

# Constraints on growth and investment in East Africa: firms, labour and transformation

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# What have we learned about successful growth leading to poverty reduction?

- 30 years of above 7% growth = success (Growth Commission, 2007)
- Two key ingredients – without a clear recipe on how to achieve them:
  - A **growth** process that succeeds in being inclusive of poorer groups via **labour absorption** into **better, higher productivity jobs and activities**
  - **Functioning social sector systems**, delivering basic health, education, security and basic protection for the **poorest, as well as skills for economy**
- Even if unclear about recipe, the necessary utensils to cook the dish:
  - An **effective state**, functioning in way that **allows economic growth** and **foster social sector systems**
  - A politics in which **leaders and elites are committed to growth** and poverty reduction

# 1. Inclusive Growth

# Theory of growth and inclusion

- Growth theory and empirics: focus on misallocation within and across sectors (Klenow, Hsieh)
  - Growth as reallocation as moving from less productive to more productive activities within and across sectors; “dual economy” “structural transformation”
  - If more reallocation of (low skilled) *labour*, the **faster poverty reduction** (e.g. Eswaran and Kotwal, 1991) (as the poor “have but their labour to sell” (Marx)).

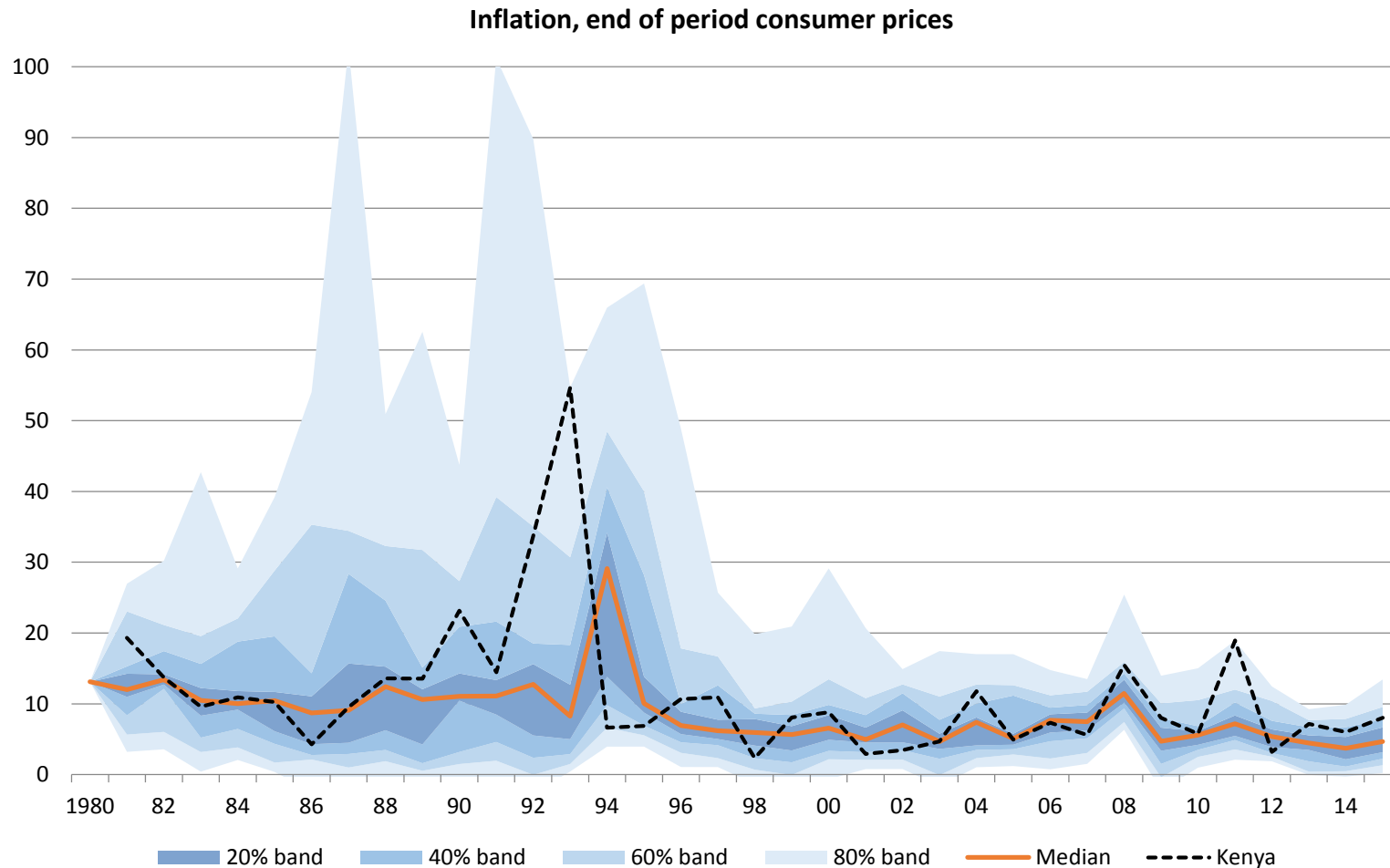
# Experience?

