malaysia and Thailand which changed there policies subsequently to a more pro-export stance. The latter group comprised of countries that pursued ISI and planned economies under communist leadership. Both these approaches suffered from many of the same difficulties that most IS countries did which comprised of; i) Macroeconomic problems which, as I mentioned above, comprised of increased BoP problems, overvalued exchange rates and imports of capital goods; and ii) Efficiency problems due to high state (or collective)

ownership and a high degree of planning leading to an inefficient use of resources. Thus the problems suffered in these countries were not that much different from what other economies suffered that also pursued an IS strategy. The first mover countries, however, instead choose to promote their exports. The high economic growth these countries experienced made many in the region aware of an alternative strategy to the ISI. The SGT changed their policies to a more export-oriented strategy during the 1970s; China from 1978 and Vietnam from 1986. With regard to the first mover countries there are three important characteristics:

I. *Active export promotion of industrial goods*: There was a strong support for exporters from the state. Exporters and their supplier often got preferential loans and were given exemptions from import restrictions. In this way there was a clear pro-export bias which is markedly different from the ISI at the time. It has been suggested that the need for foreign exchange was the true motivation behind such a strategy. The increased foreign exchange was able to finance the increased capital imports which the increased technology learning of the country. In that sense the strategy pursued by East Asia was more a complementary strategy between export promotion and import substitution. Some have suggested that this was the only viable long-term ISI policy since it provided the finance for increased imports.[86] In addition to these arguments there are three other moments worth noting; i) Active state support was given to sectors that there didn't exist comparative advantages. There are a number of authors that claim that the first movers countries created their comparative advantages, rather than let the market decide their outcome. To not hurt exports, import exemptions were given to exporters and their suppliers to overcome some of the most adverse effects of protectionism; ii) Sectors were not chosen on the basis of criteria such as labour intensive and capital intensive as in Western models. There was a more whole worthy accession where the future export potential, learning effects and linkages with the rest of the economy; and iii) Industrial and trade policy were often two sides of the same coin. In part the market forces were set out of play by allowing protectionism and imperfect competition. Most likely, the

[86] Some would claim that our Western viewpoints would not adequately describe the "*Japanese*" or the "*Korean*" model. The closest to such a model I think comes from Akamatsu (1961, 1962) with his "Wild Geese Flying" models. The Japanese economic school of thought orginateted originally more inspired by German, rather Anglo-American idea. This legacy can still be seen today. Okimoto (1989) elegantly summed up part of the difference: "*There is a fundamental divergence in expectations and objectives and hence in policy actions. Whereas Americans are content to let the chips fall where they may, the Japanese prefer to remove as much uncertainty as possible from the market processes. Their disposition to bend, twist, and shape the market is analogous to their practice of using ropes, wires, and strings to bend and twist the trunks and branches of trees into shapes that fit the Japanese aesthetic composition of a landscape, garden, or bonsai plant.*"

reason why such a policy was more effective in East Asia than in other developing regions were the stringent production and export requirements.

II. *Strategic policies*: Sectors that were promoted were part of a larger picture to upgrade the economic structure of the economies in question. Those sectors that were able to compete internationally were liberalised, those that were not were given protection in so far they were deemed to be strategic for the country's interests. The point is that trade policies, rather than being universal for all market participants, was strategic and adapted to the specific needs of the sectors and companies. This might have enhanced their working since it for instance was combined with technology policies hence increasing the overall learning of the economy as a whole. In addition trade policies were combined with other policies such as social policies. In Japan the agricultural protection was used to partly offset the underdeveloped welfare state (Chang, 1998).

III. *Institutional support*: The promotion of exports also resulted institutional support for exports. For instance Trade Promotion Centres which often functioned as a match making between their own country's exporters and potential importers abroad. For instance the "*China External Trade Development Council*" (CETPC) in Taiwan and the "*Hong Kong Trade Development Council*".

During the 1970s there was general perception that import substitution had failed. The results generated by this strategy were not what the proponents had been claiming. There are three main strands of explanations for why the IS strategy failed:

I. *Macroeconomic shocks*: From 1973 macroeconomic shocks were more profound than the pre-1973 period and this undermined the IS strategy. This explanation was often backed by leaders which implemented the IS policies.

II. *Implementation*: The ideas behind import substitution were valid, but the implementation of the policy was abysmal. For instance, the agriculture was often squeezed instead of promoted, which paved the way for an unsustainable economic development. This explanation was often backed by the proponents of IS.

III. *Wrong ideas*: Import substitution did not work since the ideas behind this strategy were wrong. This explanation was often backed by the neo-liberals.

2.3.2 – Export led development

From around 1980 the neo-liberals had gotten into the mainstream which facilitated a shift to a more liberal policy. The recommendation for developing countries was to open their economy, withdraw the state of economic activity and countries would then develop naturally based on their endowed comparative advantage. The arguments can be characterised in two main groups that are interlinked, namely pro-export arguments and pro-import liberalisation arguments. Neo-liberals see them linked because an import restriction on a production factor that an exporter uses is like a tax on an exporter. The main arguments usually are:[87]

I. *Advantages of increased exports*: Some of the main arguments for increased exports is that an increase facilitates; i) A increase the country's production; ii) Increased exports will increase the availability of foreign exchange; and iii) Increased entrepreneurship due to higher perceived pay-off by producing for the larger international market.

II. *Advantages of a more open economy*: Increased import liberalisation is according to many of the same authors to give some additional attributes; i) A orientation towards the international market will facilitate an increased access to technologies; ii) Increased openness will give dynamic comparative advantage which indicates a more sophisticated production structure as time moves on; iii) Increased division of labour which will increase the productivity of the economy as a whole and promote economic growth; iv) The increased competition will discipline domestic companies by raising the level of competitive pressure and thus making them more effective; v) Import liberalisation will give less opportunistic behaviour by disciplining governments; and vi) Producers will get access to factors of production at international prices; import restrictions would be an implicit tax on exporters.

These are not universally accepted arguments as there are host of counterarguments that goes against. For the sake on continuity I will characterise them in the same two main arguments as the pro-arguments:

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[87] See for instance McKinnon (1964), Chenery & Strout (1966), Lucas (1988), Cornwall (1977), Krugman (1987), Lal & Rajapatirana (1987), Romer (1990), Esfahani (1991) and Yarborough & Yarborough (1994).

I. *Disputed export-led growth thesis*: The export-led growth hypothesis is not universally accepted and there are a number of theoretical and empirical counterarguments: i) Several economic models have postulate that an export-led growth policy will only work if the conditions in the economy are adequate (see for instance Buffle, 1992); ii) Many of the theories that emphasise an export-led growth seem to fit better with industrial goods exports than for primary goods; iii) There is doubt whether it is politically plausible that developed countries will allow all developing countries to export their way out of poverty; and iv) There is the possibility for growth-led export rather than the opposite, something that the neo-liberals acknowledge, and there is the possibility for a two-way feedback mechanism between growth and export.[88]

II. *Disputed advantages of import liberalisation*: Import liberalisation might be more contested than the export-led hypothesis and a number of empirical and theoretical counterarguments have been made; i) There is plenty of evidence that indicates that was not due exports played an important role in the East Asian growth process, but this was not due to any full scale import liberalisation as recommended in the SAP; ii) Increased scale economics and technological intensity after import liberalisation is crucially dependent on the expansion of production; often industrial firms in developing countries have been out-competed by foreign competition (Deranigagula & Fine, 2001). The evolutionary approach says that its not given that increased competition by itself increases innovation and learning (Evenson & Westphal, 1995); iii) The decreased opportunistic argument due to import liberalisation has never been fully understood and surprisingly few studies have looked at for instance corruption before and after import liberalisation.[89] There is doubt whether trade policy is the appropriate tool to fight corruption with; iv) It's unclear how big the advantage is from resources going from inefficient to more efficient sectors which is a static one-time benefit from liberalisation. Estimates have predicted that these advantages are not more than 1-2 % of GDP and are a poor argument for import liberalisation if there are no dynamic comparative advantages present; and v) Theoretically, it seems just as plausible to argue for export

[88] All countries that after WWII have shown sustained economic growth have had a high growth in exports, but not all countries with a high export growth have had sustained economic growth.
[89] An exception is Onis (1991) who attempted to measure corruption after import liberalisation in Turkey. The conclusion was that corruption had not declined; rather it had simply taken new forms.

subsidies or less import restrictions for exporters and their suppliers as in the case for South Korea and Taiwan.

Giles & Williams (2000) took a literature overview by looking at 150 studies which examined the export-led hypothesis. The results were mixed and hence not conclusive. In all there seems, however, to be more agreement of the potential benefits of increased exports than the potential benefits from import liberalisation. The increased popularity of the export-led growth argument was based on the high export growth in countries like South Korea and Taiwan. This gave the export-led growth argument much of its legitimacy. In the 1980s many American scholars believed that South Korea and Taiwan were open economies with little state intervention and hence close to the neo-liberal "*ideal*" economic vision.[90]

Research has since shown that this assertion of South Korea and Taiwan was false and many have called it a process of myth making. [91] Bruton (1998) said that the vision of free trade in South Korea and Taiwan right from the outset was very much "*made in Washington*".[92] South Korea; as I mentioned previously had both high state intervention and used protectionist measures to promote their economies. But nobody disputed the fact that export growth was high. Hence, the export-led argument has become more important than some of the arguments related to a minimalist state. The consequences at the start of the 1980s, I would claim, were dire. The SAP was based on the neo-liberal interpretation of the East Asian miracle at the time, which was filled with myths.

The literature on more open economies has often stated that more "*open*" economies have grown faster than relatively "*closed*" economies. Edwards (1993) and Rodrik & Rodriquez (2000) have criticised this literature on the basis on methodological problems. Edwards (1993) pointed out that economists tend to put to much information into data that simply isn't there. Data between countries usually give little information on innovation, trade and growth. Rodrik & Rodriquez (2000) showed how methodological issues in the most cited studies made the conclusion of faster growing open economies more watered down. Another, not to

[90] For interpretations of East Asian economies as "free trading" countries see for instance Balassa (1982), Little (1982), Lal (1983) and Balassa (1988).
[91] For a criticism of the neo-liberal interpretation of East Asia see for instance Maganizer & Hout (1980), Johnsen (1982) and Dore (1986) for Japan; Amsden (1985) and Wade (1990) for Taiwan; and Jones & Sakong (1980), Luedde-Neurath (1986) and Amsden (1989) for South Korea.
[92] Presch (1996) mentioned that the support for free trade among American academic economists is as high as 97%!

often mentioned, criticism comes from Deranigagala & Fine (2001) which says that it more often is equations and not models that are being tested. When the theory of comparative advantage is to be tested a equation showing exports as a result of trade liberalisation might reveal that trade liberalisation increases exports. But the theory is an interlinked model of different presumptions, if a country that has it's natural comparative advantage on labour-intensive goods and capital-intensive exports increases there is a inherent contradiction within the model that does not shows itself in the equation.

Bruton (1998) said that case studies at the micro level often are more promising avenues for showing the relevance of policies and normally give a far less strategic role for trade policy than neo-liberals would claim. Exporters often do have a higher productivity than non-exporters. One of the main questions is whether this is a process of "*learning-by-exporting*" or a self-selection process of the most efficient domestic producers into exports.[93] Most case-studies do not support the "*learning-by-exporting*" argument, but rather finds that the most efficient firms in general self select themselves into exporting activities.[94] The evolutionary theory, as I mentioned, does not state that increased competition automatically leads to increased innovation. This is also dependent on a host of other factors such as technological and learning institutions that support firms. As Rodrik (1994) mentions, whether or not import liberalisation leads to increased productivity and production is case dependent rather than universal and is most likely driven by other factors than trade policy as well. Rodrik (2000a) allows questioned how much trade policy by it self could solve. The myth the trade liberalisation is a "*cure-for-all*" diseases has been debunked. There is more agreement today that trade policies alone cannot replace a development strategy.

In East Asia, the trade policy of the first mover countries did not change radically over the two periods in question. For the other East Asian countries I mentioned it did. There are large differences though. The SGT relied to a far higher degree than the first mover countries on export zones, in general relied more on international markets and less on protectionist measures to foster or protect their home industries. The former planned economies choose a gradual opening up of their economies with the creation of export zones where FDI and foreign competition was allowed. There was, however, a promotion of exports with high

[93] A problem with this literature is that often does not differentiate between a one-time static adjustment to international markets or dynamic learning effects over time.
[94] See for instance Bernard & Jensen (1995), Bernard & Jensen (1999), Aw *et al.* (1998), Kraay (1999) and Söderbom & Teal (2000)

earning potential and the trade policies pursued seemed to fit better with what the first countries pursued. Not least, China and Vietnam seemed to a higher degree to set their trade policies more independent of the neo-liberal paradigm recommendation than the SGT. Regarding the trade policies in East Asia in this period there are three main characteristics:

I. *Continued active export promotion*: The export promotion in the first mover countries continued and many of the other East Asian countries, as I mentioned, joined the freight. However, there, seems to have been a lesser degree of economic planning in the second period as the international institutional framework set higher limitations through trade negotiations within the institutions such as the GATT and later WTO.

II. *Continued strategic policies*: The trade policies in the first mover countries continued to take sector specific needs into consideration and there was a linkage between trade and other policies. China is an interesting example. IBRD (1996) stated that China was experiencing an export-led economic growth. Lo (2004a), however, found that the economic growth was negatively correlated with exports and positively correlated with imports, which does not fit the neo-liberal interpretation. The most of the economic growth, according to Lo (2004a) was driven by a growing demand from the home market which facilitated an increase of the technology intensity of the production structure driven by increased capital imports, see subsection 2.2.2. According to Lo & Chan (1998) the egalitarian income distribution together with the emergence of mass consumption and the rapid income growth fuelled much of the high productivity sectors in China. Technology and trade policies are thus in some ways combined as they were in the Japanese and Korean case.

III. *Continued institutional support*: Institutional support for exporters in the first mover countries was increased due to an overall increase in the institutions that governed the economy. In the SGT and China this led to the creation special export zones to support export and promote FDI in such areas.

Trade policies in Africa changed dramatically under the SAP. This had a number of effects on African countries:

I. *Import liberalisation*: Imports were liberalised, often without the local support which often made them vulnerable to policy reversals later on. The SAP was better in import liberalisation than in removing the export bias in many African countries. This led to a rapid increase in imports, such as in Uganda which liberalised its trade in 1987 and imports increased from around 9 % of GDP in 1987 to around 20 % of GDP in 1993. However, exports continued at around 5 % of GDP throughout this period (Ssemogerere & Fieldings, 1996). The only reason why a large BoP problem was avoided was a mass influx of donor aid. Exports have increased since 1993, but the export sector is still heavily dependent on foreign exchange to inputs of production and nobody knows what will happen when aid money halts. This has led to accusation that the SAP served external rather than African actors. Import liberalisation did have a number of less favourable effects on African economies; i) Increased volatility due to the increased openness; and ii) Domestic African firms were often not able to compete with the foreign companies, not least due to lacking institutional support leading to deindustrialisation. The liberalising of foreign trade also had two other effects; i) A reduction of state income due to decreased tariffs; and ii) The fallacy of composition since many African countries increased the supply of the same goods leading to reduced total income due to lower prices even though quantity expanded. This is what happened in Ghana which increased its exports of cacao from 149 000 tons in 1984 to 224 000 tons in 1992. But the income went down from 347 million USD in 1984 to 256 million USD. Thus a 50 % increase in volumes gave a 35 % reduction in income (Stein, 1999).

II. *Passive policies*: The SAP did not take sector specific needs into consideration. Import liberalisation was to be sector neutral to allow the most efficient firms to manage their own. Without the sector specific policies, however, the needs that the sectors had to be fostered before meeting international competition or because of specific learning needs were not taken into consideration.

III. *No real institutional support*: Many have criticised the SAP for not focusing on institutions. The institutions needed to promote exports were not present in Africa and there was no real strategy for how to create these. Even a near free trading economy like Hong Kong had active institutional support through Trade Developmental Centres to facilitate increase their exports. It’s hard to see African countries increasing their export

with such an amount of anti-export bias and the lack of export support institutions in addition.

There where thus vast differences of how trade policies were conducted and how they promoted growth in the two regions. The differences between the two regions can be summed by:

- Africa was far more prone to "*academic fashions*" than East Asia. Africa went the whole line from ISI to attempting to establish open economies through SAP. East Asia, to a far higher degree, has been independent of these trends and more choose the policies which it believed would suit their own economies at the stage of economic development that the country was at.

- In East Asia the trade policy was more strategic as opposed to passive in Africa. East Asian government saw trade policies as an integrated part of a wider economic policy and attempted to attune the trade policy to sector specific needs to achieve broader economic objectives. African trade policy was far more passive, neither during the ISI nor during the SAP was sector specific needs taken into consideration, leading to a less efficient trade policy.

- The institutional support to be able to support international trade was greater in East Asia as compared with Africa creating a framework where transaction costs for exporting were reduced by reducing the uncertainty of conducting exports.

Chapter 3 – Institutions

Development economics took institutions back into the debate after many of the failed neo-liberal reforms during the 1980s.[95] But there are differences in what authors perceive as institutions and there functioning. There are two main strands within the literature regarding institutions (for the differences between the two, see for instance Rutherford, 1996):

I. New institutional theory: Many would regard this as institutional theory based on neoclassical economics. Many of the key assumptions are similar such as the rational man (homo economicus), markets are regarded as natural and are not considered as institutions and institutions are created to minimise transaction costs for market exchange. This strand of literature follows North's (1990) view that sees institutions as "*agents of constraint*" or as "*rules of the game*". Institutions are therefore created from a bottom-up process reflecting the preferences of individuals where the preferences are taken as given. The state in this perspective is created to coordinate certain tasks that private actors cannot, for instance macroeconomic stability, protecting private property rights, and upholding the rule of law.

