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INSTITUTE

# HOW NATIONS SUCCEED

**Analyses of national transformation**

February 2021

# CREATING THE PATHWAYS FROM POVERTY TO PROSPERITY

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## FOREWORD



For the past fourteen years, the Legatum Prosperity Index has offered a unique insight into what drives progress in nations around the world. More than any other measure, it has successfully captured the holistic nature of prosperity, placing an emphasis upon social wellbeing that is every bit as strong as that on economic strength and dynamism.

Whilst we have rightly celebrated the exemplary success of developed nations such as Norway and New Zealand, it is arguably the slow, steady progress up the Index's rankings table made by numerous developing nations that has been most encouraging. Such progress is incremental, often unspectacular, and rarely linear. Yet it offers a rich body of empirical evidence that can help improve our understanding of the building blocks of institutional, economic, and social wellbeing, and thus guide nations in creating their own pathways from poverty to prosperity.

To date, too many examples of such 'best practice' have been overlooked. Leaders with a dizzying array of competing priorities rarely have the resources to look beyond the well-worn illustrations. However, the task of embedding the core tenets of prosperity – strong institutions, an open economy, and empowered people – is common to every developing nation.

This report has been motivated by our desire to understand what specific actions have helped to sow the seeds of prosperity in developing nations. Our in-depth examination of the journeys of ten nations across a period of six decades offers valuable insights into what works and, perhaps equally important, what does not. These case studies provide important perspectives on how development priorities can best be sequenced as well as the role of aid, and its limitations.

As such, this report makes a timely contribution to the ongoing debate over the validity and efficacy of aid. For example, in the UK, this has manifested itself in often fractious discussions, from the creation of the Department for International Development (DFID) in 1997 to the adoption – and later abandonment – of the 0.7 per cent target, as well as the reintegration of development objectives within UK foreign policymaking through the recent creation of a new Foreign, Commonwealth and Development Office (FCDO).

It is only right to question whether the current international approach to aid is helping – or even hindering – the ability of individuals, communities, and nations to fulfil their unique potential. Even the most committed advocates of aid would be forced to concede that the more than \$1 trillion of development aid delivered to African nations between 1960 and 2010 has failed to create the level of prosperity envisaged by donors.

Instead, this report illuminates a clear and compelling trend: aid has proven most effective when targeted in support of nations' own development priorities, notably through supporting efforts to build capacity not only in critical sectors such as healthcare and education but also improving the quality of governance, whether the administration or the judiciary. When used appropriately, aid can help reinforce the development process, but it is not a substitute for nations building their own pathways from poverty to prosperity.

This realisation leads us to draw a fundamental conclusion, one that lies at the heart of this report: ultimately, nations must develop themselves. This places the onus for progress upon the leaders of developing countries themselves. However, this requires much more than political acumen and administrative competence. Instead, it requires leaders to be men and women of both vision and character, committed to placing the long-term development of their nations above short-term political imperatives. In short, it requires leaders of virtue.

This report makes clear that such leadership can make all the difference. Between success and failure, between poverty and prosperity. Leaders' determination to do what is right has proven pivotal in the development of the most successful countries in this report - to ensure the integrity of the rule of law by subjecting themselves to it, to establish a smooth transfer of power by leaving office voluntarily, and to enable sustained economic growth by confronting the vested interests that render nations uncompetitive. In short, leadership is core to development, and to creating a robust foundation for lasting prosperity. By adopting a pragmatic and inclusive approach, avoiding factionalism, and demonstrating their determination to govern for the good of all, leaders can deliver real change.

The recommendations contained within this report are designed to provide leaders with a comprehensive framework for national transformation that is proven and effective - a blueprint for true sustainable development. In addition, examples of progress contained in this report should provide a source of inspiration for all those determined to see people in all nations fulfil their unique potential. Building prosperity is inevitably a daunting undertaking for nations in any region, and at any juncture in their histories. However, this report demonstrates convincingly that not only is it possible, but it is within reach of each and every nation.



**Baroness Philippa Stroud**  
CEO of the Legatum Institute

## EXECUTIVE SUMMARY

### FORGING A STRONG SOCIAL CONTRACT

#### Establish Statehood

- **Promote a national identity** by identifying opportunities to unify the country, whether through shared language, culture, or icons.
- **Maintain control over the key parts of your territory** by seeking to immediately contain – rather than eradicate – insecurity.
- **Maintain internal order without resorting to violence** by investing in the cultivation of a politically independent, well-trained security sector.

#### Cultivate Legitimacy

- **Establish formal and informal executive constraints** by codifying a series of checks and balances in the constitution, and by encouraging informal constraints upon executive power.
- **Champion the rule of law** by prioritising the creation of an effective judiciary, by maintaining its independence from government, and by abiding by its rulings.
- **Commit to the peaceful transfer of power** by embracing constitutionally mandated term limits and by signalling an intention to leave office peacefully.

#### Govern Competently

- **Adopt a pragmatic and inclusive approach to national development** by making development the first priority, by avoiding factionalism, and by demonstrating a determination to govern for the good of all.
- **Build a competent administration** by prioritising the creation of an effective bureaucracy, making use of international expertise where necessary.

## BUILDING OPEN ECONOMIES

### Develop Macroeconomic Resilience

- **Raise sufficient revenues** and reduce reliance upon tariffs, by creating a simple and equitable system of taxation, and by broadening the tax base.
- **Prioritise fiscal sustainability** by limiting budget deficits to prevent the accrual of debts, by avoiding reliance upon costly commercial debt, and by maximising capital investments while minimising recurrent current expenditures and overheads.
- **Deliver monetary stability** by establishing an effective and autonomous central bank, by keeping inflation low and stable, and by maintaining a singular, stable exchange rate.

### Build a Domestic Asset Base

- **Protect property rights** by dealing effectively with tribal and customary rights, avoiding the expropriation of land, and by addressing the grievances caused by the expropriation of land.
- **Cultivate a domestic finance sector** by adopting a posture of non-interference, and by avoiding using commercial banks as an additional source of government lending.
- **Encourage foreign investment, capabilities, and technologies** by moving from positive to negative investment lists and by maintaining a posture of openness to external actors.

### Promote Trade and Commerce

- **Enable competition** by minimising the detrimental impact of monopolies and SOEs, by limiting the use of price controls, and by maintaining a flexible labour market through minimising the formal and informal costs of employment and by limiting public sector employment.
- **Make innovative use of export processing zones** by using them to configure the economy towards exporting, and by experimenting with policy options designed to increase the international competitiveness of key exports.
- **Prioritise international trade** by reducing barriers to trade and ending import-substitution industrialisation, and by bolstering regional trading ties.

## INVESTING IN HUMAN CAPITAL

### Provide Effective Healthcare

- **Build institutional capacity and quality** by making judicious use of formal and informal external assistance.
- **Improve access to healthcare** by prioritising healthcare infrastructure, especially in rural areas.

### Target Universal Education

- **Create essential capacity and quality** by prioritising both the building of schools and by incentivising teacher training.
- **Maximise access to primary, secondary, and tertiary education** by addressing the need for schooling in rural areas and by preventing exclusionary access.