- (Probably) broadly consistent with East-Asian experience:
  - growth in urban, tradable manufacturing, absorbing labour from informal and rural
  - fast poverty reduction driven via expanding job opportunities.
- Note prediction (Lewis): not necessarily fast reduction of poverty in urban areas (not clear what happens to real wages), but definitely reduction of rural poverty in process
  - Consistent with e.g. China evidence or more recently Bangladesh
- Not quite the East African/Kenyan model
  - Not high enough growth
  - Not manufacturing
  - Not 'inclusive' in terms of fast labour absorption

# How to get growth? Some ingredients

- Reallocation is about investment
- Investment is about long(ish) time horizons, about risk as well as trust
- Role of the state? Role of politics?
- Role of macroeconomic stability

# Transition to Macroeconomic Stability (SSA)



- Substantial improvements in macroeconomic stability
- In 1987 and 1991, the worst 10% of countries had inflation over 100%
- In 2014, 90% of countries had inflation under 10%.
- Kenya fluctuating around mean but drifted above

# How to get growth? Some ingredients

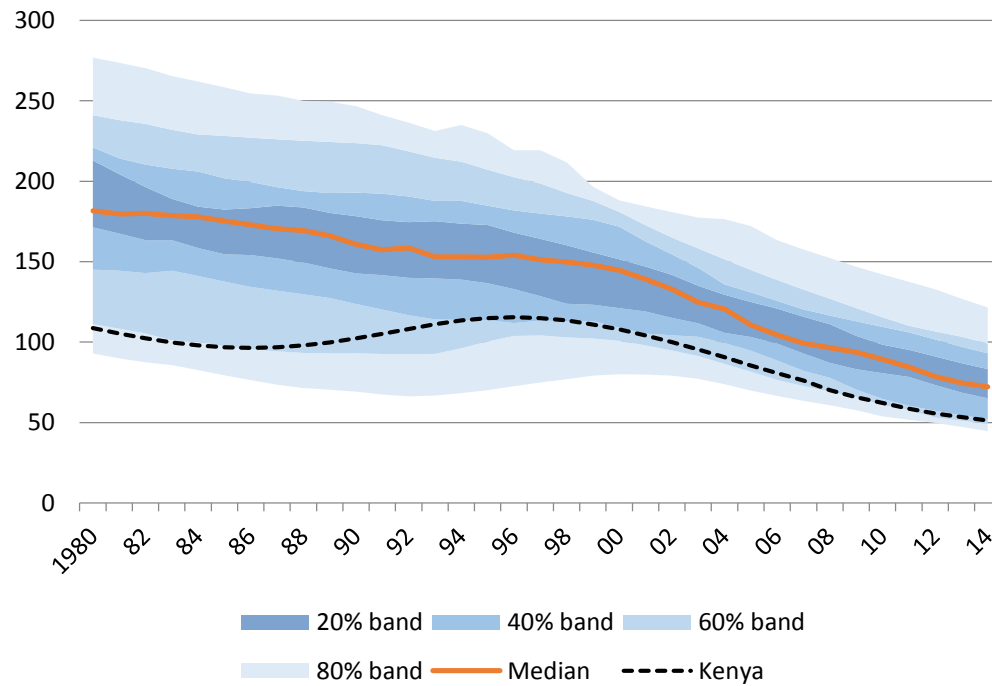
- Reallocation is about investment with structural change
- ? Agriculture? Manufacturing?
- From lower to higher productive activities, within and across sectors
- Don't be fooled by national accounts definitions of 'sectors'
  - "services" versus "manufacturing"?
- Tail of low productivity, within sectors, even within product categories
  - Strong argument to be made for 'exportable' goods --- exposed to international prices/competition (Kenya has quite good record here)
  - Strong arguments for "middle manufacturing"