II. Old institutional theory: Old institutional theory has a long history which goes back to for instance Max Weber and Joseph Schumpeter. The theories are more often based on the social man (homo sociologus), markets are regarded as institutions and are not natural and institutions are created to affect human behaviour. In this view institutions can be regarded as "*social codes*" since they affect human behaviour but institutions are also affected by human behaviour. One example is cultural norms since they affect how a person perceives the world and how this individual should act. But culture is not static and does change over time through human behaviour, although slowly. Institutions are first of all mental representations that are dependent on a concept. The state is an institution that is not a physical object but a mental representation. Buildings such a government office might represent the state, but are mere symbols of the institution. The state itself is merely a mental representation based on the concept of nationalism or social coordination. The main channel of influence is the opposite from new institutional theory. Institutions in the old institutional theory affect individual motivation

[95] There were two other events that facilitated the return of institutions into the mainstream; i) The collapse of the USSR and former communist countries following market reforms; and ii) The East Asian financial crisis; see Rodrik (2000b).

(preferences in the neoclassical theory) where institutions are more or less perceived as given.

These are some features of institutions that are not captured by new institutional theory that are vital for understanding the growth difference between Africa and East Asia. The most important might be the new institutional practice to analyse institutions in isolation rather than in their social context. An institution is an institution no matter where it's practiced and it's assumed they function they same everywhere. But, most will agree with the assertion that the democracy in the US functions somewhat differently than the democracy in Zimbabwe even though both formally are democracies. That is why I will choose the later approach and define institutions as "*social codes*" rather than "*agents of constraint*". One example can illustrate the significance. The SAP attempted to introduce private property rights in some African countries but these attempts did in general not have the intended effects. From a new institutional perspective this would seem strange since private property rights are a best practice institution will lead to increased incentives for production and innovation. Thus, since such an institution has been able to deliver economic growth elsewhere, it would be rational to adopt it. The problem is that institutions cannot be separated from their social context. Institutions co-exist with each other and interact. The institutions around property right were still more adapted to the "*old*" form of property rights. When a new institution comes in place, often the institutions around, such as values, norms and economic institutions are still geared towards the institution that has been replaced. To put it differently, private property rights was not socially embedded into to the context in which it was supposed to operate. This highlights two features; i) Institutional change does not only require an change in one institution, but in a number of related institutions to succeed; and ii) For a institution to function optimally it will need the social acceptance, or legitimacy, to function as intended, and the establishment of such trust often takes time.

My approach to institutions more as "*social codes*" gives greater weight to legitimacy as a concept. Three institutional explanations will be assessed in a comparative perspective between East Asia and Africa which are:[96]

[96] I could have added the cultural institutional approach which looks at cultural defined rules as an explanation for economic growth. This discipline is old and stems back to the works of Max Weber. Several authors have emphasised the role of Confucianism in the economic performance of East Asia; but it's not possible to trace a common cultural background for the African region which is very cultural heterogeneous. In addition, some

I. *Technology*: I will only briefly look at this approach since many of the arguments already have been mentioned. To have a framework for analysis, I found that the national system of innovation (NSI) might be most relevant to analyse the differences in the technological ability.[97] Abramovitz (1986) used the term "*national absorptive capacity*" to describe the ability a country had to attain the knowledge and diffuse them accordingly to be able to catch-up with the leading countries. The NSI describes the capacity of the economy to learn and innovate. There is a distinction between the two, learning is attributed to the process development by which companies learn to master new technologies and experience learning-by-doing effects. Innovation is the process by which completely new process, products or businesses are created. For developing countries the "*learning*" part might be more relevant, especially at a low stage of development. Human skills then become imperative. Criscuolo & Narula (2002) takes human capital as an indicator of a nation's absorptive capacity as it's highly correlated with a country's ability to catch-up technologically. The NSI can be defined according to a narrow and broad concept. The narrow concept describes an integrated system of economic and institutional agents directly linked to the use of innovation in the national economy (Adeoti, 2002). According to the OECD (1999) the narrow concept of the NSI can be divided into five main sets of actors and institutions: i) Private enterprises and the research institutes that they finance; ii) Governments that set the policy agenda; iii) Bridging institutions which include research councils and research institutions which act as the intermediate between governments and the users of knowledge; iv) Universities and related institutions that provide key knowledge and skills; and v) Other public and private organisations that play a role in the national innovations systems. In East Asia there were some differences between countries. In Japan and South Korea the private sector financed a higher degree of the research through large companies. In Taiwan, however, the public research institutions played a far larger role. The NSI was both well financed and well integrated in East Asia. A key concept is the role of human skills which affects all elements of the NSI. The level of skills was high in East Asia and promoted the learning ability of the individual institutions and the integration of the system as a whole. East Asia has shown a remarkable ability to learn, diffuse and build

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growth countries in East Asia are not predominantly Confucian with the mainly Buddhist dominated Thailand and the Muslim dominated Malaysia and Indonesia as the best examples.

[97] Freeman (1987) defined the NSI as: "*networks of institutions in the public and private sector whose activities and interactions initiate, import modify and diffuse new technologies*".

up attained knowledge and have been able to “*learn*” to a high degree which has made them catch-up with some of the leading countries. Some countries themselves, such as Japan, South Korea and Taiwan, have partly gone beyond that and start to “*innovate*” to a larger extent themselves, partly spreading the knowledge to other East Asian countries. In Africa these institutions were hampered by the lack of human skills in both quantity and quality. In addition, many of the institutions were under funded, which got worse after the initiation of the SAP, and were weakly integrated with little relevance to the needs of African firms. I have already dealt with most of these issues in subsection 3.2.2 and will not comment on the narrow concept of the NSI further. In the broader context, the NSI could include the elements within the narrow concept and in addition all institutions affecting learning, research and innovation in society for instance the financial systems and the monetary policy. In East Asia the financial systems have been credited to be able finance long-term investments in sectors with new technologies that might have been perceived to be too risky in a pure market-based system due to the high uncertainty. Given the role of conditionality, these loans were more efficiently exploited and gave incentives for continued technological upgrading. Also other elements contributed to the long-term learning of East Asian economies, such as the government’s commitment to economic growth and their consultation with the private sector, the trade policy that fostered up certain industries with protection to make them more competitive to be able to earn foreign exchange income at a later stage; and keeping a macroeconomic stable environment. In Africa the financial system, neither during the IS era or the SAP era, functioned as intended and had only a limited ability to finance long-term loans which were necessary for investments in new technologies. In addition, the government’s economic policy was inconsistent and frequently changing, trade policies did not reflect the needs of African economies and to higher degree followed the trends in the academic environments of the donors and there was macroeconomic instability which lowered the incentives for long-term commitment due to the high perceived risk in Africa. All these issues have been touched upon in chapter 3 and hence will be commented on them further.

II. Government capacity: Looking at the government institutions and the political process gives us an overview of the three major elements of the political process, namely agenda setting, policy formulation and implementation. One claim that’s repeated by the supporters of the IS approach during the IS phase and the supporters of the SAP in the

SAP phase was that implementation in Africa was a major problem. Both state intervention supporters and sceptics alike have praised the effectiveness of policy implementation in East Asia. This has been linked to the notion government capacity which I define as the ability to set the policy agenda, formulate and implement policy that a government has in relation to other actors. The more resources a government has, the greater capacity it will have; and the more independent from civic society it is, the greater capacity the government has. I will look at three levels of influence and how they affect the government in the two regions; i) The role of external actors such as financial institutions and foreign powers; ii) The internal capacity of the government measured by the competence of the ruling elite and the quality of the bureaucracy; and iii) The role of civic society in influencing government policies. I will look at these levels in section 3.1.

III. *Social embeddedness*: The final approach does not look at the government as such, but at the various elements of society in relation to the government. There are two major themes I find crucial to explain some of the differences between East Asia and Africa. Firstly, the government in East Asia was able to manage conflicts to a far larger extent than governments in Africa laying the foundations for social and political stability on which economic growth could be based. Secondly, the legitimacy of the East Asian states was in general perceived to be higher than for African states making the policies that East Asian governments formulated more legitimate and hence more effective in implementation. I will look at the differences in social embeddedness in section 3.2.

3.1 State capacity

The simplest model for policy formulation and implementation is the engineering model of economic decisions. In this approach, governments have a social welfare function which it attempts to maximise and will choose the policy that maximises this objective. After the policy is formulated it will be implemented and there is an optimal expansion of economic activity. Governments that do not implement policies that maximises economic growth must be uneducated or less informed. Many economists, still today, think that finding the appropriate policy that maximises economic growth is a technical problem, just as engineers solve a technical problem, hence the name of the model. However appealing, this model is far

too simplistic to account for the real life disparities for why certain governments choose policies that "*obviously*" are harmful for economic growth.

The engineering model was popular in the 50s and 60s and led to a great belief in what governments could achieve in society. This model did not take into account the whole political process. The policy process contains three elements; i) Agenda setting; ii) Formulation; and iii) Implementation. A policy that was formulated was not always implemented according to intention. Often influences outside the government dictated policy outcomes. These real life political processes which take place in everyday life are not accounted for in the engineering model. What Chang (2001) called "*Golden Age Economics*" did not have a theory around the political process which made them vulnerable to academic criticism.[98] The neo-liberal academic attack in the 70s and 80s through for instance Krueger (1974); and Bates (1981) brought politics back into the economic profession. Policies were in the "*public choice*" models of the neo-liberals seen as part of a political market were, unlike the market for goods and services, the outcomes were not optimal. Policies were used for "*rent-seeking*", that is to enrich a privileged few to retain power in society. These policies were similar to those pursued in feudal Europe during the Middle Ages. For the neo-liberals, policies were irrational and should be removed from the economy. The logical conclusion was that governments should withdraw from the economy. This approach is intellectual and empirically far more appealing than the previous approaches to the political process. But they do have a number of flaws themselves, which I will return to later on.

The natural question arises what characterise states that are able to maintain economic growth over a given period of time. Why do some governments promote economic growth and others not. In the public choice literature the conclusion is that governments get captured by vested interests. To promote economic growth a bureaucracy responsible for economic policy should be isolated from the political process and therefore the leadership will not have political ambitions and will "*automatically*" pursue the most efficient economic policy. Vartainen (1999) researched a number of successful "*developmental states*" and found that a political insulated bureaucracy played a major role in all. Promotion within the bureaucracy was in general not based on personal contacts, but on professional merits. Schneider (1999)

[98] "*Golden Age Economics*" got its title from the mainstream ideas in the period 1950 to 1973 which saw a phenomenal economic growth called the "*Golden Age*" and comprised of Keynesianism, welfare economics and early developmental economics (import substitution).

researched a number of failed "*developmental states*" and found that the bureaucracies were heavily entangled with the political process. Promotion was based on personal relations and political views which did not promote professionalism. I don't think that there is to much doubt that a too high degree of political interference in the working of the bureaucracy does not promote professionalism and hence economic growth.

From my previous line of argument the conclusion might be that economic policy should be isolated from the political process. The problem is that the picture is more complicated than that. Evans (1995) mentioned that an institution left to its own without check-or-balances will develop itself into a political force and start to pursue their own political ambitions. An ideal in the neo-liberal vision, an independent central bank, is a good example. In theory, a central bank that is independent from policies and controls the interest rate to meet inflation targets will function optimally. In real life, there will always be room for political interference and political ambitions.[99] No institution will ever be completely isolated from the political process. There are strong arguments for why a complete isolation wouldn't be desirable either. When a policy is to be implemented, a consensus often helps the implementation of a policy. My point is that political participation might render political formulation more complex, but might make policy implementation more effective. O'Donnel (1994) and Stepan & Skach (1994) makes the same argument by claiming that policies more seldom get reversed in parliamentary system as opposed to strong presidential systems due to the process of consensus building. The point I want to make is that isolated bureaucracies might be more effective in formulating their policies, but this not make them more effective in implementing their policies. Evans (1995) forcefully makes this argument with concept of "*embedded autonomy*". There is a trade-off between the level of autonomy and the embeddedness and striking the right balance is hard in real-life. Returning to the study of Vartainen (1999), he found that the successful "*developmental states*" all had state sectors that cooperated heavily with good organised private sectors. The state was flexible to change its policy to meet the needs of the private sector, but was not captured by the private sector. Schneider (1999) reported that the private sector in the failed "*developmental states*" were dependent on the state sector for licences, personal contacts and subsidies. There seems to be a case of too high degree of embeddedness and lack of autonomy.

[99] Alice Greenspan was in 1992 accused for helping the election of Clinton over Bush in the presidential campaign by raising interest rates.

To best show the differences in the political processes and state capacity within the two regions I will divide this section in three parts. The first part will look at the role of external influences on agenda setting and the formulation of policy. The second part will cover the internal capacity of the state to formulate and implement policy. The final part covers the domestic interests and how these are related to the political process.

3.1.1 External influence

Policy is not conducted in a vacuum. International trends like academic "*fashion*", superpower policy and external dependence all affect the policy making within a country. Not all of these trends always aim for the most efficient economic outcome. For instance how the US boycotted the apartheid regime in South Africa through economic sanctions. The boycott was not due to economic or trade goals, but racial policy even though economic instruments were used. The difference between East Asia and Africa is vast with regard to external influence even though both regions had a high dependence on the external environment.[100] Autonomy becomes a key concept.[101]

East Asia's influence from external sources is, nevertheless, diverse and it's difficult to pinpoint a set of characteristics that fit all the countries at the same time. I will briefly look at three sub-sets of countries to make a more meaningful assessment:

I. *Japan and the First Generation Tigers*: There are three major points I find important with this sub-set of countries. Firstly, Japan, South Korea and Taiwan all were highly important countries during the Cold War since they were capitalist countries "*next door*" due to their geographical position. These Asian countries obtained preferential agreements with the US which without doubt stimulated their exports. Secondly, this sub-set of countries proved very capable in the diplomatic game of trade policy and bilateral agreements (see for instance Lall, 2000). They knew the power game and were often not willing to upset their trading partners even though they felt the policies forced upon them were unreasonable. Japan is a case to the point and how Japan reluctantly has liberalised parts of its economy from the 1980s under pressure from the US. Another example might be how Japan implemented so-called "*Voluntary Export Restraints*"

[100] When I say external in this section I mean from outside the region.

[101] Mkandawire (1995) defined the state's autonomy as: "*the fiscal capacity of the state or more specifically, the revenue base of the state, and on the other hand, the constitution of civil society, the thrust of its political and economic demands and its organizational and combative strength*".

(VER) on its textile export to the US. Lastly, this sub-set of countries was very autonomous in the 1950s and 60s to choose the policy they themselves perceived to be most beneficial. For other developing countries today this might be more difficult due to a changing international framework due to for instance trade agreements under the WTO.

II. *The Second Generation Tigers and the Philippines*: This sub-set of countries were not as favourably supported during the Cold War, did not have the same degree of autonomy and were not as skilful diplomats as their first mover counterparts. The academic trends affected this sub-set of countries far greater than the first mover countries as they went the whole line from IS to outward orientation more based on the market than perhaps the first mover countries. What characterises these countries is not only a high dependence on external markets, but also a high degree of dependence on regional powers such as Japan and to a lesser extent the FGT. Economically, the SGT and the Philippines became dependent on the first mover countries for their investment, trade and, not least, their technology which created a asymmetry in the regional power structure. Partly to offset these influences there have been attempts to increase cooperation through ASEAN.[102]

III. *Former communist countries*: China (from 1978), Laos and Vietnam (from 1986) attempted to transform their economies from a communist planned economy to a more market-based approach. The neo-liberal tenants from the IBRD recommended a "*Big Bang*" approach where all market reforms were implemented at the same time. But, our sub-set of countries instead followed a more incremental and pragmatic approach which drew criticism especially from American researchers which believed that this only led to sub-optimal solutions that were worse than any of the two alternatives.[103] The high economic growth rate in China and Vietnam since the start of the economic reforms, despite, rather than because of neo-liberal recommendations has taken many analysts by surprise. There are two major characteristics which I believe the former communist countries have in common with the first mover economies. Firstly, they have a high

[102] ASEAN was founded in 1968 of Indonesia, Malaysia, the Philippines, Singapore and Thailand; today there are 10 member states; the other 5 being Brunei, Cambodia, Laos, Myanmar and Vietnam.
[103] When the USSR and Eastern Europe were to liberalise their economy they asked the IBRD for help and implemented the "*Big Bang*" approach. The results were a collapse of the economies of the former USSR and in Eastern Europe since the institutional fundaments were not present. The collapse due to "*hard-core*" neo-liberal policies led to the reappearance of institutions within the mainstream.

degree of political autonomy and have proved to be able to resist external pressure if the policies recommended were not perceived as beneficial for their economies. Secondly, they are very capable in the diplomacy game and are able to exploit current power relations to promote economic growth due to for instance WTO agreements. In my opinion, these countries show more similar characteristics with the first movers, rather than the second mover countries. A major difference is the lack of preferential treatment due to the geopolitical power structure.[104]

African countries have also had mixed political developments. Even though some relative richer African countries like Kenya, Zambia, Zimbabwe and especially South Africa have had a relative higher political autonomy, the majority of countries have had a high degree of external influence. Even though there are between country differences, in general there are three development trends that I found important for how the external environment affected African countries:

I. *Cold War influence*: During the Cold War period, which ended in 1990, support was given to different countries on the basis of their political orientation. Not in the sense of democracy of communism, but more on the basis of which of the two superpowers was to become the "*ally*". There were a lot of problems with this pattern. Firstly, if support was given to the government, say for instance from the USSR, it could be virtually guaranteed that the US would support an opposition group in the country and possibly supply them with arms. This might have contributed to increased social and political turmoil which made economic development virtually impossible. Secondly, there was often weak or no conditionality to the support with regard to domestic policies (Olukoshi, 2002).[105] This might have kept autocratic regimes afloat and hindered the domestic political development by working against democracies.

II. *Diplomatic capabilities*: Newly independent African countries often came unprepared and with poorly qualified personal to trade negotiations. This has resulted in asymmetric trade agreements with other countries. The rhetoric behind multilateral trade negotiations is that the ultimate aim should be free trade, but the political reality often

[104] Vietnam experienced the opposite end of the Cold War due to the infamous American military intervention in the country.
[105] The reason is very simple and relates to the "*exit*" strategy. If a country could not get support from one side, it could go to the other side to gain support.

follows a "*give-and-take*" mentality where some protectionist barriers are lifted in so far other countries do the same. Many would stress that African countries do have preferential market access on a number of products to the EU through the former Lome convention. But there is a great asymmetry caused by the protectionism of Western agricultural sectors which is more about the subsidies which repress international prices rather than tariffs and non-tariff barriers per se since many African countries have the latter as well.