## LIST OF ACRONYMS

AFC	Asian Financial Crisis
AfCFTA	African Continental Free Trade Area
AGOA	African Growth and Opportunity Act (US)
BDP	Botswana Democratic Party
BHS	Basic Health Services (Botswana)
CECA	Corruption and Economic Crime Act (Botswana)
DAC	Development Assistance Committee (OECD)
DAH	Development Assistance for Health
DCEC	Directorate on Corruption and Economic Crime (Botswana)
DfID	Department for International Development (UK)
EAC	East African Community
EBA	Everything but Arms
EPZ	Export Processing Zone
FARC	Revolutionary Armed Forces of Colombia
FDI	Foreign Direct Investment
FSLN	Sandinista National Liberation Front (Nicaragua)
FTZ	Free Trade Zone
GAM	Free Aceh Movement (Indonesia)
GATT	General Agreement on Tariffs and Trade
GCEC	Greater Colombo Economic Commission (Sri Lanka)
GDP	Gross Domestic Product
GID	General Intelligence Directorate, or Mukhabarat (Jordan)
GIZ	Corporation for International Cooperation (Germany)

GSP	Generalised Scheme of Preferences
HIV/AIDS	Human Immunodeficiency Virus/Acquired Immunodeficiency Syndrome
IDB	International Development Bank
IMF	International Monetary Fund
INSS	Nicaraguan Social Security Institute
ISI	Import-substitution Industrialisation
JIB	Jordan Investment Board
KANU	Kenya African National Unity
LTTE	Liberation Tigers of Tamil Ealam (Sri Lanka)
MINSA	Ministry of Health (Nicaragua)
MP	Member of Parliament
NDP	National Development Plan (Botswana)
NGO	Non-governmental Organisation
NHRC	National Human Rights Commission (Mauritius)
NLP	National Land Policy (Kenya)
NPSP	National Policy for Social Protection (Sierra Leone)
NSSIT	National Social Security and Investment Trust (Sierra Leone)
NTB	Non-tariff Barriers
OAU	Organisation of African Unity
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OPEC	Organisation of Petroleum Exporting Countries
QIZ	Qualified Industrial Zonee
RPS	Red de Protección Social (Nicaragua)
RUF	Revolutionary United Front (Sierra Leone)
SACU	Southern African Customs Union
SADC	Southern African Development Community

SDGs	Sustainable Development Goals
SDR	Special Drawing Rights
SISBEN	System of Identification of Social Programme Beneficiaries (Colombia)
SLPMB	Sierra Leone Produce Marketing Board
SME	Small and Medium-sized Enterprise
SOE	State-owned Enterprise
TFSIV	Trust Fund for the Social Integration of Vulnerable Groups (Mauritius)
TNP2K	National Team for the Acceleration of Poverty Reduction (Indonesia)
TPP	Trans-Pacific Partnership
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNP	United National Party (Sri Lanka)
USAID	United States Agency for International Development
WDI	World Development Indicators (World Bank)
WTO	World Trade Organisation
YPC	Young People's Congress (Indonesia)



*Sir Siretse Khama, Botswana's first post-independence president between 1966 and 1980.*

## INTRODUCTION

Creating a pathway from poverty to prosperity is a goal for many national leaders, and the often-stated objective of the many public and private international development organisations. But for the many countries of the world whose populations have yet to enjoy the fruits of prosperity, what is needed to realise this common ambition? Who should play what role? This report seeks to provide a holistic answer to this pair of questions.

Prosperity entails much more than wealth: it reaches beyond the financial into the political, the judicial, and the wellbeing and character of a nation — it is about creating an environment where every person is able to reach their full potential. A nation is prosperous when it has effective institutions, an open economy, and empowered people who are healthy, educated, and safe.

Countries that sit in the top half of the Legatum Prosperity Index™ tend to have a set of discernible characteristics. The level of conflict is minimal, or at least contained. Essential freedoms are mostly respected, and governments are mostly competent and accountable. The economies function relatively smoothly with sufficient diversification and productivity to support mostly salaried employment and GDP per capita levels above \$3,500. In addition, there are relatively low rates of poverty-related mortality, while standards of healthcare and education are sufficient to meet the basic needs of the majority of the population.

While these are the broad brush characteristics of the countries that are delivering prosperity for their citizens, the question this report addresses is what are the pathways countries took to achieve this? And, in particular, what are the choices taken by those that have had more successful journeys? This question - of why some nations fail, while others succeed - lies at the heart of development policy.

We were motivated by this simple fact: poor policymaking does not simply cost precious financial resources and political capital; it costs time. Time in which more children could attend school, more women could survive childbirth, and more individuals could see their own aspirations realised. It also has a long-term impact. Research into the path dependency of Roman infrastructure has shown that two thousand years later, economic activity is still

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*Sierra Leone's gross domestic product (GDP) per capita was either on a par with or greater than China's into the mid-1980s; today, the income of the average Chinese national is twenty times that of a Sierr Leonean.*

more densely concentrated around where those roads were built.<sup>1</sup> Put more simply: the decisions made today will impact the development of nations for centuries.

The post-colonial period, roughly from 1960 to the present day, has seen enormous divergence between nations which began in the same position, in terms of per capita income, life expectancy, and other basic measures of wellbeing. Sierra Leone's gross domestic product (GDP) per capita was either on a par with or greater than China's into the mid-1980s; today, the income of the average Chinese national is twenty times that of a Sierr Leonean.

Just as the prosperity of nations has evolved over the last 60 years, so too has our understanding of the nature of development. In his 1960 book, *The Stages of Economic Growth*. Walt Rostow posited that there were five distinct stages of economic and institutional development through which nations travel: traditional society, preconditions for take-off, take-off, drive to maturity, and the age of high mass consumption.<sup>2</sup> He also suggested that it was possible to speed up the rate at which countries progressed through these stages with external assistance, namely aid. But as Peter Bauer wrote in his seminal *Dissent on Development*, in specific critique of Rostow, 'societies are not aircraft which take off at a verifiable moment for a specific destination and thereafter expect to progress without interruption.'<sup>3</sup> There is little reason to believe that development is a well-ordered and predictable process; indeed, most of human history suggests precisely the opposite.

The various fields of current research into what characterises, catalyses, and sustains the process of national development are vast and divergent. No true consensus exists as to the individual policies and interventions that have the greatest impact on development, and there is no generalised agreement about the order in which a leader with constrained resources should proceed.

This is further confounded by the inconsistent growth patterns of nations over the past century. It is clear that development is not a linear process. Countries have good and bad decades, and past progress is no guarantee of future success. The development literature is

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1. Dalgaard, Carl, Kaarsen, N., Olsson, O., and Selaya, P. (2018), 'Roman roads to prosperity: Persistence and non-persistence of public goods provision', CEPR Discussion Paper 12745.

2. Rostow, W. (1991), *The stages of economic growth: A non-Communist manifesto* (Cambridge: Cambridge University Press).

3. Bauer, P. (1971), *Dissent on development*, (London: Cox & Wyman), p.486.

replete with examples of countries which were marked out for success but fell into cycles of violence and poverty, and vice versa. Prosperity, in short, is not inevitable.

More recently, the Sustainable Development Goals (SDGs) have been positioned not simply as a repository of information about broad-based indicators of wealth and wellbeing, but as a comprehensive 'blueprint to achieve a better and more sustainable future for all'.<sup>4</sup> While the SDGs are clear on what nations ought to achieve by 2030, there is little explanation as to how nations are meant to achieve these goals.