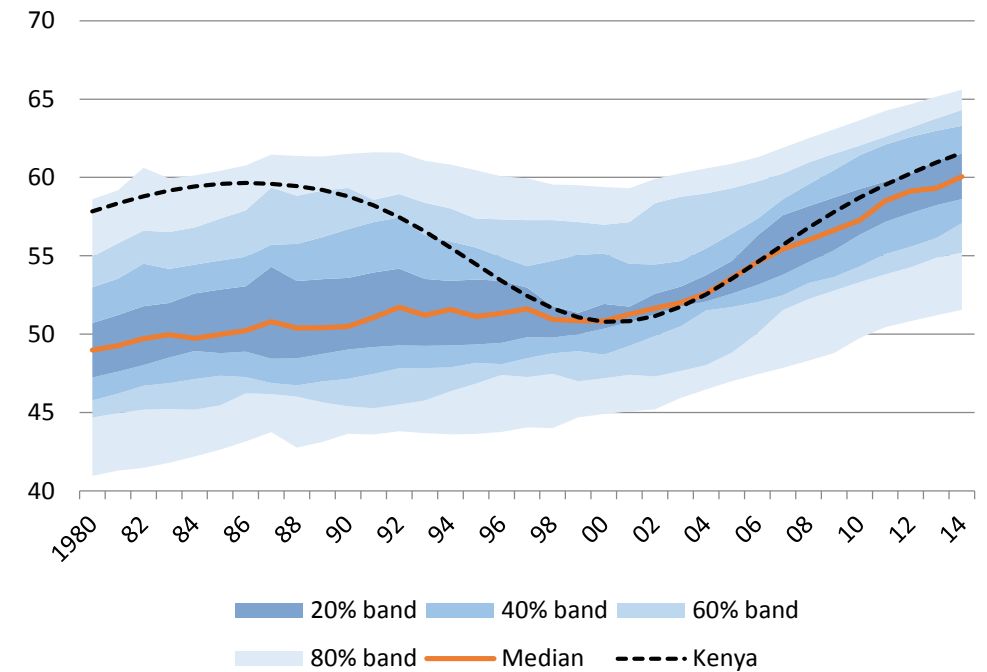
## 2. Functioning social sector systems and basic protection

# Kenya: health

Mortality rate, under-5 (per 1,000 live births)