III. Political autonomy: The debt crisis which started in the beginning of the 1980s was, as I mentioned in section 2.1.1, a capital supply shock. This also had political repercussions. As I mentioned in section 1.3.2, Mkandawire (1995) said that the independence or autonomy of an institution is closely tied to its fiscal resources. Cold War finance by itself was for many African countries not enough and there was increased donor involvement in Africa.[106] The IBRD and IMF increased their political influence by becoming a main source of finance in the region and pressed a lot of neo-liberal driven policies through conditionality, which meant that African states lost some of its political autonomy. This was even truer after 1990 when the Cold War finance halted and there was no real alternative for obtaining international fiscal resources than to follow the SAP. Soludo & Ogbu (2004b) are some of the African academics that believe that the increased foreign involvement in the African political process undermines the African political institutions and thereby decrease their political autonomy. Many neo-liberal academists, however, do not agree with this assessment and stresses that the failure in Africa is more due to weak policy implementation rather than the contents of the SAP policies. African countries according to this view have shown a "*lack of commitment*".

The external environment thus had different influences for the regions. I have focused on three factors. Firstly, the Cold War was more favourable for some East Asian countries such as Japan and the FGT countries than for Africa were it contributed to political instability. Secondly, East Asian countries showed a far higher ability to play the political "*game*" of

[106] I stress the role of the IBRD and the IMF in this section since they have had a greater influence than other donors. This does not mean that other donor involvement is irrelevant. Quite the contrary, donors often gave support in return for conditionality, for instance French support was given on the basis that the support would be used to buy French-made products. This makes one wonder about the real beneficiary from such a policy. My main point is that donors often had different objectives and different policy requirement which often contradicted one and other. The contradicting policy "*recommendations*", the volatile nature of development assistance (which saw a decline after the Cold War) and the lack of coordination among donors all contributed to make the policy process in Africa even more complicated.

trade negotiations compared to African diplomats. Lastly, East Asian countries did exhibit a far higher degree of political autonomy than African countries, which of course was linked to economic growth since East Asian countries were not as dependent on external sources of finance as the African countries.

The lack of political autonomy due to the external involvement is perhaps one of the most important factors that differentiate the East Asian and African economies. I can take one example from Nigeria cited in Soludo & Ogbu (2004b). In 1987 the Nigerian government found that some areas had the potential to become highly productive agricultural areas for products like rice, wheat, sorghum and millet needs. To promote the agricultural sector tax incentives were given and there were set up a host of trade barriers to stimulate production for the home market. The response of the Nigerian farmers was very positive with increased investments in the agricultural sector and the production in certain areas had increased 10 times by 1990, with prices declining rapidly which could indicate increased scale economics. The problem was that the trade barriers set up in 1987 stopped the import of about 600 million USD worth of agricultural goods, mainly from US farmers. The American government attempted to use various methods, including through their influence in the IBRD to pressure Nigeria to abandon their trade barriers. In 1990/91 Nigeria was subject to a debt crisis and had to resort to IBRD loans. One of the requirements was that some of the trade barriers imposed in 1987 were to be lifted. This increased the imports of agricultural goods and most of the Nigerian farmers went bankrupt when competing with subsidised American farmers. The result was many empty acres of farmland as a symbol of another failed agricultural project. I would contend that the policy did not fail due to a "*bad*" agricultural policy, but rather because Nigeria got into a conflict with a major trading partner, the US, which used the IBRD as a political tool to promote the interest of US farmers. In commenting this trade dispute Ogbu & Soldu (2004b) said:

> "*This case illustrates two key points. First, it shows that the international system of exchange embodies two sets of rules: one for the powerful and the other for the poor (especially indebted ones). Where the firms of the powerful countries can compete effectively, free trade is advocated. Where they are out-competed, the US, for example, invokes the voluntary export restraint mechanism to force its trading partners (e.g. Japan) to reduce its exports to the US. Second, the example underscores the overriding dose of external influence and the lack of independence of indebted African countries in choosing*

policies that maximize the welfare of their citizens. When policy-makers realize this choking influence of external forces and that they are, in some cases, being asked to implement policies that serve external rather than their domestic interests, their attitude to the implementation of such policies would be of aloofness or plain sabotage. In the literature, there is often talk about the policy-makers' lack of commitment. But such lack of commitment is endogenous to a set of variables, including the lack of ownership and conviction about the potential gains of the policies they are being asked to implement. Thus, unless policy-makers perceive a policy as being beneficial to their societies, even if they sign policy documents (at least to reach agreements with the donor agencies) effective implementation is likely to suffer."

Much of the emphasis on how East Asian countries were able to grow was through meeting country-specific needs through their economic policy, see for instance subsection 2.2.3. However, the autonomy was not enough as there is no clear-cut agreement what constitutes "*good*" economic policy. In the next two subsections I will emphasise how external actors also affected the internal capacity of the state and the internal political process in Africa. To use the neo-liberal public choice analogy, there seems in general to be more evidence that the African state got captured by foreign vested interests rather than domestic. The example from the Nigerian agricultural sector is one of many. The counterargument against this "*autonomy*" argument is that governments are prone to pursue policies that retard economic growth if the appropriate binding institutions are not in place. Since the African state capacity is weak, foreign forces should bind "*African governments to the mast*" and make sure they implement "*good*" policies. [107] That's why the IBRD has worked against alternatives to SAP. The alternatives to SAP were more often popular among African governments and people. [108] The argument of binding institutions is only valid if, and only if, it's possible to identify a set of neutral policies that all can agree upon promotes economic growth in the long run. Perhaps many neo-liberals see their own policy recommendations this way. The empirical evidence on which set of policies promotes economic growth, however, is mixed and thus far gives no

[107] Jaycok (1993), the former vice-president for the IBRD said:"*. . . most of this technical assistance is imposed, it is not welcome and there is no demand for it really except on the donor side. . . This is in fact an endemic problem in the donor community — expatriate management substituting for domestic management. . . What is left in that demoralized ministry is being attracted away by donors and salary supplements.*"

[108] Both the Lagos Plan of Action (1981) and the AAF-SAP (*African Alternative Framework to the Structrual Adjustment Program*) were far more attractive for African countries and more strucuralist policy recommendations, but the IBRD used its financial and political power to block such attempts.

support for a set of universal agreed upon policies that will promote economic growth in the long-run.

3.1.2 Internal capacity

The internal capacity of the state is what I define the competence of the leadership and the quality of the bureaucracy. This means that the state internal capacity comprises of these two elements. The early debates within development economics about the strength of the state looked upon on a "*strong*" state as one that had a high degree of financial transactions and large public ownership. Neo-liberal arguments regarding the "*industrial policy*" debate claimed that the state in East Asia was "*weak*" on the backdrop of that public investment and ownership was low. In Africa, public investment and ownership was higher and this was interpreted as evidence for a "*strong*" state. So the conclusion for the neo-liberals in the 1980s was that East Asia grew because the state was "*weak*", while Africa did not grow since the state was "*strong*" and crowded out the private sector.[109]

This view has few followers today. The revisionist showed that East Asian governments intervened in their economies to a large extent without the usage of public investments or ownership, for instance through "*administrative guidance*", tax incentives and quantitative import restrictions. What also characterised the East Asian governments was that they were able to achieve their stated objectives to far higher degree than African governments. In my view, East Asian governments were "*strong*" because they were more effective in controlling the political process, formulating policies and implementing the policy that was formulated far more effective than in other developing regions. This required both the presence of a competent leadership, or technocratic elite, and the presence of competent administrative capacity, or bureaucracy. Africa, on the other hand, lost more of their formulating capabilities with the increase of foreign influence (see the previous subsection 4.1.1), did not formulate sustainable policies and the implementation of the policy was often inefficient. In other words, the African state was "*weak*".[110]

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[109] A fundamental difference between the neo-liberal and the revisionists is that the neo-liberals see the state and the private sector as natural rivals. So an increased state sector will usually lead to a "*crowding out*" effect. The revisionists see the state and the private sector more as complementary and will argue for a larger degree of "*crowding in*" stemming from public investments.

[110] Root (2001) made the difference between "*weak*", "*unlimited strong*" and "*limited strong*" states. "*Unlimited strong*" states had no credibility and could use the economy for its own usage. "*Limited strong*" states had some institutions that limited its own power to make credible commitments to the economy. According to Root (2001) only "*limited strong*" states were able to promote growth.

East Asia had a strong state capacity for promoting economic growth. I would like to stress three elements with regard to state capacity:

I. *Pilot agencies*: Agencies such as MITI in Japan and EPB in South Korea comprised of a technocratic elite with a high academic qualification. The interesting feature of many of these was that they in general were not economists. In Japan and South Korea they were mostly lawyers, while in Taiwan they were mostly engineers. What was needed, according to Chang (1998), was the ability of highly qualified generalists with high learning capacity, rather than a specialist. As I mentioned in section 2.2.3, "*government learning*" was a key concept. The East Asian governments showed a high degree of flexibility and there was a high degree of "*learning-by-doing*". The policies were often incremental and pragmatic, avoiding the extremes of import substitution or an open economy, preferring to strike a strategic balance that would fit their economies. As the economies changed over time, new situations led to new policies.

II. *Bureaucracy*: A competent administration is needed for the day-to-day running of the state. Well run bureaucracies are important for increasing transparency and for effective implementation of policies. In East Asia the bureaucratic capacity is high with well qualified personal. In my view, one of the most important aspects of the bureaucracy was that promotion was based on academic and professional merit rather than personal contacts. This was important for three reasons: i) It promoted professionalism which increased the state's transparency; and ii) More neutral judgement which was more geared to promoting objective efficiency rather upholding personal relationships compared to other developing regions.

III. *Regime type*: A popular motion in the literature is that authoritarian regimes are linked to the concept of developmental states and that authoritarian regimes are more able than democracies in promoting economic growth at a low stage of development. One reason for why this link has been popularised is the role of the regimes in South Korea and Taiwan which had authoritarian regimes and high economic growth.[111] There are

[111] There are counter examples as well, such as Japan after 1945 (even though the Japanese authoritarian regime did promote economic growth before WWII), but also European examples such as developmental states with democracies in Austria, Finland and France.

several arguments for why a authoritarian regime could be more effective; i) Increased ability in policy formulation since they don't have voters to think about thereby ensuring a long-term oriented policy maximising economic growth in the long-run; and ii) The ability to force unpopular but necessary policy through. The arguments against democracies, especially at lower stages of development, are that they: i) Give more weight to short-term policies due to elections; ii) Less effective in policy formulation leading to less cohesion in the economic policy due to consensus building; and iii) More state consumption since governments only might stay in office for short periods. What seems beyond doubt is that the regimes in East Asia, democracies or not, has been stable. This has increased the consistency of policies over longer periods. The evidence on regime types and economic growth is mixed. Haggard (2004) said that the economic growth is the same for democracies and authoritarian regimes.[112] ManIntyre (2003) claimed that it not was important whether or not the country was a democracy or not. A large number of veto powers could make authoritarian regimes just as indecisive as democracies. South Korea (in 1993) and Taiwan (in 1996) went from authoritarian regimes to democracies and so far there is no evidence of any growth slowdown after the transition. The Philippines also got a democracy in 1986 and has shown greater economic growth after the transition than before. I want to make two points from my discussion; i) The ability a state has is more dependent on how the state is organised through the state structure and the competence of the administrators rather than the regime type per se; and ii) The most important characteristic seems to be political and social stability and a stable regime which is able to have continuity over several periods. East Asia had both, a good organised state sector with an effective decision-making body combined with political stability and continuity.

Africa has had a weak state capacity. I would to stress three elements:

I. <u>Low bureaucratic capacity</u>: The educational standard of the administrators is in general low for African bureaucracies (Ogbu & Soludo, 2004a). Many trade- and industry departments in Africa are without people with a PhD. According to Mkandawire & Soludo (2002) the main problem of the bureaucracy is the lack of incentives to attract qualified personal and the weak technical competence. The capacity of African

[112] Even though economic growth was the same for democracies and authoritarian regime, the nature of economic growth was different leading to a higher degree of economic development in democracies.

bureaucracy has been declining even further after the initiation of the SAP. Reduced state spending and a lowering of the state capacity meant that wages in the public sector declined and many experienced and competent administrators quit their job. The weakening of the bureaucracy has led to a decline in the African state's ability to implement policies. Ironically, the IBRD (1994) cited a "*lack of commitment*" due to inefficient implementation as the main cause for why the SAP failed. The irony was of course that it was the SAP that lowered the African state's ability to implement the policy it was supposed to. One of the main problems of the African bureaucracy is that the reason for promotion was more based on personal merits rather professional qualification. The consequences are dire since it i) Lowers the transparency of the government thereby lowering it's legitimacy; and ii) Does not distribute resources neutrally, preferring upholding personal contacts rather than efficiency.[113]

II. *Regime type*: If autocratic regimes alone were enough for economic growth, Africa would be a rich region today. As a matter of fact, the only two countries with long sustained economic growth in Africa, Botswana and Mauritius, have been democracies. The link between the developmental state and democracy in Botswana contradicts the findings from East Asia that authoritarian regimes are needed at a low stage of development. But, Botswana has undoubtedly been boosted by a stable political and social climate together with a stable regime. This can of course not be seen independently from economic growth. Economic growth boosted the legitimacy of the country's leadership, so stable long-run policies were both a cause and an effect of economic growth. In general, however, what characterised Africa were unstable autocratic regimes. The consequences of frequent policy reversals I have already mentioned in subsection 2.2.3. A criticism against the neo-liberal policies and the SAP has been the authoritarian tendencies inherent within these policies. Africans were in general hostile to the neo-liberal driven SAP. Ghana, under Rawlings, was hailed as one of the few successful implementers of the SAP. The military regime of Rawlings was stable over a longer period and was able to "*force*" the policies through (Callaghy, 1989). Ghana does not have a well organised civic society and its creation was hindered

[113] The main exception is Botswana which has a bureaucracy unique to Africa (Owusu & Samatar, 1997). There are three noteworthy characteristics; i) The academic quality of the leadership is high and the relationships within the bureaucracy are characterised by being very professional; ii) Public institutions were well embedded in the civic society with well established contacts; and iii) The bureaucracy and the state enjoy a high degree of legitimacy from society and have a high degree of autonomy from both external and internal forces.

by their rulers. Zambia is one of the few African countries with a well developed civic society and they hindered much of the effective implementation of the SAP policies. Another example is Kenya were most of the resistance not came from the civic society, but from within the state itself (Bienen, 1991). The isolation from pressure groups from within is also not sufficient for a optimal economic policy. The Nigerian military regime which took power in 1994 did neither take the advice from foreign donors nor the civic society as it attempted to maximise its own consumption based on oil revenues and an overvalued exchange rate. The regime also reversed many of the liberalisation policies that been initiated since 1986. This is an example of the general pattern of policy reversals that increases uncertainty for market participants. It also shows that governments in Africa, rather than the provider of a certain institutional environment, often are the causes for uncertainty.

III. <u>*Donor involvement*</u>: As I mentioned, the SAP decreased Africa's state capacity, but the state was at the same time burdened with the responsibility for the failings of the neo-liberal policies. The irony of the SAP policies of the 1980s was that the SAP policies of the 1990s saw building state capacity as a policy priority. But the message was confusing since the African government were on one side the main culprit of African misery and had to withdraw from the economy; at the same time their capacity rebuilding process was important so it could promote economic activity by providing public goods and institutions. This tension has never really been resolved. As Mkandawire (1998b) mentions, the IBRD has discredited the state from having any larger role in economic development, but at the same time an overextended state has to achieve good governance, create an enabling environment and stabilise the economy. The increased donor involvement from the start of the 1980s has decreased the African state's capacity not only by lowering government expenditure, but also by undermining African political institutions by attempting to "*save African states from themselves*". This has reduced the autonomy and the functioning of the African political institutions. The democracy waves of the late 1980s have created, at least on paper, a lot of democracies in Africa. But these are often undermined by foreign donors since they are not perceived as being able to choose their own most beneficial policies. This has led to what Mkandawire termed "*voiceless democracies*". This situation is aggravating and depressing for Africans as they are undermined by foreign powers. Political autonomy is a necessary condition for economic growth and the lack of it is keeping Africa at a low

stage of development. The reason for this necessity is that countries at a lower stage of development have specific needs and the solutions towards these often need to be taylor-made, as an example I can mention the institutional innovations in East Asia with a certain element of "*local flavour*". So far there is no credible evidence of universal paths to develop economies from a low starting point. As Soludo (2002b) put it: "*Asia did not industrialize by having the BWIs literarily take their economic policy-making hostage*".

There are major differences in the internal capacity of the state in the two regions. In a comparative perspective three elements have been mentioned in this subsection:

- The low bureaucratic capacity in Africa and its entanglement with the political process is most likely a major hindrance for promoting economic growth. The SAP lowered the bureaucratic capacity even further in Africa leading to an even weaker state capacity.[114] In East Asia the high quality of the bureaucracy and its professionalism has definitely been a major cause for the growth in East Asia.[115]

- The evidence on the regime type is mixed. Both autocratic and democratic regimes promoted economic growth in East Asia, while only two democracies did so in Africa. It is more likely that the organisation of the state and the effectiveness of the decision making body regardless of regime type was far more important in the growth process than the regime type per se. East Asian decision making and the effectiveness of

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[114] One of the versions of the "*impossibility thesis*" is that Africa cannot follow an industrial policy of the East Asian kind since the state capacity is too weak. There is a limitation to this argument, though. There is no doubt that the economic policy conducted in East Asia demanded a high state capacity and a competent administration. It is however not clear that it is any easier creating a "*free*" market economy which also demands a high administrative capacity. A host of institutions are needed such as secure property rights, contract rules, bankruptcy laws, a well functioning bureaucracy, rules for market participation, rules for traded goods, rules for market behaviour and a well functioning judicial system to name a few. The US has some of the largest regulatory mechanisms in the world to secure a "*free*" market. I am not claiming that a more free market economy is more costly to establish, it's very difficult to say. A stylised fact, however, is that more countries have been able to create more interventionist regimes to catch up with the leading economies than "*free*" market economies that have done the same, so far Hong Kong is the only example coming to mind.