A general lack of clarity on what should be done when, and under what circumstances, limits the usefulness of these initiatives to leaders in the developing world who face serious resource constraints. So too does a lack of perspective of the broad portfolio of issues a leader is confronted with. Failing to acknowledge this reality in the research and policy programmes that are designed to advise and influence those leaders limits their utility and impact.

To underpin the analysis in this report, we wanted to identify a set of countries that, in 1960, had been demonstrably underdeveloped in terms of both economic and social wellbeing, and to explore the patterns behind their contrasting development trajectories. This 60-year timeframe allowed us to use the full timespan of the World Bank's World Development Indicators (WDI) database, and also included roughly two full commodities cycles, ensuring that temporary upswings in copper or oil prices were not mistaken for steady economic growth.<sup>5</sup>

Identifying which countries have journeyed from poverty to prosperity over the last 60 years entails setting thresholds for prosperity in both 1960 and the present day. If there was a reliable prosperity measurement that captured social and economic wellbeing from 1960 to the present day, we could use that to determine which countries went on successful journeys. However, as this data does not exist, we needed to find an alternative. In 1960, an annual GDP per capita level of \$1,500 represented a mid-ranked country. Likewise, a life-expectancy of 60 years represented a mid-level country. Accordingly, we have used both measures to establish our 1960 benchmark for prosperity.

4. UN (2020), 'About the Sustainable Development Goals – United Nations Sustainable Development'.

5. Erten, B. and Ocampo, J. A. (2012), 'Super-cycles of commodity prices since the mid-nineteenth century', DESA Working Paper No. 110.

For a country that started below this 1960 threshold to be an example of successful development, we included those whose life-expectancy has since risen to above 70, GDP per capita to above \$3,500 and annual growth rate to above 3.5%. Of the approximately dozen countries satisfying these criteria<sup>6</sup>, we have selected six for analysis in this report: Botswana, Colombia, Dominican Republic, Indonesia, Mauritius, and Sri Lanka.

In order to contrast these examples, we chose some less successful examples, where the current GDP per capita is less than \$3,500 and where the annual per capita growth rate has been below 2%. There were many such examples, from which we chose four with varied experiences: Kenya, Jordan, Nicaragua, and Sierra Leone.

1960 Life Expectancy	1960 GDP per capita	2018 Life Expectancy	2018 GDP Per Capita	60 year per capita GDP growth rate	Category
<60	< \$1,500	>70	>\$3,500	>3.5%	<b>Emergent</b>
			<\$3,500	<2%	<b>Stalled</b>

One notable characteristic of these different categories of countries is that the successful ones all have ranks better than 80th in the Legatum Prosperity Index™; and correspondingly the less successful nations all fall in the bottom half of the Index.

It has been our intention throughout to focus on what appears to have worked, as well as what has not. Consequently, this report is focussed on neither the best nor the worst examples of national development, but rather those who have moved from nearer the bottom to above the middle. These nations show that 'success' is not confined to the stratospheric growth of South Korea, or the institutional maturity of Sweden. Their experience over the past sixty years – of halting, unglamorous development – has the

6. Others include China, South Korea, Malaysia, Paraguay, Thailand. Our preference was for less prominent examples that provided a more diverse sample of population, constraints, and geography.



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*An environment which enables prosperity is the result of careful and conscious management of both economic and social wellbeing.*

potential to offer the best guide to policymakers in those nations that remain mired in poverty today.

The approach of this work has been to examine the contrasting approaches of different sets of countries against different aspects of development and prosperity. Comparative case studies of national development are a well-established form of analysis.<sup>7</sup> Conducting primarily qualitative research into the histories of the ten country case studies allowed for a similarly holistic approach to determining the drivers of prosperity over the past sixty years.

The analysis that follows reflects the broad structure of the Legatum Prosperity Index, which divides national-level policymaking into institutional, economic, and social outcomes. While this work was not able to capture each of its sixty-five elements, it underscores the same core philosophy:

An environment which enables prosperity is the result of careful and conscious management of both economic and social wellbeing.

For each area, such as 'executive constraints' or 'rule of law' or 'property rights', the experiences of the successful and less successful countries are compared and contrasted. For each dimension of prosperity, we have examined the extent to which the more successful countries have adopted a particular policy stance in contrast with the less successful, drawing upon the conceptual framework provided by Lant Pritchett's four rules of development interventions:

1. Is it more prevalent in more developed countries vs. less developed countries?
2. Is it more prevalent in more developed countries today vs. historically?
3. Is it more prevalent in more rapidly developing countries vs stagnant countries?
4. Does a country's progress accelerate/decelerate as it becomes more/less prevalent?

The clearer the difference in choices between the two sets of countries, and the more consistent the difference, the more likely an issue is to be an important component of the development process.

The research which forms the foundation of this report was primarily qualitative: studying the histories of each of the ten country case studies, which included a series of invaluable,

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7. See Acemoglu, D. and Robinson J.A (2012), *Why nations fail: the origins of power, prosperity, and poverty*, (New York: Crown) and Rodrik, D. (2002), *In search of prosperity: Analytic narratives on economic growth*, (New Jersey: Princeton University Press).

off-the-record conversations with in-country experts. We chose to place our trust in the imprecision of detailed narratives, rather than the precise inaccuracies contained within regressions.<sup>8</sup> While this approach is, of necessity, one of judgment, it allows for a richer view of the political economy to be incorporated into the analysis. By considering the wide range of factors that encompass prosperity, this work is necessarily broad, rather than deep. Hence, it should be seen as illustrating and consolidating mostly pre-existing theories of development, rather than demonstrating conclusively any components de-novo. However, the deliberately broad sweep, which has not been a feature of similar previous studies, serves to shed light on the macro and holistic patterns of successful pathways to prosperity.

This question – of what would be most useful to the leader of a developing state, today – has been at the forefront of this research. Those policymakers are the primary audience for this work. The experiences of these countries reiterate that at its essence, development is a domestic project. Put another way: for whom are we conducting research into development, if not for the benefit of those currently responsible for the development of nations?

This report is composed of three parts. Part One examines the formal and informal institutions that underpin the social contract and comprises three chapters on statehood and national identity, legitimacy, and governmental competency. Part Two reviews the conditions that enable sustained economic growth and broadened participation in the national economy, and includes chapters on macroeconomic policymaking, the domestic asset base, and trade and commerce. Part Three assesses the components of social wellbeing that allow individuals to become more productive and better-connected members of society; this encompasses chapters on health and education. In each case, the observed patterns of success are synthesised into principles of development.

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8. Sala-i-Martin, X.X. (1997), 'I just ran four million regressions', National Bureau of Economic Research Working Paper 6252.

# Part One

Forging a strong  
social contract

## INTRODUCTION TO PART ONE

A strong social contract lies at the heart of every successful nation. The concept can perhaps best be understood as the implicit agreement whereby the people willingly surrender certain rights in return for the protection and provision afforded by the state. As such, a strong social contract binds together a nation's leaders and its population, creating an environment of stability, opportunity, and shared identity.<sup>1</sup>

The weakness inherent in many developing states' social contracts is often cited as an explanation for why they have yet to prosper.<sup>2</sup> However, the social contract is, by its very nature, abstract; whilst people can usually describe the nature of the social contract in their own country – whether only 'fools' pay taxes, or whether the police can be trusted – the concept defies more precise measurement.<sup>3</sup> So what are the key features of the social contract in developing nations? Are all equally important? How can leaders strengthen their nation's social contract? Or create a new one altogether?