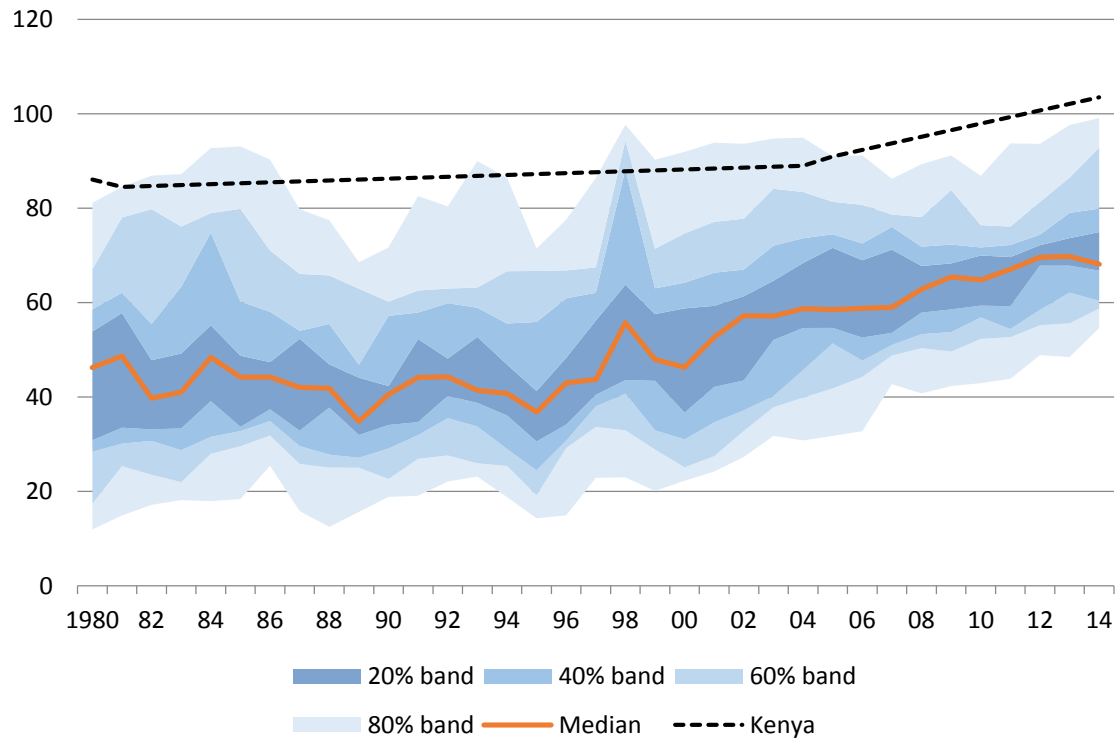


Life expectancy at birth, total (years)

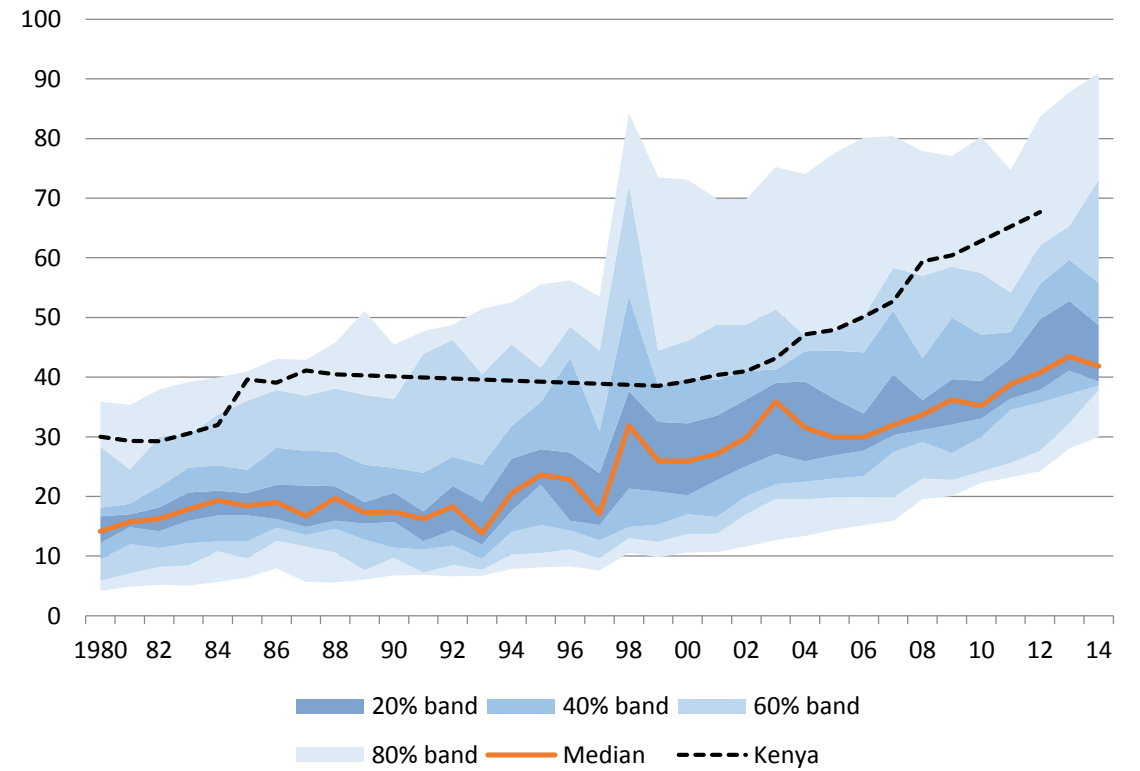


# Kenya: education

Primary completion rate, total (% of relevant age group)



Gross enrolment ratio, secondary, both sexes (%)



# Role in growth? Cannot do it on its own...

- Role of growth and labour market in growth as reallocation
  - Best policies probably not about labour market itself (Fields, WDR 2012). Job need to be offered by the economy. Labour market policies cannot create these, beyond e.g. regulatory reform.
  - **Labour demand** (by firms in more productive activities) is the main constraint – not labour supply characteristics (skills and human capital).
  - Limited to what ‘skills programmes’ can do.
  - Matching issues – often not quite a ‘education’ or ‘training’ issue
- Role of human capital of the poor (and therefore social sectors)
  - In the poorest settings, definitely provides means for poor people to be more included in growth process, but less clear that it will drive growth or drive job creation.
  - In both: social sector outcomes have **value in themselves** (not just for incomes)
  - But in themselves usually **not enough to create the opportunities**

# Health, Education, Social Protection Systems

- It won't drive growth, but can fuel it, and definitely help with inclusion
- Relevant for state of society and economy
- Strong systems, affordable to state and society to be sustainable

... effective state required....