[115] Some, like Berger & Hsiao (1988) and Tai (1989) have linked the high bureaucratic quality to their Confucian heritage (see also IBRD, 1993). This has led to another version of the "*impossibility hypothesis*"; other developing countries could not follow the same path as East Asia since the East Asian societies had "*favourable historical condition*" which is not present in other countries. Chang (1998) was of a different opinion and points to the fact that neither South Korea nor Taiwan had a competent bureaucracy in 1960. Both were notorious for being corrupt around that time. South Korea and Taiwan send their bureaucrats to Pakistan and the Philippines until the end of the 1960s. There was, however, a rapid "*learning-by-administrating*". In addition, Hong Kong and Singapore to a higher degree reflected British rather than Confucian bureaucracies. The message Chang (1998) is trying to get across is two-fold. A good bureaucratic heritage such as an Confucian tradition can become corrupt very fast. Also, a good quality bureaucracy can be build faster than people in general believe; it took South Korea and Taiwan a little more than a decade to build up a competent bureaucracy.

policy implementation was far larger than in Africa. One of the main reasons is the more stable regimes in East Asia, while frequent shifts in power have come to characterise Africa increasing uncertainty for market participants.

- A number of East Asian countries had the so-called "*pilot agencies*", but almost all countries had some form of technocratic leadership attempting to promote economic growth. The leadership normally comprised of a high educational quality and showed a high learning capacity. In Africa such technocratic leaderships did not emerge. An exception might be Uganda since the start of the 1990s when an technocratic elite in "*the Minsistry of Finance and Development*" and the Central Bank have dominated the country's policy formulating since the beginning of the 1990s and Uganda is one of the few African countries that recently has experienced economic growth. The SAP was an attempt to stimulate the economy through a growth vision, but unlike the East Asian growth vision, it was not embedded in the countries were it was to be implemented.[116] As UNRISD (1995) put it: *…the neoliberal "political-economist"… push for a minimalist state whose role is to produce an "enabling environment" for the functioning of an essentially self-regulating market economy based on free competition – and the "thickering of civil society". This is a vision of the economy and of the role of the state in it which corresponds to no known actual experience in the recent history of the world.*"

3.1.3 Internal influence

The policy process was, as I mentioned, brought back into the economic profession by the rise of the public choice literature. The likes of Balassa, Krueger and Bates attacked the notion that the state was able to promote economic growth. Fearing a capture by vested interests, policies should be removed from the economy. Public choice models are very constructive in

[116] The IBRD themselves attempted to create a technocratic elite which would promote "*local ownership*" and help with a more efficient implementation of the policy. Economists with the "*right*", that is to say neo-liberal, background were handpicked by the IBRD to function as an autonomous institution which would pursue the "*right*" economic policy. These attempts were in general not successful; at least three reasons can be mentioned; i) The principal of handpicking personal on the background of their political orientation is a breach of the "*Weberian professionalism*" leading to less transparency; ii) These institutions were not autonomous but dependent on the IBRD which limited their functioning; and iii) They were too far away from the African political process and were not embedded into those societies they were meant to operate. Often they were perceived as being too close to the foreigners. When African governments under the SAP had to slim the state expenses, these foreign created institutions were the first to go despite having the trust of the IBRD.

understanding how apparent "*irrational*" government policies are pursued. Also, they show some of the potential dangers with state intervention.

Despite the apparent advantages of these models they do have their weaknesses. Policies are analysed on the basis of individual self maximization which excludes other motivations for policies. I want to stress three problems with these models:

I. The concept of "*rents*" is very simplistic and does not differentiate between so-called productive and non-productive rents. Also, it does not recognise that the inherent goal of capitalism in itself is the creation of surpluses and hence rents.

II. Analyses are ad-hoc as the persistence of policies is easier to understand as opposed to the evolution of policies. For instance, if the government chooses to place a factory in my home town it must be because I bribed someone in the government. It's easier to see that when the factory is present and I am employed in it I will attempt to keep the factory there. Bates & Devarajan (2000) themselves admitted the ad-hoc weaknesses within the models.

III. Outcomes are very deterministic since the result always will be that the government will maximize itself at the expense of society.

According to the neo-liberal criticisms following the East Asian financial crisis, East Asia was a case of "*crony capitalism*" based on personal contacts and corruption. For many scholars this was more a case of trying to press the economic crisis situation in the public choice framework. The adequacy of such an assertion is questionable. It is not so much that anyone doubts that there were some forms of corruption present and selective support was given, but it does not explain how East Asian economies could grow sustained these last couple of decades with "*crony capitalism*", while other developing countries could not. If a scientific framework like the "*public choice*" models is used to explain everything, at the end of the day it explains very little.

East Asia for me fits better in other frameworks like for instance the "*embedded autonomy*" concept. There are three factors I like to highlights from the East Asian internal influence:

I. *Private sector consultation*: I have mentioned this argument already in subsection 2.2.3 and 3.1.2. The East Asian governments were able to respond to the needs of their producers through consultation mechanisms. As Mkandawire (1995) mentioned, the governments are very sensitive to the policy demands of their main source of finance. The manufacturing sector both provided the government with finance, it also provided the government with increased legitimacy since they were able to fuel the economic growth, see subsection 2.2.2. The building of a consensus around the economic policy might have been vital for the latter implementation for two reasons; i) It increased the accountability of all parties since they all were responsible for the results of the policy; and ii) Increased legitimacy of the economic policy not only because the state became more accountable, but also since the private sector in part affected the policy process.

II. *Consensus around economic growth*: The high mobilisation around economic growth which I mentioned in subsection 2.2.3 and I will come back to in subsection 3.2.2 has also been of vital significance. This national mobilisation might have contributed to a feeling of a common cause. If one starts by explaining all "*rents*" as corrupt and maintaining the status quo as in the "*public choice*" models it is difficult to explain why anyone was lobbying for a non-existing information technology sector at the start of the 1980s. The agreement around common goals made both the state and the private sector give something to achieve something later on. This is might be adequately summarised by the concept of "*mutual hostage taking*".

III. *Shifting balance*: The balance between the private sector and the state is delicate and one party can easy start to dominate the other. In some East Asian countries the balance shifted over time. The most illustrative example might be South Korea. In the 1960s, the state was very powerful, but promoted large conglomerates which emerged as a private sector counterweight. At the start of the 1980s the Chaebols had grown very powerful and the balance of power shifted in their favour. From the 1980s, and especially since 1990, there has been a lot of liberalisation in South Korea driven on a internal desire for liberalisation often stemming from the Chaebols. The balance of power shifted again at the end of the 1990s when public opinion went against the Chaebols. Following the East Asian financial crisis the IMF attempted to break part of their dominant role in the South Korean economy. Another example can be Thailand were it's claimed that the private owned banking sector has a too large political power relative to the state.

African states have been criticised by the neo-liberals for their "*irrational*" policies. The standard explanation fronted is that this was the result of a post-colonial state which was left without "*check-and-balances*". The public choice literature mentions at least six points for why the state lowered growth in Africa:[117]

I. Excessive and counterproductive intervention in domestic economies which hurt the private sector and market forces.

II. Excessive bureaucratisation which led to a excessive state sector.

III. The state was captured by a clientist network and a urban coalition which lobbied against the rural (productive) sector and "*rational*" macroeconomic policies.

IV. Power populism that was laid up to a vocal urban elite.

V. Monopolisation of all layers of economic activities which resulted in rent-generating of different niches and branches.

VI. Excessive centralisation which did not encourage local (private) initiative.

This created a strong anti-state attitude and the African state became one of the most demonised institutions on the continent.[118] There are a host of empirical problems connected to this interpretation though. I can briefly mention three of them:

I. <u>Lack of urban coalitions</u>: There is little evidence of urban coalitions in most African countries (Mosley *et al.*, 1991). Interests in urban areas are normally badly organised and inherently contradictory. Most decision in African countries is taken in small circles

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[117] See for instance Bates (1981), Jackson & Roseberg (1982), Callaghy (1987), Ergas (1987), Rothchild & Chazan (1988), IBRD (1989), Medard (1991) and Barkan (1992).

[118] As Olukoshi (2004) noticed, there was almost a personal competition among the public choice authors for the most fitting characterisation of the African state: "*Depending on the particular angle from which they entered into the debate, the state was variously described by different scholars as "neo-patrimonial", "unsteady", "omnipresent but hardly omnipotent", "a bare leviethan", "soft", "sultanist", "prebendal", "hemned on", "over-extended", "kleptocratic", "predatory", "parasitic", "crony", "inverted" and "humpty-dumpty*".

of power, sometimes even a single person (Healey & Robinson, 1992; and Grindle & Thomas, 1991).

II. *Doomsday perspective*: Neo-liberals often characterise the African state prior to the 1980s and SAP has been as a total failure. This does not match the evidence. The region as a whole experienced economic growth during the 1960s, but experienced negative growth since the SAP started in Africa. Some countries, such as Kenya and Nigeria, recorded growth rates as high as 8-9 % in GDP per capita during the 1960s. The growth rate for SAP countries was a maximum of 3-4 % in GDP per capita (see for instance Mkandawire, 1995; Gibbon & Olukoshi, 1996; and Havnevik & van Arkadie, 1996). I am not saying that the African state was functioning extremely well before the 1980s or that other factors than the SAP affected the growth performance in this period. But, the characterisation of African states as complete failures prior to the 1980s is little nuanced and gives a wrong picture of the record of African states.

III. *Authoritarian tendencies*: As I mentioned previously, the neo-liberals see it as the state's job to "*force*" unpopular, but necessary policy through. More radical political economists have claimed that a democracy and SAP cannot mutually exist since there are authoritarian tendencies within the neo-liberal policies. This is because the conditionality attached to the SAP is undemocratic and authority is needed to "*force through the SAP*".[119] The problem in Africa was that there was little evidence of urban coalitions or vested interests through civic societies which were blocking the implementation of the SAP. Instead, the resistance towards the SAP was widespread and even came from those groups that were supposed to benefit from these policies.[120]

A point that I have emphasised throughout the discussion of the political process is how foreign powers increased their influence in the African political process. This also affected the internal policy process. I would like to stress three factors of how it affected internal policies:

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[119] See for instance Bangura (1986), Mustapha (1992), Campbell (1989), Olukoshi (1991) and Mkandawire (1996).

[120] Ironically, Herbst (1990), a neo-liberalist, welcomed the democratic transitions at the end of the 1980s since democracies would punish unpopular leaders and there "*neo-patrinomial*" relationships. In other words, the urban minority was going to be punished by the rural majority. The irony is that some of the social instability was caused by a popular resistance against the SAP and many governments were elected on the basis of an strong anti-SAP rhetoric. The problem was often that, once in power, the financial situation did not allow them to have any other choice but to implement the "*policy recommendations*" of the SAP.

I. *IBRD a political player*: The IBRD attempted to block alternatives to the SAP policies by for instance blocking the formation of civic society groupings. Authors like Nelson (1989) and Bates & Krueger (1993) attempted to find out who the winners and losers from policies would be so they could wrong foot any opposition.[121] Pro-SAP groups were promoted and anti-SAP groups were attempted blocked (Beckman, 1992). One of the biggest problems with the neo-liberals and the IBRD is that they see their own policies as neutral and value free based on science. But, there is not sufficient evidence to support the notion that those countries which follow neo-liberal policy recommendations will develop from a low stage of development or that those countries following neo-liberal policies will grow faster than other countries. As a matter of fact, there is no real example of how a country has become industrialised on the basis of the policy recommendations inherent in the SAP. Other policies than the neo-liberal recommendations are than either irrational or based on the rent argument. The IBRD only supported the outcomes of democracies if they were they were in line with their one "*market friendly view*", see for instance Collier (1996).[122] This led to what Mkandawire called "*voiceless democracies*" where democracies were unable to pursue their own economic policy. The whole concept of "*local ownership*", which was attempted at the beginning of the 1990s, merely received lip service. The initiatives supported were solely those that supported the liberalisation policies. In the worst cases IBRD personal wrote documents themselves in their office and went around to different local leaders asking them to claim authorship (see for instance UNDP, 1993; Botchwey *et al.*, 1998; and Bangura, 1999).

II. *Big resistance*: As Olukoshi (2002) mentioned, people from the poor and middle class often lost out through the SAP policies due to: i) Increased economic stresses on workers and poor through devaluations which increased inflationary pressures; ii) Wage

[121] One of the main reasons why such a policy failed was that models often operated with groups like "*informal vs. formal*", "*tradables* vs. *non-tradables*", "*market vs. state*", "*agriculture vs. manufacturing*". The problem is that reality often does not fit into such nicely fitted categories and there are lot of grey zones. Since it's not given where certain groups belong to, it therefore becomes unclear which groups looses out and which gains from reforms (Bangura & Gibbon, 1992)

[122] A fitting analogy would be Ford's famous quote: "*You can choose any car you want as long as it's black*". African academic environments are usually not neo-liberal, but have more structuralism sympathies. If Africans were to decide their own policy to a larger extent the possibility is high that this would increase the state intervention and the institutional building process. Both the African academic tradition (with a strong link to pan-africanism) and the East Asian tradition (especially the Japanese) have closer links to structuralists paradigms than the neo-liberal. Thus, the "*Washington consensus*" does not apply to these regions. Given the different academic orientation the perceived causes and solutions to the different crisis are naturally different.

freezing to avoid hyperinflation leading to decreasing real wages; iii) Public sector downsizing leading to increased unemployment; iv) Cost retrieval with the introduction of school and user fees for health services excluding a lot of the poor from these basic services; and v) High inflationary pressure as a result of price regulation and a quick deregulation adding to the inflationary pressures from devaluations. Thus there was a wide-spread opposition to the SAP policies coming from the grass-root level. This could have policy implementation very difficult.

III. *Implementation difficulties*: The formation of the policies was not the main difficulty during the SAP. But, the implementation was weak. Actors in Africa are not active in the political formulation process since the political institutions are not well developed and a lot of the decision making takes place in small circles.[123] However, the implementation of policies is often affected by the actors that bare the consequences of such policies. When a policy is to be implemented by local officials people offer for instance bribes or other beneficiaries to be exempt from the policies or get a more lax implementation. Because of this, the effective implementation of a policy on the ground can often be very different from the formulated policy. It also allows for large regional differences reducing the cohesiveness of the policy in question. This being the case, given the highly unpopular nature of the SAP policies, it is no surprise that the effective implementation is as poor was as poor as it was. My point is that a real consensus around political issues would make the effective implementation far greater given that the political institutions have the legitimacy and are being perceived as autonomous.

Public choice models were positive in the sense that the political process was brought back into the economic profession. But the paradox is that the conclusion was that politics should be removed from the economic process. The evidence to support their models, though, is far from conclusive. This goes for both East Asia and Africa. Conditionality as a policy tool was

[123] In Kenya from 1963 to 1978, the so-called Kenyatta regime, the economic policy was achieved by a consensus with the main economic actors and laid close to their needs. Kenya did experience economic growth until 1973, but did experience increased macroeconomic shocks since. From 1978 to 2002, the so-called Moi regime put more of the economic policy formulation process up to the president which meant that the policy got more centrally formulated. The SAP was officially adopted during the 80s, but it was not until the early 1990s that it was truly adopted. Policies conducted during the 1980s were not taken local considerations and central economic actors were not consulted. My point is that increased consulting increases the dangers of selectivity, but a too centrally formulated policy as under the Moi regime in Kenya during the 1980s increases the dangers of poor implementation. This is a case of the difficult balance of "*embedded autonomy*" that Evans (1995) mentions.

implemented so that the African states would implement the economic policies according to the neo-liberal vision. One finding that is very important is the role of feedback mechanisms in the East Asian growth experience to make i) Policies more adequate and avoid some of the information problems governments have; and ii) Increase the legitimacy of the policy by allowing it to be subject to some form of consensus thereby increasing the effectiveness of implementation. The BWIs, however, had a larger focus on "*forcing*" unpopular, but "*necessary*" policy through in Africa. The lack of real consensus building and the high insistence of the workings of neo-liberal policies in an environment that has other academic sympathies are two of the main reasons for why the SAP had such a difficult time being implemented as it proponents intended.

3.2 Social Embeddedness

Often ignored in economic literature is the fact that the state has a multitude of tasks that are non-economic in nature. If a random person in the street was asked the question: "*What's the role of the state?*" the answer would most likely not be only to promote markets. Economic growth and increased welfare would most likely be a key requirement, but the state's role runs deeper than that. The legitimacy of the state is for a large part depended on economic growth which most likely increases the welfare of the people. But economic growth alone is not the only factor determining the legitimacy of the state. Rather people will look at the whole set of tasks that people perceive the state should be dealing with. This means that the legitimacy of the state will be judged by an assertion of the fulfilment of different tasks, where economic growth is one of the most important. My point is adequately summarised by Olukoshi (2004):

> "*…in addition to its trial and error nature, policy is an essential political affair... It is therefore important for effective policy making to recognize that policy is not solely a product of economic considerations but also of a host of other considerations, including national unity and stability, conflict management, and cultural values. This being the case, the efficacy of policy cannot be assessed solely on the basis of economic criteria, and certainly not on the kinds of narrow market-based criteria that are central to the structural adjustment agenda of the IMF and the World Bank*".

To assess how these more non-economic tasks affect the economy I wish to focus on two elements which are very relevant for economic growth. Firstly I will look at the role of the state as a conflict manager. Secondly I will assess the question of legitimacy.