Though the nature of the social contract inevitably reflects the unique social, economic, and political dynamics within each nation, a number of common features can be identified. These common features – comprising national identity and statehood, the legitimacy of the relationship between the government and the governed, and the ability of government to deliver public goods in a competent and fair fashion – are the subjects of Chapters 1, 2, and 3, respectively.

There are no firm benchmarks for success or failure for these components of institutional development, and progress in one area does not guarantee progress in others. But the broader developmental outcomes of successful countries tend to match the extent to which their governments are capable of providing the following building blocks: a sense of national identity, control over most sovereign territory, maintenance of internal

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1. Stoer, S. and Magalhaes, A. (2002), 'The Reconfiguration of the Modern Social Contract: new forms of citizenship and education', *European Educational Research Journal*, Volume 1, Number 4, pp. 692-704

2. See Neirrotti, R. (2015), 'Barriers to development: Pushing the boundaries', *Brazilian Journal of Cardiovascular Surgery*, Vol. 30, No. 1, pp. 104-113, and Raimondo, E. (2019), *Social contracts matter for development: What can the World Bank do about it?*, World Bank Group Discussion Paper.

3. 'Only fools pay taxes: The Greek edition', *Financial Times*, 24 July 2012.

security (and control over the security services themselves), formal and informal executive constraints, the rule of law, the peaceful transfer of power as a norm, a pragmatic and inclusive approach to policymaking, and a competent and well-staffed administration. The contrasting experiences of our case study nations are used to illustrate the role these building blocks play in the pathway to prosperity.

## 1. ESTABLISH STATEHOOD

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Statehood encompasses more than legal sovereignty or physical control over territory: it also includes the ties of common purpose and shared values which bind citizens to one another. The efficacy of the social contract, and a government's ability to govern, is therefore inextricably linked to the concept of statehood.

Though foundational, the key tenets of statehood are often unclear; although the nation state has been defined as a 'human community that (successfully) claims the monopoly of the legitimate use of physical force within a given territory', the role of government within this dynamic varies considerably.<sup>4</sup> Moreover, notions of statehood invariably encompass more than the tenets recognised by the 1933 Montevideo Convention.<sup>5</sup>

Many developing nations were colonised at some point in their history, prompting each to confront similar questions about statehood. These included considering how, and whether, to recognise and defend borders designed by former colonial powers, which often disregarded pre-existing political, ethnic, and religious boundaries.

The question of whether to acknowledge or seek to reshape this geographic inheritance can prove fundamental. Equally important has been the question of how – and to what extent – the government was able to extend its authority over its territory.

This chapter examines the relationship between statehood and the social contract. It assesses the importance of three key components: first, the need for a sense of identity underpinning the state; second, demonstrating that government could achieve a monopoly on the use of force; third, that it could use that monopoly to maintain order without resorting consistently to violence within its borders.

### National identity

The creation of a common identity equips a government to avoid the dangers of ethnic division or religious sectarianism, which threaten to undermine the safety and security

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4. Weber, M. (1946), 'Politics as a vocation', in *From Max Weber: Essays in Sociology*, trans. Gerth, H.H. and Mills, C.W., (Oxford: Oxford University Press, pp. 77-128).

5. The Convention established a widely accepted definition of statehood which asserted that a nation must possess a permanent population, a defined territory, a government, and the capacity to conduct international relations.

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*Following Indonesia's independence in 1945, Sukarno created an entire national philosophy, Pancasila, in an attempt to encompass what it meant to be Indonesian.*

of nation states and hinder their development.<sup>6</sup> As Francis Fukuyama acknowledges, the issue of national identity 'has been pivotal to the fortunes of modern states.'<sup>7</sup> Regardless of whether or not states are subject to democratic rule, national identity provides a patina of legitimacy to the political system and its actors, and thus constitutes what Fukuyama characterises as the 'connective tissue' which allows diverse communities to thrive.

Inculcating a credible national identity poses particular challenges for developing nations, many of whom have found their borders imposed by external actors to create new sovereign entities.<sup>8</sup> In nations with very low levels of ethno-religious homogeneity, creating an effective – and inclusive – national identity required the investment of significant political capital by new and often untested leaders. For countries that did not have a pre-colonial national identity or concept of a nationwide society, there has been the additional question of how to persuade citizens to embrace a national rather than sub-national identity.

Cultivating a national identity is particularly challenging in nations with complex ethnic and religious diversity. In this regard, two examples of successful development, Indonesia and Sri Lanka, illustrate contrasting experiences. Following Indonesia's independence in 1945, the country's first president, Sukarno, created an entire national philosophy, Pancasila, in an attempt to encompass what it meant to be Indonesian. Its 'five principles' (the literal meaning of Pancasila in Sanskrit) deliberately emphasised values common to the overwhelming majority of the population, including the belief in an Almighty God, a just and civilised humanity, a unified Indonesia, democracy led by wisdom, and social justice for all.<sup>9</sup> These principles were intended to resolve the competing interests of the young nation's many religious groups, and to provide a shared identity beyond that of a common coloniser. Though it was not wholly successful in preventing religious conflict (most notably in Aceh, where the separatist movement was catalysed, in part, over a dissatisfaction that Indonesia was not declared an Islamic republic at independence), it proved pivotal in enabling the government to assert its moral and actual authority over its vast and disconnected territory.

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6. Herbert, S. (2013), *Promoting national identities*, GSDRC Helpdesk Research Report 978, (Birmingham, University of Birmingham).

7. Fukuyama, F. (2018), 'Why national identity matters', *Journal of Democracy*, Vol. 29, No. 4, pp. 5-15, p. 7.

8. Arguably the most apposite example of this is the 1885 General Act of the Berlin Conference, which determined the national borders of numerous sub-Saharan African nations, which were then divided into spheres of interest amongst Europe major powers.

9. See the 1945 State Constitution of the Republic of Indonesia.

The inclusive approach of Pancasila was mirrored in the new government's approach to language. Recognising the need for a single national language, the Young People's Congress (YPC) determined in 1928 that Bahasa – a relatively straightforward version of Malay – would be the language of their new nation instead of Javanese, which was spoken by 40 per cent of the population but considered more hierarchical in its nature and more complex to learn.<sup>10</sup> This ensured that a common language would be available for communication between islands and ethnic groups. It was at the same Young People's Congress that the delegates decided that they would one day be called 'Indonesians'.<sup>11</sup>

Conversely, the violence endemic to Sri Lanka's post-independence history offers a stark cautionary tale about the dangers of an exclusionary national identity. Unlike the Portuguese and the Dutch, both of which had chosen to rule the island as two separate kingdoms, the British merged the two, in spite of the fact that the two main ethnic groups of these respective kingdoms – the Tamils and Sinhalese – did not share a language, religion, or common history. Upon independence in 1948, the Sinhalese-controlled government moved to restrict the rights of the Tamil population, disenfranchising them altogether in 1956. Instead of highlighting Sri Lankans' shared national identity, successive governments actively exacerbated divisions. In July 1983, the then-president JR Jayewardene appeared to incite violence against the Tamil minority in response to the killing of thirteen government soldiers by the Liberation Tigers of Tamil Eelam (LTTE) in an attack near Jaffna. In an interview with the *Daily Telegraph* of London, Jayewardene stated that "we cannot think of [the Tamils], not about their lives or their opinions... Really, if I starve the Tamils out, the Sinhala people will be happy."<sup>12</sup> While Sri Lanka has been a relatively successful example of development, the inability of successive governments to unify the nation undoubtedly proved an obstacle to further progress.