# Wage costs matter?

## Kenya

- Average incomes considerably higher (of course, very long tail of low earnings)
- Unions in formal sector relatively strong
- Long history of private formal sector wage employment
- \$4-5/day?
- Retention issues?

## Ethiopia

- Urban population considerably poorer than Kenya
- Limited formal private sector wage employment
- Limited unionisation – highly flexible labour market (informal and formal wage sector roughly similar earnings – Blattman and Dercon, 2016)
- ? \$2-3 a day
- Low end labour market retention issues

**But in both countries wage only fraction of costs**

# 3. Effective state

# Some ingredients...

- Effective state... not really about market versus the state,
- but what is the state for?
- In Africa, lots of images of the state



Many claim they want to be Tigers



# Predatory States

States seem to be designed to extract and plunder from people and the economy

Like a Tiger Fish: living from eating little fish



# Predatory State par excellence...: DRC...

## Mobutu – the Master:

- Article 15 of the Constitution “Débrouillez-vous” (get it while you can)
- “If you must steal, then steal a little bit and leave the rest for the nation.”

## Current tax and regulation:

-DRC: lots of taxes (and rules).

- coffee exports from Matadi need 57 signatures and 7 stamps;
- goods travel on the Congo river 17 permissions;

-VAT: change business taxation – by 2014 more refunds than receipts...

# Failing States

- Violent
- Eating the scraps; scavenging economies
- States or regions in conflict... Somalia, South Sudan, ...



## (Illiberal) State-Builders

*A class of countries with leadership with genuine ambitions in state building and development...*

### *Roaring lion*

Often emerged from victory in conflict, stable with monopoly of violence

Modernist, developmentalist ideology, beyond redistributive to particular group:

Strong structures, military or political, strong leaders

Quite effective in delivery of development

**Legitimacy seeking through development, even though no question of their authority**



# Neo-Patrimonial States

Redistributive state: resources to followers for loyalty

Mix of 'modern' and patrimonial/personalised...

**“ship not seeking to go anywhere but simply staying afloat”** (temp alliances, ethnic coalitions and manipulation of electoral systems)

a bit like *a floating hippo*: pretty stable, seemingly too big, unclear what its aim is but potentially pretty dangerous too...

But no interest in change, in transformation but just reproduction of relative dysfunctionality (even predatory) behaviours

not effective states, but marginal improvements possible ---



# Neo-Patrimonial States

- They also lead to interlinked business-state relations
  - “private sector” is not an independent player
  - But thrives on connections, benefits from the state
    - E.g. favourable trade regimes
    - Controls and interventions; exemptions of tax and rules
    - More direct: procurement etc.
  - Harder to offers entry, innovation or reallocation
- Progress possible – but slow

Uganda: patrimonial, but pockets of excellence:

- commitment to growth as essential part of ‘deserving’ loyalty by voters plus requirements to deliver patronage – space for growth
- But e.g. handled oil deals quite well...
- Political incentives? Need resources to be able to buy alliances for election, need to deliver some public goods,...
- But comes at a growth premium



4. Implications for economic policy?



# Can one 'change' the economy? Say, foster industrialisation?

- Require serious long-term political commitment of leaders and elite – even though there are easier sources of short-term rents for politics
- Providing incentives within the state for real delivery – overcoming collective action/coordination failures
  - Goes beyond 'state-led' or 'market-led'
  - Beyond elections
  - Examples in East-Asia, China, but also Bangladesh?
- But extremely difficult in countries with lots of natural resources:
- Fundamental governance challenge: why try to get growth if financing elite is easy in other ways
  - Nigeria, DRC, Angola
- But also difficult in states in which politics is about persistently needing to do 'deals' to keep all in the tent

# How to build long-term horizons?

How to build that confidence and trust? Commitment devices.

- Tying the hand of policy makers. E.g. independence of central bank
- Requiring fiscal restraint, as well as convincing public financial management
- Requires rational, transparent, rule-based policy making
- “Realistic state”:
  - “ a mature state that takes only on what it can handle properly, given its own weaknesses” – strong delivery incentives