3.2.1 Conflict management

Conflicts have had adverse effects for social and political stability in Africa. These conflicts seemed to have occurred with a lower frequency in East Asia compared to other developing regions. The natural question becomes whether this was more or less independent from the economic situation and thereby enhancing East Asian growth prospects from the outset. Or did the economic growth in East Asia create the political and social stability needed to continue the economic growth spurring a virtuous cycle. I believe that both of these questions can be answered with a partial "*yes*". Economic growth can also create conflicts and how the government deals with for instance income inequality and the shifting importance of different sectors which affects political relations. Thus the management of conflicts becomes important for the continuation of the social and political stability that economic growth is dependent upon. In addition, there needs to be social and political stability for the economy to take off.

Economic activity is about the allocation of resources which in practice means that certain sectors normally change their relative and sometimes their absolute importance compared to other sectors. Such shifting structure over time creates new power relationships. According to standard economic theory, the whole society benefits from long-term economic growth. But there is less agreement what happens in the short-term and how these changes should be dealt with. Neo-liberal in theory operates with highly efficient markets which imply flexible prices and a high resource mobility which means that short-term effects will be short-lived and hence these don't warrant attention. The argument, on theoretical level, is that income inequality is not an issue since it doesn't affect efficiency.

In practice the neo-liberals acknowledge that in certain developing countries inequality has adverse effects for economic growth by affecting social and political stability. One suggestion is to composite "*the losers*" since "*the winners*" win more from economic growth than the losers lose and thus income redistribution could smooth structural transition by compositing "*losers*".

The revisionists do not promote the notion of highly efficient markets and allows rigidities. If the losses from market competition are too high for the market agents suffering these losses, they might not accept the market outcome and take "*political action*" (Chang, 1994a). Rodrik (2000a) claims that healthy societies have a range of institutions which makes such "*social coordination errors*" less likely, for instance "*the rule of law*", high quality judiciary, representative political institutions, free elections, independent trade unions, institutional representation of minorities and social safety nets. These institutions operate to make the potential "*pay-off*" for "*winners*" of social conflicts less and guarantees that "*losers*" do not get excluded. This will increase the incentive for cooperation. Chang (1994a) mentioned that the possibly most effective way to handle and prevent future conflicts is to facilitate redistribution from "*winners*" (often high-income groups) to "*losers*" (often workers). In practice, it's hard to see that any other institution than the state can fulfil this role. According to Chang (1994b) there are five ways to solve social conflicts with regard to resource allocation:

I. *Let the market decide*: For some neo-liberals, for instance Barr (1987), this is seen as the most just outcome since it rewards those actors that are most efficient.[124]

II. *Give selective support to vulnerable groups*: Given selective support to those who do not benefit from the market outcome. For instance given employees who get fired from a big plant unemployment benefits. This is a way of directly addressing the adverse effects of market outcomes. The problem with this method that it might be seen as discriminating at some stage since certain groups get increased protection over others

III. *Give selective support to vulnerable outcomes*: Has the same effect as the previous by elevating the adverse effects, for instance unemployment benefits, but has at the same time a more neutral outlook by not targeting groups per se, but rather adverse outcomes.

[124] Personally, I find the reasoning somewhat odd. Firstly, the morale that more efficient players are "*better*" or more "*eglideible*" gives the impression of an Bentham ideal, who's moral reasoning are somewhat controversial. Secondly, and for me most important, the argument is partly contradicting itself. Today's institutional context, resource distribution or power sharing are historical products of previous state intervention at some point and thus "*distorted*" from the outset.

IV. *Change the political agenda*: The boundary what is political and what is economical is elusive and shifting over time. Thus governments have the option not to intervene in adverse economic outcomes by stating that it's not a political problem.

V. *Use force*: Hardly recommendable, but an historical used tool, is to press the new outcomes using force. Amadeo & Baduri (1991) said that such a method might work in the short-run, but would have more adverse effects in the long-run.

I believe that the social stability in East Asia was not given as such. If one were to turn to East Asia in the year 1950, the outlook for economic growth would appear to be bleak. Japan was still under American occupation which lasted until 1953. Korea was split following the Korean War which was still ongoing in 1950. China had been taken over by Mao and the communist party in 1949 which was followed by "*economic*" reforms such as the persecution of capitalists and landowners. Taiwan was taken over by the KMT party, which in the West was seen as unreliable. The build-up before the economic take-off is very important to understand the growth miracles, as I mentioned in section 2.2.3. Chang (1998) mentioned that the East Asian governments showed a high ability to redistribute wealth and increase the national cohesion of the countries. This goes for both the build-up prior to take-off and in dealing with redistribution after economic growth had taken off. I want to elaborate on a number of aspects regarding these policies:

I. *Land reforms*: In Japan, South Korea and Taiwan there were a number of land reforms prior to take-off. In the Japanese case, these reforms were long overdue according to some and the American occupation was able to press these through. The reforms restructured ownership by setting limitations on the amount of land each farmer could own and introduced rules for cultivation. This increased the amount of land each single farmer had by strengthening their private ownership. This might have boosted agricultural productivity since the increased returns were more related to the farmers own efforts, hence there were increased incentives to increase production. The increases in agricultural productivity were important for the economic take-off of the countries by freeing up labour which could move to the cities and this increased urbanisation boosted industry and thereby income. An interesting point made by Kay (2001) is that the landowners, the supposed "*losers*" of these reforms were compensated by the state and they virtually disappeared after the land reforms. Many, as a matter of fact, became

investors and thereby capitalists in the new industrial economy. The Philippines attempted similar land reforms, but did not succeed to the same degree as the countries thus far discussed. The increasing land pressure in Malaysia and Thailand, on the other hand, was solved by opening up tropical areas for cultivation, thereby reducing social tensions.

II. <u>*Social safety net*</u>: An interesting aspect of the land reforms was the increased protectionism against foreign products; the same went for small traders such as local shop owners in Japan, South Korea and Taiwan. Chang (1996) mentioned that this was an important aspect of the overall economic policy since the increased agricultural prices increased agricultural production and the small shops and more "*traditional*" economic activity was being protected which meant that the "*losers*" from the modern transformation could be compensated. In developing countries welfare states and social safety nets might be poorly developed and the "*losers*", if not compensated, might take political action to stop some of the modern economic growth. By allowing a "*safety valve*" for those falling outside the "*new society*" and a gradual opening up (and also perhaps a modernisation of for instance the agricultural sector after growth has taken off) the potential for social conflicts were dampened.

III. <u>*Luxury consumption*</u>: In Japan, South Korea and Taiwan there were also limitations on so-called luxury consumption. This facilitated at least three effects; i) It decreased consumption and hence increased savings; ii) Import substitution since the domestic producers started to produce some of the luxury goods that were not being imported any more. This one of the reasons why some scholars prefer to see these countries more as complementary in their usage of export promotion and import substitution; iii) Most important for our argument is that these measures also had a political dimension since the governments wanted to avoid an unintended "*demonstration effect*" during the Cold War days (Chang, 1997). An increase in luxury consumption could increase the class struggle and increase communist sympathy. An interesting point regarding the opening up of China from 1978 was that Deng Xioaping wanted to create a "*demonstration effect*" by letting some Chinese getting rich first so other would which to follow and increase the capital accumulation.

IV. *Housing projects*: This goes first of all for the city states of Hong Kong and Singapore which have their own unique problems due to the status of city states. Land rents are high in these states and to elevate some of the pressure in an attempt to keep land rents low the Hong Kong and Singaporean government subsidised housing projects.[125] This reduced the potential for social conflicts due to housing schemes which had been building up after 1945.

V. *Labour conflicts*: Both Singapore and South Korea have had infamous clashes with regard to labour conflicts; see for instance Ogle (1991) for South Korea. These pressures have undoubtedly been repressed by partly harsh means, but the labours did get a lot of their demands through, such as for instance work compensation for working accidents and a right for payments of labour firstly ahead of other interests if a company was deemed to be bankrupt. Probably it would have been unsustainable not to meet many of the demands of the demonstrators since, as I mentioned, violence most likely is not a long-term mean of solving conflicts.

VI. *Ethnic redistribution*: An interesting case study is the New Economic Policy (NEP) conducted by Malaysia (see Snodgrass, 1995). Malaysia after independence was ethnical heterogeneous, has large ethnically divided income differences and a primary goods production structure. In 1969 there were racial riots after the minority population of Chinese (30 % of the population) and Indians (8 % of the population) threaten to take political power from the more numerous, but impoverished Malay population (62 % of the population). The NEP was an attempt to conduct an ethnical redistribution based on economic growth to reduce the possibilities of ethnical conflicts by decreasing the level of poverty and increasing the employment of the Malay population. The measures included a modernisation of the rural areas, a rapid but balanced population increase in urban areas, the establishment of a Malay commercial and industrial sector, ethnic quotas on higher education, quotas on ownership and increasing the numbers of public companies.[126] This was intended to decrease the relative importance of the wealthiest

[125] Hong Kong pursued a more laissez-faire strategy than the other Asian countries. The subsidising of housing projects was perhaps the biggest exceptions to this policy.
[126] A promotion of the rural areas with many farmers was also a pro-Malay policy since most of the Malay population were living in rural areas and dependent on agriculture.

Chinese and increase the relative share of the Malay population.[127] The policy managed to induce a state-led economic growth with important, mainly labour-intensive export zones, which managed to decrease some of the ethnical disparities, thereby dampening some of the potential for future ethnic conflicts.

Africa has had more episodes of civil war than any other region in the world since 1960. The lack of economic growth has partly been a cause of the social tensions and economic conflicts, but is also an effect of the lack of political stability. This is a vicious circle were poverty feeds violence, violence leads to social and political instability, which makes economic growth virtually impossible thereby increasing the problems. The lack of economic growth can thus be a potential topic for an endless discussion of what comes first; the chicken or the egg? African governments did not exhibit the ability to decrease social conflicts; as a matter of fact they were often the reason for conflicts. In addition to economic growth, there are a number of factors that have affected the government's ability to solve political and social conflicts;

I. <u>Colonial foundations</u>: In Africa "*favoured*" ethnic groups often got the colonial state as a "*reward*" for their support during the colonial era. These favoured ethnic groups often collaborated more than others with the colonial powers and were also often the groups that were wealthier than other ethnic groups. This fuelled ethnically divided income differences which were exacerbated by the usage of a "*divide-and-rule*" policy from the colonial powers that attempted to put the different ethnic groups up against each other. After independence the colonial institutions were often taken over by these "*favoured*" groups were the colonial policies often were continued by native groups. The policy of mutual alienation by the colonial powers left the state with little legitimacy and laid the foundations for partly ethnically motivated conflicts. Often these conflicts were between the so-called "*favoured*" groups and non-favoured groups such as in Angola, Burundi, Chad, Djibouti, Nigeria, Senegal, Somalia, Sudan and Uganda and Zaire (Jinadu & Ake (2004)).

[127] The reforms can be deemed to have been successful on the basis that it managed to redistribute the national wealth. In 1970 the Malay population only had 2 % of the national wealth, the Chinese and Indians had 43 % and foreigners had 65 %. In 1990 the distribution of wealth had increased for both the Malay as well as the Chinese/Indian population to 20 % and 46 % respectively, while the relative share of the wealth for foreigners had decreased to 25 %. The economic growth also meant that not only the slices, but also the size of the cake increased and the overall poverty level went from 49 % of the population in 1970 to around 15 % in 1990.

II. *Ethnic redistribution*: When non-favoured groups got control of the state institutions there often was a rhetoric favouring an ethnic redistribution of wealth. Under import substitution the income differences were attempted to be fought by increasing the state sector and paying favourable wages to close some of the disparities in income. In general these attempts did not succeed. I believe that several factors contributed to this failing: i) There was a willingness to achieve income redistribution before economic growth. So the size of the cake did not expand, even if the slices were redistributed, in stark contrast to Malaysia; ii) There was a tendency to favour the ethnic group that had control of the government, thereby creating a situation were state control was a means of securing that one's own group got a share of the cake and therefore controlling the state often became the cause of the conflict, making it difficult for the state to attempt to resolve income differences. In Nigeria different industrialisation efforts were attempted at various times and the geographic concentration of the efforts normally reflected which ethnic group was in power. This led to a number of industrial clusters in various locations and a fragmented industrial structure in the country; and iii) Related to the previous argument, minority groups did not have efficient institutional protection leading them to be excluded from the political process which created increased discontent which could have fuelled increased instability. The lack of institutional protection for minority groups might be a major reason for why attempts of democracy, especially with a simple majority vote, often has failed in Africa, there was no protection for the "*tyranny of the majority*".

III. *Structural Adjustment Programs*: The SAP was highly unpopular in Africa as it often was seen as an increased political influence from non-African foreign powers. As I mentioned in section 3.1.3, the IBRD/IMF themselves got entangled in the local political process favouring groups that supported their policies and worked against those that opposed it, thereby undermining the political institutions of the various countries and creating "*voiceless democracies*". The SAP might have increased ethnic tensions in Africa even further through several channels; i) Capital restrictions for certain ethnical groups that did not support the SAP policies; ii) Reducing the public spending thereby increasing the speed of the divergent income process; iii) The privatisation of public companies seems to have favoured the already relative "*richer*" segments, increasing the income differences; and iv) The intuition fees for primary education excluded the

poorest from education which led to a process where the poorest had less abilities to increase their incomes through the formal economy.

IV. Sudden changes in ownership: A sudden change in the ownership structure of a country as negative long-term implications for economic growth since it raises uncertainty and thereby the perceived transaction costs. There have been a lot of episodes in Africa were governments have intervened directly to change the ownership structure, thereby raising the perceived risks by investing in Africa. In Uganda, Idi Amin attempted to change the relative income distribution by throwing out the relative richer ethnically Indian population and confiscating their properties. In Zimbabwe Robert Mugabe also attempted a "*redistribution*" policy in 1995 by confiscating the land of white farmers and giving them to political supporters. Since 1994 there has been a lot of pressure on the South African government to tackle some of the income differences in the country and some land reforms are underway to reduce the relative importance of white farmers. Such reforms might have been easier to implement after what happened in nabouring Zimbabwe out of fear that the same drastic measures might be taken in South Africa.

V. Geographic concentration: Ethnic conflicts often get more intense when ethnic groups have identified geographical power bases. Zimbabwe, for instance, has ethnic groups which clearly had their geographical bases as compared with for instance Botswana. In Botswana the ethnical groups were evenly spread out without having the same clear geographic connections as ethnic groups in other African countries. In Singapore the government was very aware of this and set quotas on the maximum number of each ethnic group that was allowed to live in certain blocks or part of the city thereby spreading the ethnic groups more evenly.

A host of scholars have criticised the East Asian governments for being protectionist by having inefficient sectors such as agriculture. This criticism is understandable, if countries were to open up for agricultural goods they could be imported cheaper and the producers that would remain would have to produce more efficiently. The NEP in Malaysia has also been criticised for being racist and not favouring the most efficient solutions through for instance ethnical quotas on education. Even though these arguments are valid, they seem not always to take the bigger picture into consideration. In regional negotiations Japan has often been asked to liberalise its agricultural sector. A Japanese diplomat was once quoted saying: "*In Japan,*

rice is 10 % economics and 90 % politics". My point is that the East Asian governments did not attempt to optimise the most efficient economic solution, but the most efficient social solution. Social stability can be fragile and is at the same time a necessary condition for economic growth to take place. Chang (1998) makes the point by saying that the social stability that the East Asian governments "*bought*" was expensive, but lay the necessary foundations that economic growth could be build upon. In the Malaysian case, the non-favoured ethnic group, the Malay population, saw their situation created by the colonial powers which favoured the Chinese population. In such a view the colonial powers used state intervention to favour some groups over others to create more favourable distributions of wealth. Once the political power was taken over by the Malay population, they believed it was their right to correct these "*distortions*" created by previous interventions of the former colonial powers. The point is that present institutional and political structures are historical products and have therefore been influenced by various factors which render the view that the markets give the most "*natural*" outcome less legitimacy since the present outcome is a product of intervention of the past. I am not saying that the policies in East Asia are the most efficient nor do I necessarily recommend the same policies for present developing countries. But, my argument is that these policies did manage to maintain the social and political stability in East Asia which fuelled economic growth. Also, increases in income made the societies more stable and increased the powers of the state to promote social stability as the growth process went on.

The African situation is a major contrast to the East Asian case. There is no doubt that much of the political and social upheavals in Africa are linked to the lack of economic growth and the weak increases in standards of living. But also, a lot of the problems were left over from the colonial regime such as high income inequalities and ethnical fragmented populations. The state itself was a colonial creation and control over the state was often a source of conflict by it self. This made the state's ability to maintain political and social stability very difficult. Collier (1998b) believes that ethnical fragmentation does not give the same problems if countries are democracies. The problem is that it doesn't solve the problem the "*tyranny of the majority*". The state needs greater capacity and legitimacy to be able to handle conflicts and democracy with build mechanisms that limits it power such as guaranteed minority rights has the potential to work in Africa. The increased foreign presence, however, has put further strains on many African people and undermined the already weak political institutions in Africa making matters worse. The most troublesome development has been the emergence of

"*voiceless democracies*" where foreign powers decided which economic policy Africans should pursue. Redistribution policies that have been pursued have often not succeeded. To be able to handle conflicts more autonomy is needed. There are, however, increasing regional attempts to handle social conflicts through for instance the African Union.

3.2.2 Legitimacy

I define legitimacy as the social acceptance of the users of the institutions towards the institution in question. This definition has an important implication; legitimacy is a process that goes down-up. Institutions can be created through a top-down process through for instance the governments, but its legitimacy can only be granted by the end-users of these institutional arrangements. Without legitimacy there will be no real solution to the problem of who supervises the supervisors (Stiglitz, 1999). Capitalism as an economic system emphasises the role of the market as a central allocation tool. As Rodrik (2000a) put it: "*Social insurance legitimise the market economy because it renders it compatible with social stability and social cohesion*". The justification for income redistribution is according to this view based on the need for legitimacy for the market economy. This highlights another important feature; the market system is a means to higher living standards, not a goal by itself. Sindzingre (2004) criticised the neo-liberals for their distinction between formal and informal institutions since it gives the impression that informal institutions are something vaguer and less binding than formal institutions. This is according to Sindzingre not true for many developing countries where so-called informal institutions are more widespread, more binding and enjoy a higher degree of legitimacy than formal institutions. The reason for the failure of the SAP, according to Sindzingre, was therefore the lack of focus on informal institutions and a too high focus on building formal institutions. Sindzingre (2005) emphasised a number of attributes that affects the legitimacy of institutions:

I. *Relations to pre-existing institutions*: An institution needs to have a certain degree of embedeness with pre-existing institutions to achieve legitimacy. Institutions do not exist in vacuums, but in relation to each other, if the distance between a new and old institution becomes too big, the new institutions might not achieve the necessary legitimacy to function optimally. Market reforms in many developing countries to create Western style economic institutions have often failed which might partly be explained by the differences in institutions such as cultural values.