Nations that succeeded in establishing a cohesive sense of national identity also tended to have inspiring founding fathers, who were lionised. For example, probably the single-best source for explaining the nature of Botswanan identity in the post-independence period – how it was formed, and how it survived colonisation – is its founding president, Sir Seretse Khama. Khama's life was emblematic of the racial injustice which black Africans faced under

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10. Anderson, B. (1966), *The languages of Indonesian politics*, p.104.

11. Paauw, S. (2009), 'One land, one nation, one language: An analysis of Indonesia's national language policy', in Lehnert-LeHouillier, H. and Fine, A.B. (eds.), *University of Rochester Working Papers in the Language Sciences*, 5(1), pp.2-16.

12. Interview with the *Daily Telegraph*, 11 July 1983.



*[Khama's] speeches to Botswana's National Assembly, and to audiences abroad, offer an extraordinary insight into the psychology of nation-building, especially where failure has been widely predicted.*

colonial rule. He was effectively forced into exile by British authorities as the result of his marriage to a white Englishwoman, under considerable pressure from the government of the Union of South Africa. Khama went on to establish the Botswana Democratic Party (BDP), led the country to independence in 1966, won the presidency, and then established a track record as one of the most effective leaders on the continent.

Khama's effectiveness as a leader also stemmed from his intimate understanding of the notion of resistance, which has been central to the Botswanan identity in the postcolonial era. This idea – that people could resist, not just a colonial oppressor, but also the idea of failure itself – was a source of inspiration. His speeches to Botswana's National Assembly, and to audiences abroad, offer an extraordinary insight into the psychology of nation-building, especially where failure has been widely predicted. This was heightened, in the case of the Batswana, by the knowledge that the failure of their national project would almost certainly lead to their absorption into apartheid-era South Africa. In a 1970 speech to the Scandinavian Institute for African Studies, Khama described the few assets which his country had at independence, singling out the character of the people for particular praise:

"[the] most important was the character of the Batswana. Even before the establishment of the Protectorate, the Batswana recognised whence the real and long-term threat to their independence would come. And the refusal to accept absorption by South Africa or Rhodesia which characterised the colonial period, lives on the dogged determination to ensure that Botswana develops as independently as possible of our minority-ruled neighbours... Furthermore, although, as I have said, political consciousness in the conventional modern sense developed late among the Batswana, the sturdy tradition of democracy which survived the distorting pattern of indirect rule has served us well in developing our national sense of purpose."<sup>13</sup>

The experiences of these nations illustrate how the purposeful cultivation of a shared identity can improve social cohesion and reduce the risk of conflict. However, its success is contingent upon the political skills and legitimacy of national leaders. Those able to conceive and articulate a compelling and inclusive vision of national identity were able to use it to overcome national divisions, rather than to exacerbate them. Successfully forging a common identity provided political latitude for some of the many difficult choices confronting leaders, not least over how to prioritise investment in some areas of

13. Khama, S. (1970), "Botswana – A developing democracy in Southern Africa", speech to the Scandinavian Institute of African Studies, Uppsala.

the country but not others. A widely-shared national identity – disseminated through mass education and a common language - formed a foundation of trust between otherwise unconnected citizens, allowing them to look past their individual, local, or regional needs.

### Territorial control

A government's ability to maintain effective control over its sovereign territory has long been considered an essential condition of statehood. That control is predicated upon two key principles in international law: negative sovereignty, the right to non-interference from other states, and positive sovereignty, in which a state has the strength to assert its control, to behave as 'own master' and to provide for its citizens.<sup>14</sup> Nations where governments have insufficient strength to assert their control universally are considered to be fragile or crisis states, subject to potentially intolerable levels of insecurity.<sup>15</sup>

Maintaining control over territory poses particular challenges for developing nations, where notions of sovereignty and government legitimacy are often less well established, and challenges to authority more commonplace. Furthermore, it requires an ability to project military force effectively and consistently, placing significant fiscal burdens on developing nations that they can often ill afford. Government expenditure on defence is typically proportionately higher amongst low and middle-income nations, producing a significant negative effect on economic growth.<sup>16</sup>

Many developing nations have experienced some form of internal challenge to the government's monopoly on the use of force, and its control of sovereign territory. However, when confronted with such threats, successful nations tend to contain these threats without recourse to significant increases in defence spending, limiting the geographic spread of those groups who challenged the rule of the central government, thereby minimising the effect of these conflicts on their citizens.<sup>17</sup> This pattern is consistent across the successful nations surveyed in this work.

14. Jackson, R. (1991), *Quasi-States: Sovereignty, International Relations and the Third World*, (Cambridge: Cambridge University Press), p.29.

15. Collier, P. (2009), *The Political Economy of fragile states and implications for European development policy*, (Oxford: University of Oxford).

16. Hou, N. and Chen, B. (2013), 'Military expenditure and economic growth in developing countries: Evidence from system GMM estimates', *Defence and Peace Economics*, 24:3, pp.183-193.

17. Smaldone, J. (2006), 'African Military Spending: Defence versus Development?', *African Security Review*, Vol 15, No. 4, pp18-32.

Indonesia's Free Aceh Movement (GAM, in Bahasa) sought to pressure the government to declare an Islamic republic and to enshrine sharia law within the country's constitution. From 1976 onwards, over 15,000 people died in separatist violence, with the strength of the GAM peaking in 2002 at around 50,000 militants. Though the Indonesian government was unable to achieve a military defeat of GAM before 2006/7, they succeeded in confining them geographically to the island of Aceh, through short periods of military intervention. This included the 2003-04 offensive in which GAM lost half their force strength and several key members of their leadership.

Similarly, though the government of Sri Lanka lost control over various parts of its territory in the course of its twenty-five-year civil war, it was successful in limiting the geographic expansion of armed non-state actors. The campaign of violence waged by the LTTE began with targeted political assassinations and high-profile terrorist attacks in the late 1970s, transitioning to full-scale guerrilla warfare in 1983. However, as in Indonesia, the government succeeded in using its military dominance to contain the LTTE throughout this period of crisis, with the group asserting control over only four of Sri Lanka's twenty-five districts.

It is perhaps Colombia that provides the most recognised example of how a nation can continue developing in the face of sustained and complex instability. For more than five decades, multiple armed actors fought for control of various parts of the country, from the Revolutionary Armed Forces of Colombia (FARC), to a succession of powerful drug cartels and paramilitaries. Vast regions of rural Colombia were outside government control, creating significant ungoverned spaces exploited by those non-state actors, not least narcotraffickers. Colombian cocaine production, virtually non-existent in 1980, had reached some seven hundred tonnes a year by 2000.<sup>18</sup> This rapid increase in production consumed tens of thousands of hectares of land, and forcibly displaced millions of Colombians, most of them from the countryside.