II. *Accountability*: An institution that is accountable for its result has a tendency to increase its legitimacy by being responsible for the results it produces. That is why democratic elected governments in general are perceived as more legitimate than autocratic regimes.

III. *Source of the institutional innovation*: Institutional innovations created through a down-up process tend to have a greater legitimacy than institutional innovations that are created through a top-down process. The reason might be that the legitimacy itself is a down-up process and that's why implementation without a consensus or grass root initiatives can be less effective. Also, national sources of legitimacy also tend to have a higher degree of legitimacy than foreign.

I will use these attributes as a framework for understanding legitimacy in the two regions. In East Asia governments were able to achieve a relative high degree of legitimacy. The economic policies and institutional innovations were therefore more effective implemented than in the case of Africa. The East Asian governments managed the different attributes of legitimacy in an adequate fashion:

I. *Cultural identity*: Englebert (2000) emphasised that the state itself often was an endogenous product of the East Asian societies and therefore by definition was a product of the pre-existing institutions which increased its legitimacy. In Japan, the American occupation forces allowed the country to keep the emperor as a symbol of national unity. This increased the continuity and legitimised the national values which were severely dampened after the military loss of World War II which needed to be rebuilt. Another example of how institutions were put close to pre-existing institutions were China and Vietnam which choose to open up gradually and the institutional innovations were in accordance or close to pre-existing institutions. This is what Rodrik (2000a) called institutional innovations with a "*local flavour*", which I elaborated on in sub-section 2.2.3. I believe this is a very important part of the economic growth in East Asia and why the policies and institutional innovation were as effective as they were. Another attribute that has been emphasised, see for instance Tenold (2002), is the national unity or national mobilisation around economic growth in a number of East Asian countries, which I also mentioned in sub-section 2.2.3. According to Vartainen

(1999) a common external threat often helped this sense of national unity as for instance the North Korean threat for South Korea or the Chinese threat for Taiwan.

II. Accountability: The presence of "*deliberation councils*" in a number of East Asian countries led to a feedback mechanism were the different institutions were bounded by a mutual hostage taking were the different elements were responsible for the results they produced thereby creating a system were the various actors were accountable for their results, as I have mentioned previously. The fact that the private sector not only was consulted, but also had a part in policy formulation led to a process were policies and institutional innovations in part came through a down-up process which increased the legitimacy and the effectiveness of these policies. An interesting feature with a number of high growth countries in East Asia is the gradual emergence of democracy. According to the modernisation theory, democracy is a natural development that follows economic development. Other scholars disagree and contend that democracy is partly independent of economic development and can therefore occur at any stage of economic development. Nevertheless, there seems to be a two-way feedback mechanism. Firstly, an increase in living standards can legitimise autocratic rule since the ruling party is able to increase the material wealth of its population. Secondly, an increasing standard of living beyond a certain material well-being can increase the demands for political participation partly due to higher education and shifting preferences with a higher standard of living. These tendencies oppose each other. The modernisation theory claims that the former dominates at a early stage of economic development and the latter dominates at a latter stage after the living standards has passed some kind of "*critical mass*". In South Korea and Taiwan democracies have developed over time following economic development. In Japan, however, democracy preceded the post-WWII economic development (but not the pre-WWII economic development). In China the ruling party is afraid of losing legitimacy and has allowed capitalist into the ruling party so the policies formed are not too far away from the needs to increase the legitimacy by having a down-up element into the policy formulation. More importantly, capitalists create a lot of the wealth that the Chinese economic growth is dependent upon and economic growth is the new source of legitimacy for the ruling communist party after it de facto abandoning communism (though never officially denouncing it).

III. *Legitimate source*: Foreigners do not have a high legitimacy in many East Asian countries, for instance Japan and South Korea. The low degree of FDI in their development partly reflected this. The state as a source for institutional innovation was often regarded as a legitimate partner and as I mentioned, many policies and institutional innovations were also consulted and thereby the private sector also was a major source behind the economic policies. South Korea has liberalised its economy far more during the 80s and 90s than Japan and this reflects to a higher degree shifting preferences within South Korea rather than external pressure. In Japan, the economy has somewhat reluctantly been liberalised partly on the backdrop of foreign pressure, but these institutional innovations do not always have the same legitimacy as compared with national solutions. The US attempts to pressure China on human rights through trade negotiations.[128] For me it seems unlikely that such a policy will be effective unless these correspond to some form of national movements that can increase the pressure on the Chinese authorities from within.

The African state has not had the same degree of legitimacy as their East Asian counterparts. According to Sindzingre (2004) the whole concept of "*state*" in Africa was not comparable with the concept "*state*" in East Asia. The very foundation, nature and its existing within the societies they are supposed to govern cannot be compared. Therefore, the different elements that can give states legitimacy varied in contrast to East Asia:

I. *Artificial states*: I would like to make three points; i) The state lacked legitimacy in Africa since it often was not based on local African institutions or local power structure. Also the policies and institutional innovations did often not have a "*local flavour*" to make them adapt to the African context, see subsection 2.2.3. States in Africa were to a higher degree than other regions an exogenous product of the societies they were meant to govern (Englebert, 2000). The state as an institution was in itself an imported concept. An exception to this general rule was Botswana. The British were not interested in this colony and allowed the local Tswana kings to rule, thereby upholding the local institutions of government. In 1966 at independence Botswana was one of the 10 poorest countries in the world inheriting virtually nothing in form of human capital and infrastructure, but they did inherent democracy (Owusu & Samatar, 1997). The first

[128] Even though the so-called war on terror with Guantanomo Bay and various prison scandals have reduced the legitimacy of such a policy somewhat in the near future.

prime minister was a prince of one of the local Tswana kings and thereby continuity and legitimacy was upheld. The Botswana success story is at odds with the modernisation theory that predicts that democracies develop after and not before economic development takes place. The general picture for African countries, though, is of people that did not associate themselves with the new states that they inherited in 1960 and hence the term "*artificial states*". Often the policies and institutional innovations, in contrast to East Asia were conducted in closed circles with little grass root input which rendered policies and institutional innovations less legitimate and made them harder to implement; ii) Attempts to create a national unity have been thwarted by the presence of other forms of autonomy which were being perceived as more legitimate which goes for individual ethnical groups and pan-africanism. As Mkandawire (2004) points out, the search for identity is always ongoing and many have over time started to identify themselves with the "*artificial states*" they inherited. Mkandawire was opposed to the word "*artificial states*" since all states are social contracts and by definition artificial. Some policies attempted by the African governments were attempted to create some forms of national unity, many of these attempts did not succeed.[129] As Landes (1999) points out, nothing is as unstable as dual autonomy. African people associate themselves first of all with their ethnic group, then Africa (through pan-Africanism) and lastly with the state they live in. Its not that they do not associate themselves with their countries, but they seem themselves as African first, and then as Nigerian or Ghanaian; iii) The fear of loss of autonomy has hindered regional cooperation's which has severely dampened the development of potential constructive economic relationships among African countries. Regional cooperation through supra-national bodies requires a certain amount of loss of sovereignty, but the newly independent countries following independence were at the time not willing to give away their hard won freedom. This dampened regional cooperation and has led to little regional economic integration despite attempts to contrary through various schemes.

II. <u>Lack of accountability</u>: The lack of accountability for the results that policies have produced in Africa refers to two levels, namely the state level and the international level through international financial institutions. Both have not been able to boost growth in

[129] Another "*artificial*" state that broke away from European control, the USA, is a case to the point of how national unity is created as an concept used to legitimise the control of the government. In class rooms in the US the national anthem is often song so that children from their upbringing associate themselves with the American nationalism.

Africa and have often blamed each other for this failure. On the first level, the state, I already have mentioned in section 3.1.3 that most policies were not consulted with the people or the private sector leading to little potential feedback. The presence of autocratic regimes and frequent coups also did not help to create a sustainable environment for accountability to promote legitimate economic policies which would boost economic development. The democracies that developed in the end of the 80s and the beginning of the 90s have at times been seen as unsustainable since they have been undermined by external donor pressure. On the second level, the international financial institutions, the lack of "*local ownership*" where governments realistically can affect the policy formulation has created an environment of weak legitimacy where economic policies are weakly implemented both at the state and the grass root level. The results of the SAP were blamed on "*lack of commitment*". But the lack of real accountability for the results that the SAP has produced has decreased the legitimacy of the IBRD/IMF. My point is that the little "*real*" consultation and the blocking of African alternatives have created an environment where policies are more forced upon Africans rather than the results of real policy consensuses making them less legitimate and hence subject to policy reversals and lack of effective implementation.

III. <u>*Lack of legitimate source*</u>: African states were not seen as legitimate during the IS era and had difficulties in implementing their policies and institutional innovations as a result. Often the question was: "*Who does the state belong to?*" As I mentioned, control over the state was often a goal for different ethnic groups and thus the state was not seen as legitimate if "*the others*" had control over it. Perhaps one of the few plusses from the increased donor involvement has been the increased focus by Africans on the state as a source of identity. The increased involvement of the IBRD and the IMF has prompted popular anti-BWI sympathy. Policies or institutional innovations on the initiative from foreign sources, especially the BWIs, are in general not perceived as being legitimate at least three reasons; i) The lack of accountability for policy outcomes; ii) Lack of consulting and consensus building in the policy formulation process; iii) Contradictions with what policy recommendations developing countries are prescribed and what developed countries themselves pursued historically;[130] and iv) Contradictions what the

[130] As I mentioned in subsection 2.2.2, today's rich countries all used selective industrial support and protectionist trade polices at an earlier stage of development. The message thus become; "Do as I say; not the

developing countries are prescribed and which policies the developed countries themselves pursue today.[131]

The differences between in legitimacy argument I have fronted between the two regions is summarised by:

- East Asian countries identified themselves with the states they were living in as compared to Africans were the state formation process was a legacy from colonial times.

- The government and the private sector were both accountable for the results of the economic policy in East Asia. In Africa, the state was not accountable under the ISI period, while the BWIs rendered themselves not to blame for the SAP from the 1980s despite being the main formulators of these policies.

- Institutional change in East Asia normally needed an element of internal pressure for it to do be successful. In Africa attempts of grass root levels initiatives were often thwarted either by the government of the IBRD (see subsection 2.1.3). Thus down-top institutional innovations were normally blocked, while the foreign sources of institutional change did not have much legitimacy rendering many of their reform attempts unsuccessful.

way I did it." Chang (2002) summarises this argument in his book, which his adequately called, "*Kicking away the ladder*".

[131] Often, infant industry protection and protectionist trade policies are still used by developed countries today. These are very often hidden. For instance how the US has been able to foster many high technological companies through government procurement of the military as a strategic sector, hence defending its policy by buying their goods from American producers. Another example could be some of the environmental and health standards of food products coming from the developing countries.

Conclusion

East Asia has had the fastest economic growth of all regions since 1960, while Africa has had the worst economic growth record of all regions in the same period. I have attempted to shed light on two questions during this thesis.

I. Which factors can explain the divergence in terms of economic performance between East Asia and Africa?

II. How can differences in the role of the government with regard to economic policies and institutions explain the growth divergence between East Asia and Africa?

There were three major sets of causes I have discussed; i) Structural; ii) Policies; and iii) Institutions. Given my focus on the role of the government it was natural to put the main weight on the policies and institutional causes.

Structural causes

The set of causes, which I termed structural causes, are to some degree independent of the government's actions. But at the same time they may enhance or limit the ability of the government to promote economic growth. The first of the structural causes I emphasised was geography and demography. There were three main causes which the literature mentioned which I found important:

I. Africa has a far higher degree of its land mass in the tropics relative to East Asia and is hence far more prone to these effects. This includes a heavy disease burden which increases individual and social costs and might reduce life expectancy.

II. East Asia has a far higher population density and access to waterways than Africa. The higher population density in East Asia might have increased the potential for economics-of-scale and scope and might have led to a more advanced division of labour which would increased the productivity historically relative to Africa. The higher access to waterways in East Asia decreased transportation costs and might thus potentially have increase trade which might facilitate increased division of labour and availability of

technology. Africa has been more hindered by natural large transportation costs due to the low degree of the region that borders sea or ocean-going rivers in the interior.

III. The growth of the working population in East Asia was higher than the general population growth from 1965 to 1990 leading to decreased costs due to less cost on education and pensions (declining dependency ratio) and at the same time boosting output by an increased availability of labour. This has been termed a "*demographic bonus*" for the part of East Asia. In Africa, however, the total population growth was higher than the growth rate in the working population from 1965 to 1990 leading to an increasing dependence ratio which due to the lack of economic growth led to great fiscal burdens. To follow the analogy of the previous term, I would label this a "*demographic drag*" for the part of Africa.

I have looked at other structural causes as well and found three of them in particular relevant:

I. *Colonial legacy*: The Japanese colonial legacy in northeast Asia might have led to a more favourable colonial legacy as compared with the European legacy in both Southeast Asia and Africa. This goes not only for the economic structure which was more focused on industry than other colonial legacies, but also the institutional legacy which left a far more exploitive state structure in Africa.

II. *Ethnic fragmentation*: This might have had some adverse effects for Africa such as; i) A reduced incentive to produce public goods; ii) Increased social and political instability; and iii) Increased transaction costs for conducting business.

III. *Primary goods dependence*: Africa has a far higher dependence on primary goods than East Asia; the latter has been able to exports vast amounts of industrial goods. This might have been important for at least three reasons; i) Primary goods seem to have more volatile prices and a long-term decline in prices; ii) Trade in manufacturing goods has expanded far greater the last 50 years than trade in primary goods; and iii) There seem to be higher learning externalities connected to the production of industrial goods rather than primary commodities.

All the structural aspects I mentioned have affected the effectiveness of policies and institutions. Some aspects are also more directly linked to the political process. I have mentioned two important aspects of how these structural aspects affect policies and institutions:

I. Geography and demography have made policies less effective in promoting economic growth in Africa than in East Asia. Different authors draw this line of reasoning to different levels. While Bloom & Sachs (1998) claim that almost 2/3 of Africa's weak growth performance is explained by geography and demography; Collier (1998) believes that the main causes for Africa's economic performance lay in policies and institutions.

II. The historical legacy of colonialism influenced the ethnic composition of the new states and which ethnic groups would be left with the political and/or economic power after independence. In Africa there seems to have been a correlation between whether a majority group has been in political power and pro-growth policies and minority groups were allowed to keep their economic wealth as long as they were no political threat. In East Asia this link is less clear. Governments were able to promote economic growth also in states where ethnic minorities where in power, such as in Taiwan.

III. The presence of a large primary goods sector and ethnic fragmentation is though be correlated with increased potential for ethnic conflicts. Africa could be more prone to political and social instability. Given the many episodes of political and social unrest in the region some of the potential conflicts became real. East Asia, though not spared completely for turmoil was less prone to such unrest and had far fewer episodes of political and social unrest.

IV. The political life in Africa is far more dominated by ethnic issues than ethnically heterogeneous countries in East Asia. Given this history of political organisation, ethnic issues thus become a far more troublesome issue in Africa, which might have increased some of the adverse effects of ethnical fragmentation.

Economic policy causes

There was a major shift in the economic paradigm from the 1950s until today. The first paradigm within developing economics, import substitution, dominated from the 1950s until around the mid 1970s. In general this approach did not deliver the desired results neither in Africa nor in those East Asian countries that adopted it. In general, import substitution economies in both regions were prone to macroeconomic difficulties which stemmed from inflationary pressures and balance-of-payment problems. A sub-set of five East Asian countries, Japan and the Tiger economies, instead actively promoted exports and were the fastest growing developing countries in the period until 1980. This gave the impression of an alternative strategy for development.

The second paradigm took over the mainstream in the mid 1970s, the neo-liberals, and emphasised macroeconomic stability, free markets and open economies with a strong scepticism against state intervention. The fast growing East Asian economies were interpreted as virtual free markets and open economies and it was though that this strategy would function in Africa as well. Other East Asian economies such as China, Malaysia, Indonesia, Thailand, and later on, Vietnam also started to liberalise their economies and actively promote their exports. They were all able to achieve considerable economic growth following the policy shift. The increased donor involvement from the IBRD and IMF through the stabilisation and SAP were attempts to impose neo-liberal policies on African countries. These attempts were in general very disappointing. The blame, however, was according to the IBRD and IMF not on the policies itself, but on the African governments that were supposed to implement them citing a "*lack of commitment*".

A host of scholars have criticised the neo-liberal approach. I have concentrated on only one of these academic groups and termed those who argue in favour of developmental states away from the neo-liberal paradigm for "*revisionists*". It was especially the characterisation of the East Asian economies as virtual free market and open economies that draw a lot of scepticism. Scholars like Johnson (1982), Amsden (1989) and Wade (1990) were able to show that the East Asian countries did use a high degree of state intervention and protectionism, which reluctantly has been accepted by the neo-liberals. The neo-liberals questioned the effects of industrial and trade policies and the debate of its working is still ongoing and unlikely to die any time soon. The revisionists have criticised the SAP since the neo-liberal policies did not take the historical or institutional preconditions in Africa into consideration.

The debate of the adequacy of neo-liberal policies in the African context is still ongoing, just as in East Asia.

To cover the various aspects of the economic policy, I have concentrated at three forms of policies which have been mentioned in the literature; i) Macroeconomic policies; ii) Industrial policies; and iii) Trade policies.

Macroeconomic policies were far more capable in East Asia relative to Africa. East Asian governments managed to keep a low and table inflation, debt levels at reasonable rates and kept the exchange rates "*realistic*" or undervalued. African government had a far more difficult time keeping the macroeconomic balance which was reflected by more volatile inflation, increasing debt levels and overvalued exchange rates. There is no doubt that one of the key failings of the ISI was the weak priorities given to macroeconomic stability. The macroeconomic stability that emerged in East Asia and the macroeconomic instability in Africa explains a considerable part of the growth differences between the two regions.

The **industrial policy** debate is vast and at times confusing since different authors emphasise different concept. My approach was to divide the debate into three main parts; i) Financial systems; ii) Learning and technology; and iii) Coordinating economic policies.

The first of the three industrial policy issues was financial systems and under import substitution a policy of repressed interest rates, called financial repression, was pursued in both regions. Financial restraint seemed to function better in East Asia than in Africa due to:

I. The higher economic growth in East Asia which facilitated increased liquidity to the system.

II. Increased rural presence of financial institutions in East Asia which helped the access to credit for many of the poor and increased their ability to save.

III. Africa financed a higher degree of public investment and often without conditionality attached to preferential loans, while East Asia more often financed private investments with a high degree of conditionality which facilitated more effective investments.

IV. The policies geared to the financial sector were to a higher degree coordinated with other economic policies in East Asia than in Africa.

In the period after 1980 many East Asian countries liberalised their financial systems. Africa also attempted to liberalise their financial systems through the SAP. The liberalisation process was however far more successful in East Asian relative to Africa: I would claim that there are at least four reasons for this outcome:

I. Liberalisation in East Asia was more custom-made to the needs of the individual economy while the reforms of the SAP were more universal "*one-shoe-fits-all*" solutions which to a lesser degree took country specific needs in Africa into account.

II. There was economic growth present in East Asia which facilitated increased liquidity to the financial sector, while this was not the case in Africa.

III. There was a far greater macroeconomic stability in East Asia relative to Africa which made the financial liberalisation more successful.

IV. East Asian governments were better than their counterparts in Africa in building the institutions that would facilitate a transition to more open financial systems.

There is a large ongoing debate regarding the nature of the financial systems reforms under the SAP and why they failed in Africa. Also the nature of the recent East Asian financial crisis is hotly disputed with some blaming faulty industrial policies while others claim that it was faulty liberalisation policies. A consensus that is emerging from the debate, however, is the need for strong institutions to allow the smooth functioning of financial systems.

The second of the three industrial policy issues was learning and technology. There seem to be three areas of consensus regarding the learning and technology arguments.

I. The first area of consensus is the vital role of human skills. East Asia started with a far larger base of human skills than Africa and was also able to build on this early advantage far better than Africa. The focus of studies was more adapted to the needs of

the manufacturing sector and the quality of education was far higher in East Asia relative to Africa.

II. The second area of consensus is that learning takes place at the firm level. Firms were far more capable to learn and innovate in East Asia than in Africa. Some would attribute to the increased availability of human skills and finance alone. Others will also emphasise the role of the state, which was far more effective in East Asia giving more relevant and direct support for the learning process of firms than in Africa. The role of direct industrial support, however, is debated and is often at the heart of the industrial policy debate. This debate is unlikely to die any time soon with evidence pointing in multiple directions. What both critics and sceptics of selective industrial support seem to agree on is that this support was far more effective in East Asia since there were a number of conditionality attached to this support such as export and production targets which meant that resources were more efficiently exploited and this gave incentives for technological upgrading. Also, there seems to be an agreement that the lack of effective conditionality or competitive pressure was much of the reason for why such selective industrial support failed in promoting an efficient utilisation of resources and facilitate a process of learning and technological upgrading in Africa.

III. The last area of consensus is that most technology is generated internationally. East Asia have had a stronger institutional framework to learn and diffuse technology through for instance reverse engineering and this might partly the higher success of this strategy for countries like Japan and South Korea. Foreign Direct Investments (FDI) played a more vital role for other East Asian countries, but to varying degrees. FDI in Africa, especially in manufacturing has been very scarce. The availability of technology has been higher for East Asia than for Africa. But it seems that lack of learning and technological upgrading in Africa to a large extent was a function of the weak national absorptive capacity rather than the availability of the technology per se. Also, the economic growth process and the upgrading of industrial and human skills in East Asia made more technologies available and thus the availability of technology was partly a function of economic growth.

The last of the three areas of industrial policy I covered was the coordination of economic policy. Normally, this goes for the complementary investment argument, but I extended the

argument to cover two vital elements of economic growth; i) Take-off; and ii) The continuation of economic growth. East Asia was able to achieve both. I emphasised three elements what made the East Asian take-offs qualitative different from those countries that managed to achieve them in Africa:

I. *The agricultural fundament*: In East Asia there was a large increase in the productivity of the agricultural sector which laid the necessary fundament for a sustained economic modernisation process; in Africa this did in general not occur and I believe this can be attributed to a combination of poor policies and geographic hardships.

II. *The growth vision*: East Asian countries managed to create challenging but realistic growth visions for their economies and were able to mobilise and coordinate investments and other resources to achieve these growth visions. In Africa growth visions were either unrealistic, non-consistent and/or frequently changing due to the frequent changes in leadership which all contributed to the lack of "*real*" growth visions might be vital to achieve economic growth from low stages of development.

III. *Institutional innovations*: In East Asia the institutional innovations that were needed for the economic take-off were often given a "*local flavour*" so they would not be too far away from the local environment thereby achieving more legitimacy and the institutions were more adapted to the local needs which enhanced the workings of the institutions in question. African institutional innovations often lacked a certain degree of local embeddeness which made these institutional innovations less legitimate and less adapted to the African context. At least equally important were the rapid shifts in institutions which often followed shifts in the political leadership which often led to those institutional innovations became a source of uncertainty rather than its decrease.

Maintaining growth might be more difficult than the initial take-off which might be shown by the fact that many developing countries have had short growth spurts without being able to maintain this growth over longer periods. I believe that four elements account for much of why East Asia has been able to maintain a high growth rate over a longer sustained period:

I. The role of coordinating institutions to secure a more cohesive economic policy.

II. Governmental learning with feedback mechanisms with the private sector which helped forming a pragmatic policy in a process of "*learning-by-doing*" by policy makers

III. Structural changes were dealt with by compensating so-called "*declining industries*" so they could restructure or lend them liquidity in times of short-term distress

IV. The role of binding institutions such as property rights and the rule-of-law which shows that government had a credible commitment to economic growth by reducing its own power thereby potentially increasing entrepreneurial activity.

I believe that the continuation of the lack of economic growth in Africa for a large part was explained by.

I. The lack of coordination in the state sector with a fragmented decision structure and unclear responsibility across departments.

II. African states have been plagued by frequent changes in power and policy reversals which have left a legacy of a "*stop-and-go*" policy which increased the transaction costs of economic activity by increasing uncertainty.

III. The lack or the underdevelopment of binding institutions such as property rights or the rule-of-law has left the government as a non-reliable partner since they were not perceived to be committed to economic growth.

The last of the three economic policy causes which have been looked at are **trade policies**. Until the 1970s import substitution industrialisation (ISI) meant that; i) Imports were to be substituted with domestic production; ii) Overvalued exchange rates would facilitate increased imports; and iii) Increasing trade barriers were set up to prevent balance-of-payment problems. In Africa the ISI strategy was not sustainable due to:

I. Increased macroeconomic difficulties due to an increasing BoP deficit and increasing inflationary pressure.

II. High levels of protectionism and economic planning led to a highly inefficient industrial sector.

III. Small home markets reduced the potential for home-market led development even further in Africa and implementation problems due to a weak state capacity increased some of the adverse effects.

Some of these effects were shared by the implementers of the IS strategy and planned economies in East Asia. But, Japan and the FGT were able to grow faster than other developing countries. Other fast growing East Asian countries started to copy the trade policy of the first movers countries from the 1970s and onwards. The trade policy had three major characteristics which remained more or less the same until today:

I. There was an active promotion of exports, especially in industrialised goods. There was a focus on fostering international competitive industries with high earning potentials.

II. Trade policies were often strategic in the sense that they supported sector specific needs and protected sectors that were not ready for international competition. Often trade policies were seen as a small part of a larger economic policy

III. There was a high degree of institutional support for exporters, for instance through the Trade Promotion Centres.

From the 1980s and onward the East Asian trade policies followed along similar lines as before, but the African trade policy changed dramatically. There were attempts to follow a more export-led development, but there were large qualitative differences with East Asia:

I. There was a substantial import liberalisation following the SAP, but the anti-export bias remained in many countries. This led to increased import competition, without the same possibilities for export increases.

II. Trade policies were adopted universally across all sectors bypassing sector specific needs giving less attention to the technological upgrading of the export sector.

III. The institutional support to support an export-promotion strategy were lacking in Africa.

The broad differences between the trade policies in the two regions can be summarised as:

- Africa, to a far larger extent than East Asia, was prone to "*academic fashions*" going the whole line from ISI to an open economy strategy. East Asia's trade policies were more independent from such fashions and to a higher degree the policies that were deemed most beneficial for their economies were pursued.

- East Asian governments to far larger extent were able to take sector specific needs into account when forming their industrial policies since trade policies only was a smaller part of a larger coherent economic policy. The SAP did not take sector specific needs into account since neutral market incentives would make the most efficient firms prosper, but many of the African companies were instead out-competed as imports increased faster than exports.

- The institutional support framework in East Asia, even in the liberal trade regime of Hong Kong, was far stronger than in Africa. There was no apparent strategy for upgrading the institutional framework for supporting exports in Africa within the SAP, making the export-promotion strategy a more daunting challenge.

Institutions

I have chosen to define institutions according the old institutional theory closer to the term "*social codes*", rather than the new institutional theory "*agents of restraint*". A reason for my choice is that institutions have synergy effects and need to be analysed in their social context to be able to make a meaningful assessment. Thereby a term like legitimacy becomes vital in the understanding of institutional change. I have emphasised three institutional explanations; i) Technological; ii) State capacity; and iii) Social embeddedness.

Firms in East Asia have shown a far higher ability to master new technologies with the state, universities and public research institutions all playing important supporting roles in a well integrated NSI network relative to Africa. In Africa, in addition to having a weak and

fragmented NSI network at the outset of the period, have experienced declining funding of these institutions during the SAP era reducing their ability to learn and master new technologies. Also human skills play a crucial role in the functioning of the various elements of the NSI and there integration. The higher human skills in East Asia gave them a major advantage over Africa. In addition, other policies that supported the wider functioning of the NSI framework, such as competition rules and the financial system were far more supportive of firms in East Asia than in Africa.

The second institutional explanation regards the state capacity where it looks at state's ability to set the agenda, formulate and implement economic policy. The effects of other sources of influences and the ability to resist pressures thus become significant. I covered three levels. The first was at the international level. It is clear that East Asia has been far more autonomous than Africa in choosing their own policies. In addition some countries got US support during the Cold War through preferential market access and were very skilful diplomats in international trade negotiations. Africa seems to have lost more of its autonomy, especially after the 1982 debt crisis and the end of the Cold War in 1990 which increased the foreign financial dependence. The second level covered the internal capacity of the state. East Asia had; i) Pilot agencies consisting of highly skilled technocratic economic planners; ii) A competent and efficient bureaucracy; and iii) Efficient decision making bodies with stable and continues policies. Africa, on the hand, had; i) A low bureaucratic capacity; ii) An inefficient decision making-body with unstable and frequently changing policies; and iii) Increased donor involvement in the national policy-decision weakening the internal political institutions and which also led to decreasing funds for the bureaucracy. The final level was the influence of domestic political forces on the state's policies. The "*public choice model*" predicts a capture of the state by vested interests. In East Asia, though, this seems not to have happened. Instead, the state has been able to consult the private sector in the policy formulation process without being captured by it. This is closer to Evans' (1995) concept of "*embedded autonomy*". In Africa as well, there seems to be little evidence that urban coalitions have captured the state. As a matter of fact, there seems to be more evidence that the state has been captured by vested foreign, rather than domestic interests in most African countries. The BWIs have increasingly become entangled in the domestic political process since the initiation of the SAP blocking alternatives to the neo-liberal policies.

The third institutional explanation looks at the state's social embeddedness in society which comprises of more than their mere economic role. Regarding conflict management East Asian governments have been able to maintain social stability which is partly interlinked with economic growth. There were a host of means, for instance protectionist measures to protect farmers. Many have criticised such practice since it was economic inefficient. But, they often tend to forget the bigger picture that these reforms did not look for the optimal economic solutions, but the most optimal social solution. Economic growth is crucially dependent on social stability and non-economic factors such as social stability are imperative. Africa has had more conflicts than any other region in the world and the lack of economic growth certainly plays a large role. The state often did not have the capacity to deal with these conflicts and was very often the source of conflict itself. This brings me over to the second aspect of social embeddedness, namely legitimacy. The East Asian governments were perceived as being far more legitimate than their African counterparts due to a higher accountability and the ability to better align institutional change close to the pre-existing institutions. In addition, the increased foreign involvement is even less legitimate in the eyes of many Africans and this has contributed in making foreign policy "*recommendations*" very hard to implement. Institutional change, just like policies, need to come from a reliable source. The BWIs don't have much legitimacy in Africa, especially through their lack of accountability for the results of their own policies, and have become less and less legitimate as a source for institutional and policy change over time.

Putting the threads together

There is no doubt that the evidence is abundant enough to support the claim that Africa had more difficulties from the outset in achieving economic growth than East Asia due to a number of causes such geography, demography and the burden of history. Government polices may therefore have had less effect in affecting economic growth in Africa than in East Asia due to these causes. But, there is a limit to such an explanations and growth episodes in Africa show that geography is not destiny.

Economic policies have varied in both regions throughout the period. The debate has mainly been between the neo-liberal policy recommendations and the structural schools of thought I have covered in this thesis, which I termed the revisionist. The evidence, which policy promotes economic growth, is mixed. The neo-liberals seem to have their strongest arguments with; i) The differences in macroeconomic stability; ii) Economic growth in East Asia driven

by private investment, while Africa had a high degree of public investment; and iii) The high export growth in East Asia and the lack of such in Africa. Some of the counterarguments from the revisionist have most validity in explaining: i) The learning and technology upgrading process in both regions; ii) Strategic industrial and trade policy in East Asia; and iii) The role of the bureaucracy and pilot agencies in East Asia and their lacking quality in Africa. The role of the financial systems is still disputed and it's not evident which "*camp*" has the "*best*" evidence. All in all it's difficult for one school to claim superiority over the other since the evidence is mixed. I still believe the revisionists have somewhat huger validity in arguing for country specific rather than the more universal neo-liberal solutions. Developing countries seem to have different needs than developed countries, something that also has been acknowledged by the WTO when arguing for preferential trade agreements for the least developing countries. But, at the same time, since the policy recommendations are country-specific the policy recommendations become somewhat less clear which might historically have weakened the revisionist position politically due to less clear messages than the neo-liberals. In all the role of policies in the East Asia growth process was, nevertheless, far more efficient, consistent, stable and transparent than in the African case. The SAP in Africa has contributed rather than to resolve this situation. A large mistake in the formulation of the SAP was that all state intervention was seen as undesirable, leading to a weakening of the state and its ability to formulate policies and build institutions which would support economic activity.

Institutional explanations gave a far clearer message than the economic policy I reviewed. The institutional explanations I have covered have shown a far more favourable institutional climate for East Asia than for Africa. As Haggard (2004) mentioned, one should be cautious when analysing institutions. The biggest error could be to assume that when economic growth takes place, the institutions are automatically "*good*". Also, it makes one wonder what is a neutrally "*good*" institution. All three institutional explanations emphasised the decreasing institutional support since the initiation of the SAP in Africa. It also emphasised that the technological support, the state capacity and the social embeddeness of the state all were greater in East Asia prior to the SAP as well, explaining a large part of the growth difference. Technological institutions lost funding during the SAP and have weakened the African economies ability to be able to catch-up technologically. Another large mistake in the SAP era was the undermining of African political institutions, given foreigners more political influence in Africa. Political autonomy is a necessary, but in it self insufficient condition for economic growth. The conditioanlities and the creations of binding rules for African

governments would have been valid in so far the neo-liberal economic policy recommendations were far superior to other recommendations. The evidence, as I reviewed above, is far from conclusive, but more country-specific policies seemed to have played a large role in East Asia. Autonomy is needed to pursue such country-specific policies. The lack of accountability also has made the BWIs policy "*recommendations*" less legitimate, thereby lowering the implementation of their policies.

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Appendix #1

Sub-Saharan Africa

Angola	Kenya*	Saint Helena
Benin	Congo	Sao Tome
Botswana*	Congo, DR (Zaire)*	Senegal
Burkina Faso	Lesotho	Central African Republic
Burundi	Liberia	Seychelles
Comoros	Madagascar	Sierra Leone
Djibouti	Malawi	Somalia
Cote D'Ivoire	Mali	Sudan*
Equatorial Guinea	Mauritania	South Africa*
Eritrea	Mauritius	Swaziland
Ethiopia*	Mayotte	Tanzania*
Gabon	Mozambique	Chad
Gambia	Namibia	Togo
Ghana	Niger	Uganda
Guinea	Nigeria*	Vest Sahara
Guinea Bissau	Reunion	Zambia
Cameroon	Rwanda	Zimbabwe
Cape Verde		

East Asia

Philippines*	China*	Singapore
Hong Kong, China	Laos	South Korea*
Indonesia*	Malaysia	Taiwan, China
Japan*	Myanmar (Burma)	Thailand*
Cambodia	North Korea	Vietnam*

The countries that are marked are the common reference countries in tables in so far there is data available. In tables aggregate figures plus figures for the seven most populous African countries plus Botswana and the seven most populous countries in East Asia based on the population statistics by Maddison (2001) for the year 2000. In that way the figures are most relevant since they affect such high proportions of the populations of the regions. Botswana is the only exception to the rule since I will touch upon the Botswana example numerous times during my discussions. The seven most populous countries in East Asia amount for 93.8 % of the regions total population in 1950 and this figure was stable during this period and amounted 93.2 % in the year 2000. The share of the eight African countries was 52.9 % of the region's total population in 1950 and this figure was also relatively stable and amounted to 54.1 % in 2000.