Despite losing effective control over such significant portions of its rural territory, the Colombian government was, crucially, able to maintain a minimum threshold of security in key urban centres. Despite the appalling impact on rural populations, the government's consistent ability to insulate major cities like Cali, Bogota, Barranquilla, and Medellin from chronic insecurity ensured it did not fatally destabilise the country. The containment of violence to the 'periphery of the periphery' prevented it from undermining the Colombian

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18. Cárdenas-Santamaría, M. (2007), 'Economic growth in Colombia: a reversal of 'fortune'?', *Revista Ensayos Sobre Política Económica*, 25(53), 220-259.

*The containment of violence to the 'periphery of the periphery' prevented it from undermining the Colombian economy*

economy, and the interests of its urban establishment actors (also referred to in the academic literature as 'elites') who provided the government with essential political support.<sup>19</sup>

This equilibrium was maintained successfully in the face of episodic outbreaks of violence until the assassination of Liberal presidential candidate Luis Carlos Galán in 1989. His targeting by Pablo Escobar's Medellín Cartel proved to be a watershed moment, highlighting that insecurity had escalated to a point where it could no longer be contained in the countryside. In response, establishing physical control over such territory became an increasingly dominant focus of successive Colombian administrations throughout the 1990s and 2000s. The administration of Alvaro Uribe (2002-2010) was especially aggressive in its efforts to root out non-state armed actors from the Colombian countryside. He added more than 80,000 soldiers to the army, financed through a 'democratic security tax' aimed at the wealthiest Colombians.<sup>20</sup> Uribe also accepted nearly a quarter of a billion dollars from United States Agency for International Development (USAID) for the National Consolidation Plan, which sought 'to establish the presence of the state in areas from which FARC had been driven', but which was also utilised to reassert control over territory under the control of other non-state actors.<sup>21</sup>



*Luis Carlos Galan is shown speaking at a rally. Many Colombians had expected the 46-year-old former senator and journalist to be their next president before his assassination in 1989.*

19. Robinson, J. A. (2013), 'Colombia: another 100 years of solitude?', *Current history*, 112(751), pp.43-48.

20. *Ibid.*

21. *Ibid.*

Despite major setbacks, successive governments did not relinquish their desire to reassert control over the entirety of the country. As former president Cesar Gaviria stated, "no one has ever questioned the viability of the state."<sup>22</sup> Instead, the government's maintenance of a minimum threshold of security enabled the country's socio-economic development to continue in spite of the chronic instability that characterised large swathes of its rural territory.<sup>23</sup> The work of the Colombian military and police forces bought the central government time in which it could attempt to establish the institutions of the 'core' in the 'periphery'.

Although holding the monopoly of force is considered an essential condition of statehood, the experience of these successful nations suggests that states can continue to develop, despite the temporary loss of parts of their territory. Those nations that demonstrated the determination to contain – and eventually overcome – such insecurity, ultimately succeeded in doing so. Their respective experiences indicate that, to develop successfully, a government does not necessarily need to control all of its territory, all of the time.

### Internal order

Upholding the social contract requires that the state's monopoly on the use of force be used effectively to ensure the safety and security of the population. It also requires that the state's monopoly is not abused. For the security sector to maintain its legitimacy and the cooperation of the public, it must act proportionately. Citizens must not be subjected to political violence, arbitrary arrest, or detention without trial. For the security sector to maintain their legitimacy and the cooperation of the public, it must act proportionately.<sup>24</sup>

Ensuring that order can be effectively maintained without recourse to violence poses significant challenges for many developing nations. Rates of violent crime tend to be higher than in developed nations, whilst countries' security sectors are typically more poorly paid, equipped, and trained.<sup>25</sup> Countries with less successful development experiences, especially when incumbent rulers become reliant upon the support of security sectors to remain in office, become more prone to politicisation, and consequently violence.<sup>26</sup>

22. Mills, G. (2015), *Why Africa is poor: And what Africans can do about it*, (London: Penguin).

23. Cárdenas-Santamaría, M. (2007), 'Economic growth in Colombia: a reversal of 'fortune'?', *Revista Ensayos Sobre Política Económica*, 25(53), pp.220-259.

24. Tyler, T. (1990), *Why People Obey the Law*, (New Haven: Yale University Press).

25. Heinemann, A. and Dorte Verner, D. (2006), *Crime and violence in development: A literature review of Latin America and the Caribbean*, World Bank Policy Research Working Paper 4041.

26. Brzoska, M. (2006) 'Introduction: Criteria for evaluating post-conflict reconstruction and security sector reform in peace support operations', *International Peacekeeping*, 13:1, pp.1-13.

For example, Jordan's faltering development can be traced, in part, to its historic insecurity. This enabled the country's state security services, the General Intelligence Directorate (GID) or Mukhabarat, to play a disproportionately politicised role. The heavy reliance of successive rulers upon the Mukhabarat for protection has been a consistent feature of civil relations, in part as a result of a string of high-profile assassinations including those of King Abdullah in 1951 and Prime Minister Wasfi al-Tal in 1971. Consequently, the Mukhabarat grew to wield substantial power to rival that of the monarchy itself and became the unacknowledged third pillar of the government. One commentator described the relationship between these three pillars of government as follows:

"A member of parliament (MP) receives a call from the Royal Court on a matter, and then the prime minister calls on the same issue urging the opposite action. Finally, the security services contact the MP asking for a third course of action. This reflects not only an absence of coordination among the institutions, but also the fact that there are effectively three governments in the country: the government of the Royal Court, the government of the security services, and the actual government—which appears to be the weakest of the three."<sup>27</sup>

King Abdullah went so far as to suggest in a 2013 interview that the security services had fomented riots in Ma'an in 1989, which spread throughout the country and represented some of the most significant civil unrest in Jordan's history.<sup>28</sup> The close relationship between conservatives inside the security services and conservative tribal leaders of the East Bankers makes this claim credible, if extraordinary. It was indeed King Hussein's carefully managed patronage of the East Bankers and the security services (including the military) which helped to keep him in power for almost half a century. But for an absolute monarch (whose critics are still regularly imprisoned under *lèse-majesté* laws) to suggest that he is not in control of the security services is tantamount to an admission that it is the Mukhabarat, and not the Royal Court, parliament, or any other public-facing body, which is running the country.

Other nations have proved to be even more reliant upon their security sector for the maintenance of political power, notably through their role in the coercion of labour. The discovery of diamonds at Kono in Sierra Leone in 1930 resulted in the mobilisation of a

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27. Bani Salameh, M. (2017), 'Political reform in Jordan: Reality and aspirations', *World Affairs*, Vol. 180, No. 4, pp. 47–78.

28. 'The modern king in the Arab Spring', *The Atlantic*, April 2013.

*Nations that ensure the legitimacy of government's monopoly on the use of force is only rarely abused are able to establish themselves as agents of order, rather than an agent of disorder, by preventing the widespread misuse of violence.*

significant police presence under the pretence of securing the deposits. In reality however, this redeployment ensured that the diamond-rich areas of the country were 'effectively sealed off from the rest of Sierra Leone', providing a lucrative source of illicit finance for senior members of the police.<sup>29</sup> The erosion of public trust in the police was a contributory factor in the decline of state legitimacy and the subsequent outbreak of the civil war in 1991.