Appendix #2 – HDI index

Table HDI Index						
	Rank 2003	HDI index value 2003	Expected life expectancy at birth 2003	Share of adults with reading and writing abilities 2003	School attendance at primary, secondary and tertiary level 2003	GDP per capita (PPP) 2003
Japan	11	0,943	82,0	-	84	27.967
Hong Kong	22	0,916	81,6	93,5	74	27.179
Singapore	25	0,907	78,7	92,5	87	24.481
South Korea	28	0,901	77,0	97,9	93	17.971
Seychelles	51	0,821	72,7	91,9	85	10.232
Malaysia	61	0,796	73,2	88,7	71	9.512
Mauritius	65	0,791	72,2	84,3	71	11.287
Thailand	73	0,778	70,0	92,6	73	7.595
Philippines	84	0,758	70,4	92,6	73	7.595
Kina	85	0,755	71,6	90,9	69	5.003
Cape Verde	105	0,721	70,4	75,7	73	5.214
Vietnam	108	0,704	70,5	90,3	77	4.230
Indonesia	110	0,697	66,8	87,9	66	3.361
South Africa	120	0,658	48,4	82,4	78	10.346
Equatorial Guinea	121	0,655	43,3	84,2	65	19.780
Gabon	123	0,635	54,5	71,0	74	6.397
Namibia	125	0,627	48,3	85,0	71	6.180
Sao Tome	126	0,604	63,0	83,1	62	1.231
Myanmar	129	0,578	60,2	89,7	48	n.a.
Cambodia	130	0,571	56,2	73,6	59	2.078
Botswana	131	0,565	36,3	78,9	70	8.714
Comoros	132	0,547	63,2	56,2	47	1.714
Laos	133	0,545	54,7	68,7	61	1.759
Ghana	138	0,520	56,8	54,1	46	2.238
Sudan	141	0,512	56,4	59,0	38	1.910
Congo	142	0,512	52,0	82,8	47	965
Togo	143	0,512	54,3	53,0	66	1.696
Uganda	144	0,508	47,3	68,9	74	1.457
Zimbabwe	145	0,505	36,9	90,0	55	2.443
Madagascar	146	0,499	55,4	70,6	51	809
Swaziland	147	0,498	32,5	79,2	60	4.726
Cameroon	148	0,497	36,3	81,4	66	2.561
Lesotho	149	0,497	36,3	81,4	66	2.561
Djibouti	150	0,495	52,8	65,5	24	2.086
Mauritania	152	0,477	52,7	51,2	45	1.766
Kenya	154	0,474	47,2	73,6	52	1.037
Gambia	155	0,470	55,7	37,8	48	1.859
Guinea	156	0,466	53,7	41,0	41	2.097
Senegal	157	0,458	55,7	39,3	40	1,648
Nigeria	158	0,453	43,4	66,8	64	1.050
Rwanda	159	0,450	43,9	64,0	55	1.268

Angola	160	0,445	40,8	66,8	30	2.344
Eritrea	161	0,444	53,8	56,7	35	849
Benin	162	0,431	54,0	33,6	55	1.115
Cote D'Ivoire	163	0,420	45,9	48,1	42	1.476
Tanzania	164	0,418	46,0	69,4	41	621
Malawi	165	0,404	39,7	64,1	72	605
Zambia	166	0,394	37,5	67,9	48	877
Congo, DR (Zaire)	167	0,385	43,1	65,3	28	697
Mozambique	168	0,379	41,9	46,5	43	1.117
Burundi	169	0,378	43,6	58,9	35	648
Ethiopia	170	0,367	47,6	41,5	36	711
Central African Republic	171	0,355	39,3	48,6	31	1.089
Guinea Bissau	172	0,348	44,7	39,6	37	711
Chad	173	0,341	43,6	25,5	38	1.210
Mali	174	0,333	47,9	19,0	32	994
Burkina Faso	175	0,317	47,5	12,8	24	1.174
Sierra Leone	176	0,298	40,8	29,6	45	548
Niger	177	0,281	44,4	14,4	21	835

N.a. stands for not available)
Source: Human Development Report 2005 s. 219-222

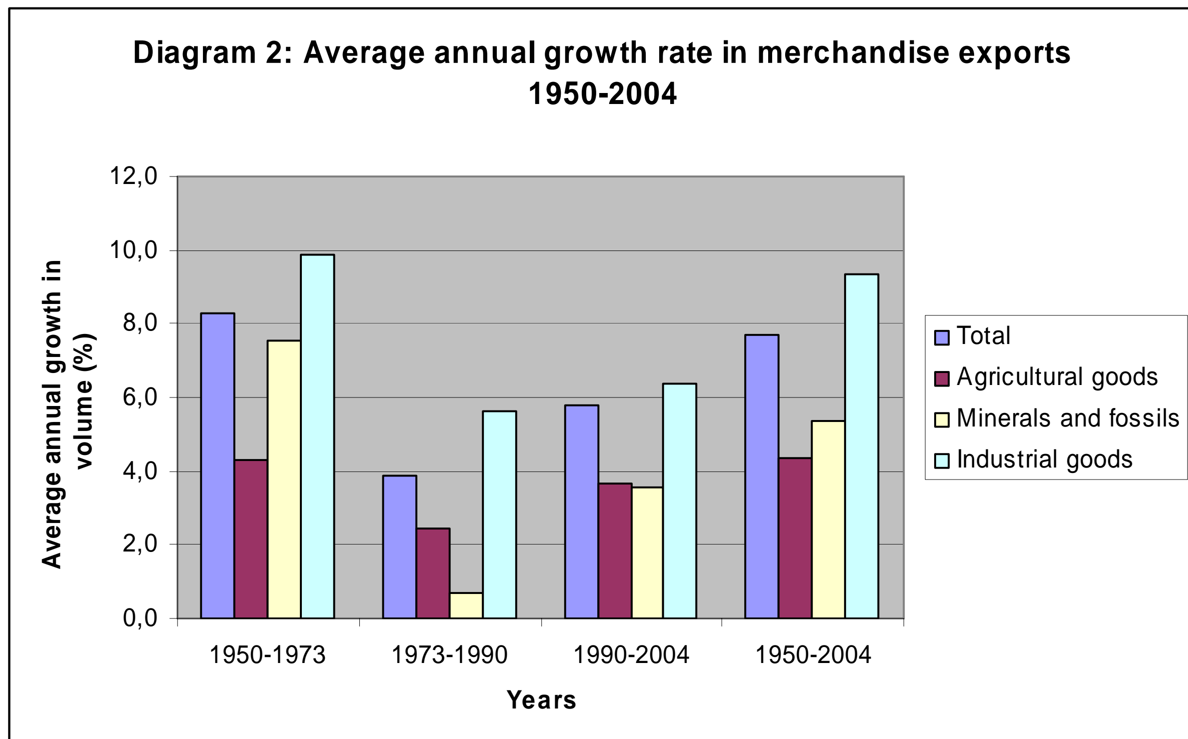
Appendix #3 – Ethnic Fragmentation (EF) index

Table EF index			
	EF index value	*Ranking*	*Region*
Congo DR	0,885	1	Sub-Saharan Africa
Uganda	0,883	2	Sub-Saharan Africa
Kenya	0,877	3	Sub-Saharan Africa
South Africa	0,873	5	Sub-Saharan Africa
Cameroon	0,852	6	Sub-Saharan Africa
Mali	0,844	7	Sub-Saharan Africa
Philippines	0,838	8	East Asia
Nigeria	0,827	9	Sub-Saharan Africa
Tanzania	0,827	9	Sub-Saharan Africa
Cote D'Ivoire	0,826	11	Sub-Saharan Africa
Mauritius	0,814	13	Sub-Saharan Africa
Zambia	0,813	14	Sub-Saharan Africa
Chad	0,810	15	Sub-Saharan Africa
Guinea-Bissau	0,806	16	Sub-Saharan Africa
Senegal	0,778	20	Sub-Saharan Africa
Madagascar	0,776	21	Sub-Saharan Africa
Angola	0,771	22	Sub-Saharan Africa
Gabon	0,765	24	Sub-Saharan Africa
Gambia	0,764	25	Sub-Saharan Africa
Central African Republic	0,757	26	Sub-Saharan Africa
Ethiopia (pre may 1993)	0,756	27	Sub-Saharan Africa
Indonesia	0,754	28	East Asia
Liberia	0,745	30	Sub-Saharan Africa
Ghana	0,742	31	Sub-Saharan Africa
Guinea	0,741	32	Sub-Saharan Africa
Burkina Faso	0,734	35	Sub-Saharan Africa

Mozambique	0,727	36	Sub-Saharan Africa
Ethiopia (post 1993)	0,717	38	Sub-Saharan Africa
Sudan	0,715	39	Sub-Saharan Africa
Eritrea	0,699	43	Sub-Saharan Africa
Malaysia	0,694	44	East Asia
Malawi	0,691	45	Sub-Saharan Africa
Togo	0,689	46	Sub-Saharan Africa
Congo Brazzaville	0,685	48	Sub-Saharan Africa
Niger	0,671	53	Sub-Saharan Africa
Namibia	0,663	59	Sub-Saharan Africa
Mauritania	0,660	61	Sub-Saharan Africa
Benin	0,660	61	Sub-Saharan Africa
Djibouti	0,585	78	Sub-Saharan Africa
Cape Verde	0,551	89	Sub-Saharan Africa
Thailand	0,535	95	East Asia
Zimbabwe	0,522	100	Sub-Saharan Africa
Myanmar	0,520	101	East Asia
Singapore	0,479	116	East Asia
Sao Tome and Principe	0,420	129	Sub-Saharan Africa
Botswana	0,418	130	Sub-Saharan Africa
Equatorial Guinea	0,395	137	Sub-Saharan Africa
Vest Sahara	0,343	144	Sub-Saharan Africa
Vietnam	0,262	163	East Asia
Burundi	0,258	164	Sub-Saharan Africa
Somalia	0,256	165	Sub-Saharan Africa
Lesotho	0,253	172	Sub-Saharan Africa
Komorene	0,241	173	Sub-Saharan Africa
Cambodia	0,238	175	East Asia
Swaziland	0,186	185	Sub-Saharan Africa
China	0,125	202	East Asia

Seychellene	0,115	205	Sub-Saharan Africa
Macao	0,096	211	East Asia
Japan	0,079	216	East Asia
Taiwan	0,039	228	East Asia
Hong Kong	0,039	228	East Asia
Mayotte	0,020	231	Sub-Saharan Africa
Korea, North	0,004	239	East Asia
Korea, South	0,002	240	East Asia
Source: Yeoh (2001)			

Appendix #4 – Increase in world trade



It's worth nothing at least three points from the diagram. Firstly, there has been an high growth rate in world trade in the whole period from 1950 to 2004, in excess of 7 % annually; and growth rate was the highest in the period from 1950 to 1973 when it exceeded 8 % annually. Secondly, in all periods the growth in industrial goods has been higher than for primary goods in all periods and driven most of the increase in world trade. Industrial export growth was especially high in the period from 1950 to 1973 when it laid close to a annual growth rate of 10 %. Finally, there are large variations between periods with regard to the growth rate of minerals and fossils as well as agricultural goods. This has made the reliance on such goods for the majority of ones export income has lead to difficulties for those countries with such dependence. The annual growth in minerals and fossils declined from 7 % in the period 1950 to 1973 to less than 1 % in the period 1973 to 1990. Such a major decrease of course is related to the oil price shocks, but oil alone cannot explain the whole drop in yearly growth rates.

Appendix #5 – Enrolment in Sub-Saharan Africa

Figure A5.1: Gross enrolment ratios in Africa 1960 – 1995

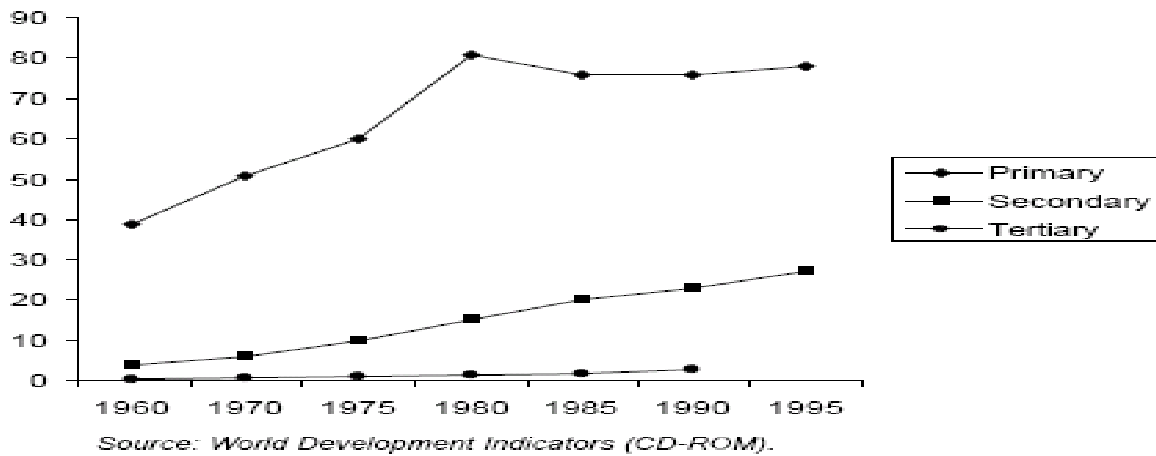
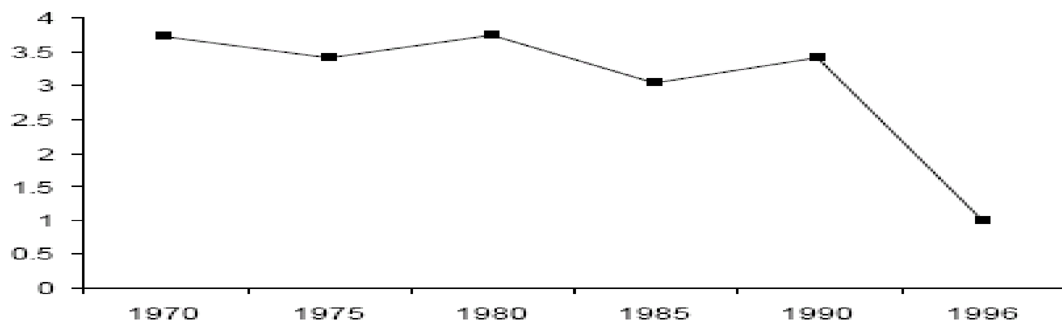


Figure A5.2: Public Expenditure on Education as a percentage of GDP, 1970 to 1996



Source: ADEA, Statistical Profile of Education in Sub-Saharan African, 1999.

Figure A5.3.1: Government Expenditure on Primary Education per student in Sub-Saharan Africa (constant 1990 US$)

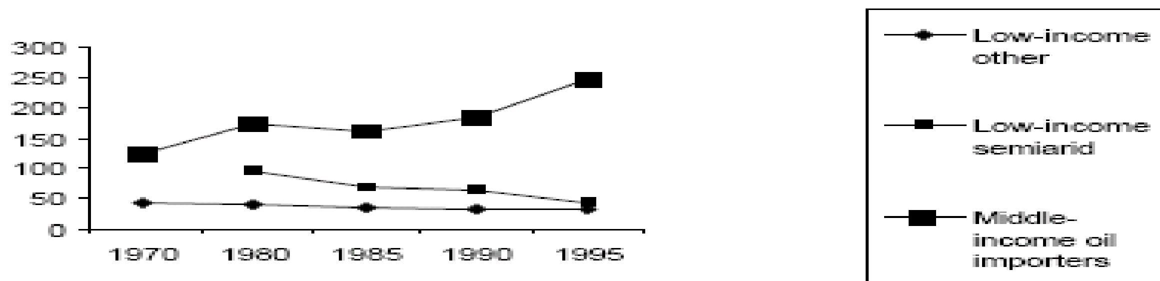


Figure A5.3.2: Government Expenditure on Secondary Education per student in Sub-Saharan Africa (cost in constant 1990 US$)

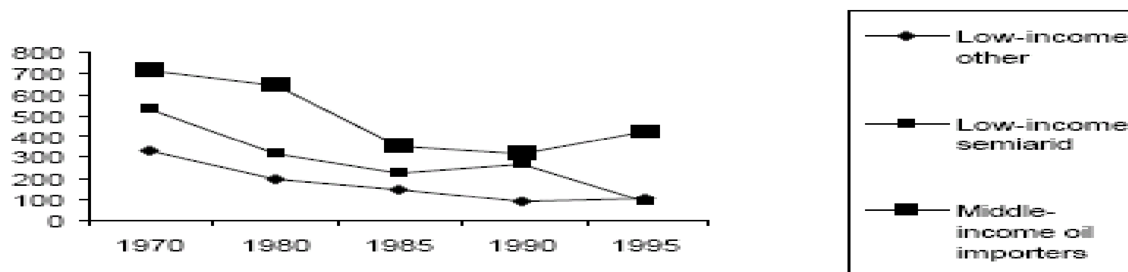
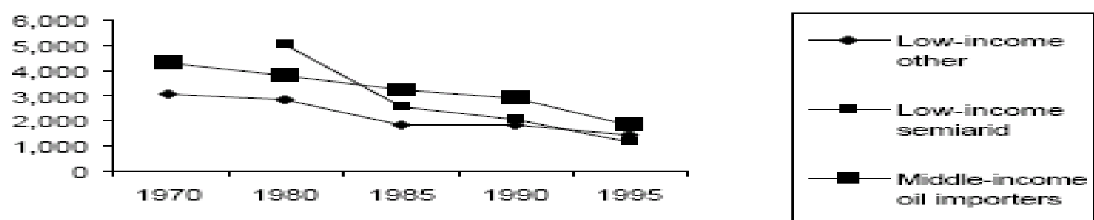


Figure A5.3.3: Government Expenditure on Tertiary Education per student in Sub-Saharan Africa (constant 1990US$)



Source: ADEA, Statistical Profile of Education in Sub-Saharan African, 1999.