While political violence is not unknown in more successful countries, it is much less routine.<sup>30</sup> For example, in Mauritius, instances of the excessive use of police force were almost unheard of prior to the 1999 death in police custody of Kaya, a popular Creole reggae singer. The overwhelming evidence of police brutality resulted in widespread riots in Port Louis demanding an end to police impunity and for the government to address 'la malaise Creole', the perceived exclusion of the Creole population from the country's economic and social prosperity.<sup>31</sup> The government responded swiftly to this unrest, establishing the Trust Fund for the Social Integration of Vulnerable Groups (TFSIV), allocating almost two per cent of its annual budget in 1999/2000. Substantive reform followed in 2002, with the establishment of the National Human Rights Commission (NHRC), tasked with automatically investigating all deaths occurring in police custody, overseen by the country's Director of Public Prosecutions. The country's commitment to police legitimacy was further reflected in its 2010 National Policing Strategic Framework which stated the government's intention to transform the police 'force' to a police 'service'.<sup>32</sup>

These examples illustrate the link between the efficacy and legitimacy of a nation's security sector and its development trajectory. Despite episodic instances of police brutality, nations that made the most progress succeeded in maintaining order without resorting consistently to violence against their citizens. Put simply, such violence in those nations was the exception, rather than the rule. Conversely, those nations that faltered had security sectors which were historically ineffective or viewed as a highly politicised institutions – or worse still, became active agents of state repression – and where such political violence at the hands of agents of the state was routine.

29. Fithen, D. (1999), *Diamonds and war In Sierra Leone: Cultural strategies for commercial adaptation to endemic low-intensity conflict*, pp. 1-268.

30. See for example Poteete A.R. (2013), 'The absence of intergroup violence in Botswana: An assessment of the role of development strategies', in: Ascher W. and Mirovitskaya N. (eds.), *The economic roots of conflict and cooperation in Africa: Politics, economics, and inclusive development*, (New York: Palgrave Macmillan).

31. Miles, W. F. (1999), 'The creole malaise in Mauritius', *African Affairs*, 98(391), pp.211-228.

32. The Mauritius Police Force (2020), *National policing strategic framework*, pp. 1-14.

## Summary

The varying dynamics of insecurity and identity outlined above provide instructive lessons in establishing statehood. Successful nations (notably Botswana and Mauritius) managed to avoid serious violence altogether, by incentivising their respective establishment actors to support peace, rather than violence. Others (Colombia, Indonesia, and Sri Lanka) were able to mitigate the impact of significant civil unrest over the course of multiple decades. Among the less successful examples, Jordan found itself challenged by internal unrest, whilst Sierra Leone illustrates the calamitous impact of conflict, and the repercussions for development.

Establishing statehood is, in essence, a political exercise. Leaders must confront the daunting task of convincing individuals that they share a common destiny as citizens of the same nation state; persuading an often-sceptical population that the government exists to promote the prosperity of each and every citizen requires integrity, imagination, and persistence.

Maintaining an effective monopoly on the use of force does not require the state to be able to provide security across the entirety of its territory, nor to all of its population. Instead, in order to develop, the government must succeed in maintaining sufficient – rather than absolute – control over its sovereign territory, achieving a minimum threshold of security. Nations that have succeeded in containing insecurity have been better able to develop, especially without having to embark upon unaffordable programmes of military expenditure.

As well as identifying mechanisms for unifying the population, nations that ensure the legitimacy of a government's monopoly on the use of force is not habitually misused are able to establish themselves as agents of order, rather than an agent of disorder, by preventing the widespread misuse of violence. By doing so, such nations succeed in enhancing their legitimacy, gaining the confidence of the population and incentivising national establishment actors to lend their support to the process of development.

### To establish statehood:

- **Promote a national identity** by identifying opportunities to unify the country, whether through shared language, culture, or icons.
- **Maintain control over the key parts of your territory** by seeking to immediately contain – rather than eradicate – insecurity.
- **Maintain internal order without resorting to violence** by investing in the cultivation of a politically independent, well-trained security sector.



## 2. CULTIVATE LEGITIMACY

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A strong social contract is contingent on governments being viewed as legitimate by the majority of their population. The existing orthodoxy posits that free, fair, and regular elections are the best way of providing formal consent, ensuring that accountability exists between the government and the governed. This orthodoxy has shaped the longstanding insistence of western donors on regular elections<sup>33</sup>, and has persisted even in parts of the world where such elections are frequently accompanied by violence and fraud, where electoral outcomes are widely disputed and where, consequently, leaders are not considered to be legitimate by the majority of the citizenry.

However, this emphasis on elections is a relatively recent phenomenon. During the Cold War, the desire to promote democratic values and institutions was frequently subordinated to more immediate priorities, namely the geostrategic imperative to resist or promote communism. Though democratic representation is evidently the system of governance best aligned with the ideal of personal liberty, the normative assumption that democracy is an essential precondition to national development requires interrogation. In the history of developed nations, the evolution of democratic institutions, the extension of suffrage, and the ability to hold free and fair elections has proved to be slow and fitful.<sup>34</sup>

This chapter analyses how governments establish and maintain legitimacy. It is divided into three component parts. The first examines the differing formal and informal constraints on the power of government. The second assesses the centrality of the rule of law in formalising both the accountability of governments and the personal freedoms of their citizens. The third explores the need to commit to the peaceful transfer of political power, even where the catalyst for such a transfer may not be the ballot box.

### Executive constraints

Governments cannot be deemed legitimate if they are able to act with impunity. Written constitutions tend to provide formal constraints on the power of the executive, using mechanisms from term limits to the separation of powers. Ensuring the independence of the legislature and the judiciary, such that they are able to act as a check upon that executive,

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33. See, for example, DfID, (2011), *Electoral Assistance and Politics: Lessons for International Support*

34. Collier, P. (2009), *The Political Economy of fragile states and implications for European development policy*, (Oxford: University of Oxford).

*Economic establishment actors not only deterred poor policymaking, but also played a pivotal role in conferring legitimacy on the governments of Mauritius and Botswana.*

improves governmental outcomes, increasing the impartiality of policymaking and the implementation of executive functions. Without such clear separations, the legislature's role in enacting laws, and the judiciary's role in enforcing them, is compromised.

Most nations have established broadly similar formal constraints as part of their constitution, either in the aftermath of independence or as part of a constitutional review.<sup>35</sup> Based upon varying forms of the separation of powers, they, in theory, provide sufficient system of checks and balances. However, such formal mechanisms can be effective only if they are enforceable by other political actors with sufficient independence from government, and sufficient leverage to intervene. This requires the existence of an establishment whose economic interests are largely dependent upon the core functionality provided by the state, from infrastructure to basic property rights.<sup>36</sup> Establishment actors (or 'elites') thus provide a form of complementary, informal constraint.<sup>37</sup>

Establishing such practical executive constraints poses particular challenges for developing nations. Local elites were frequently discouraged or even persecuted during the colonial era, ensuring that this key constituency was a weak force at independence. Similarly, the economic establishment actors of developing nations often tend to be concentrated in a limited number of growing sectors and are therefore less representative of national priorities.

The contrasting development experiences of the nations reviewed in this study illustrate the importance of informal mechanisms in establishing robust and effective constraints on executive power. Nations that did not seek to curtail the influence and political independence of their establishment actors made more progress in their development – as these actors were able to act as an essential constraint on the executive.

Economic establishment actors not only deterred poor policymaking, but also played a pivotal role in conferring legitimacy on the governments of Mauritius and Botswana. In Mauritius, the government did not seek to appropriate sugar plantations owned by the Franco-Mauritian minority, instead allowing them to retain their status and influence. The

35. See Negretto, G. (2020), 'Constitution-making and liberal democracy: The role of citizens and representative elites', *International Journal of Constitutional Law*, Vol. 18, Issue 1, pp. 206–232 and Alberts, S. (2009), 'How constitutions constrain', *Comparative Politics*, Vol. 41, No. 2, pp. 127–43.

36. Schraeder, P.J. (1994), 'Elites as facilitators or impediments to political development? Some lessons from the 'Third Wave' of democratization in Africa', *The Journal of Developing Areas*, Vol. 29, No. 1, pp.69–90.

37. Boettke, P.J., Coyne, C.J. and Leeson, P.T. (2008), 'Institutional stickiness and the new development economics', *American Journal of Economics and Sociology*, Vol. 67, No. 2, pp. 331–358.

determination of the government to remain inclusive of the descendants of Mauritius' former colonial power 'may contribute to explaining the prolongation of the Franco-Mauritian elite position, as well as that of the Mauritian success story.'<sup>38</sup>

Botswana's cattle-herding economic establishment actors had a strong interest in the protection of property rights, the expansion of export opportunities, and maintenance of a stable exchange rate regime. Many of Botswana's early political leaders – including Sir Seretse Khama himself – were themselves part of this key constituency of influence. This helped ensure that Khama and his successors would not initiate any measures injurious to the bedrock of the Botswanan economy, such as to experiment radically with the currency (as Zimbabwe did), or to cut themselves off from global markets (as South Africa did). Because of their own backgrounds in agricultural production, those in power had a first-hand appreciation of what the economy required from government to flourish, and what would cause it harm.

Botswana also relied heavily – and successfully – on an established framework of social norms, customs, and conventions which acted as a powerful informal constraint on executive power. These included several key pre-colonial institutions and powerbrokers, including the country's network of kgosis (chiefs) and kgotlas (community councils or courts). These institutions formed the foundation of Botswanan independence, with Sir Seretse Khama himself the kgosi of one of the country's largest tribes. To this day, the president is customarily expected to consult with the kgosi and the kgotlas before implementing any major legislative changes, and major infrastructure projects have failed due to insufficient consultation.<sup>39</sup>

Botswana also succeeded in establishing powerful informal conventions limiting executive power. No term limit existed prior to 1997, however all of Sir Seretse Khama's successors abided by the convention he established to serve no more than two terms in office. Similarly, his determination to preserve the political independence of the kgosis led him to resign his tribal title before running for office, establishing a convention that has successfully delineated tribal and national politics. Today, the presence of party activists at kgotlas is met with widespread criticism.<sup>40</sup> This separation of traditional leaders from tribal

38. Salverda, T. (2015), *The Franco-Mauritian elite: Power and anxiety in the face of change*, (New York: Berghahn), p. 2.

39. Scudder, T., and Coley, R.W. (1993), *The IUCN review of the Southern Okavango Integrated Water Development Project*, pp. 1-543.

40. 'Khama's dirty tricks campaign defiles the Kgotla', *The Sunday Standard*, 24 July 2014.

politics has proved critical to Botswana's development; as the legitimacy of the central government is decoupled from specific tribal interests, Botswana has never had a major problem with patronage or patrimonialism (unlike Sierra Leone, where tribal chiefs are active agents of political parties, and major beneficiaries of patrimonialism).<sup>41</sup>

In Indonesia, where Dutch expatriates had dominated industry and agriculture prior to independence, President Suharto's ambitious programme to indigenise the economy was heavily reliant upon the continuing support of the country's military. Suharto's solution was to apportion parts of key nationalised industries to senior military figures. The resulting dynamic, though evidently nepotistic, provided a clear informal constraint on the power of the executive, eventually forcing Suharto from office in the wake of his divisive response to the Asian Financial Crisis (AFC), which threatened the Generals' economic interests.

Nations that made least progress towards their development have often sought to limit or even persecute their establishment actors or compromised their political independence – thereby inhibiting the ability of such actors to constrain the executive. Of the countries surveyed, Jordan and Kenya provide perhaps the most illustrative examples. Employment in Jordan's vast public sector served to mollify potential critics of the monarchy and the country's lack of productive economic activity, especially after the loss of the East Bank in 1967. This rentier model had been at the heart of Jordan's social contract from the foundation of Transjordan in 1921, resulting in a public sector which accounts for 40 per cent of the labour force today, and a professional class which is largely unable to critique the effect of government policies on the economy.

Similarly, the process of Kenyanisation following independence actively inhibited the influence of non-Kenyan establishment actors, with foreign business owners subject to discriminatory licensing regimes. The resulting exodus of a sizable portion of the country's economic establishment actors removed a key constraint on the executive and exacerbated existing shortages of skilled and well-educated citizens.

These contrasting experiences indicate the particular importance of informal executive constraints in holding governments and their leaders to account. Nonetheless, the viability of executive constraints ultimately relies on incumbent leaders' willingness to acknowledge all limitations upon their power. Such limitations, whether formal or informal, should be

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41. Sebudubudu, D. (2011), Wealth sharing for conflict prevention and economic growth: Botswana case study of natural resource utilization for peace and development, *World Bank*, pp. 1-26.

viewed as assets to leaders rather than obstacles, conferring additional legitimacy, and demonstrating governments' responsiveness to the concerns of their populations.<sup>42</sup>

### The rule of law

Creating a robust – and predictable – system to uphold the rule of law is an essential precondition for national socio-economic development. Though definitions of the concept of the rule of law vary, most affirm the supremacy of the legal system over all individuals and organisations, including the state.<sup>43</sup> A strong legal system serves as a key constraint on the conduct of both the population and those who lead them. For the rule of law to constitute a key element of an effective social contract, it must therefore apply – and be perceived to apply – equally to all.<sup>44</sup> Additionally, the consistent application of the rule of law removes a substantial barrier to foreign investment, as governments are able to provide a reputable, legally enforceable guarantee that foreign assets and capital will not be subject to expropriation.

Creating such a system to uphold the rule of law requires the existence of an effective judiciary comprised of several essential components. First, it requires a unified body of enacted legislation (a statute book) to enable the prosecution of criminal acts in accordance with the notice principle.<sup>45</sup> Second, it requires a bench of judges with sufficient experience and independence to interpret and apply the law to both the government and population alike.<sup>46</sup>

Historically, this has presented significant challenges for many developing nations. The judiciary has all too often been a heavily politicised institution, with judges subject to executive appointment and thus unable to ensure that governments are also bound by the law.<sup>47</sup> Additionally, judiciaries have often lacked the manpower to resolve cases rapidly and consistently, serving to undermine its legitimacy and therefore encouraging the population to circumvent the justice system.

42. Acemoglu, D. and Robinson, J.A. (2020), *The narrow corridor: States, societies, and the fate of liberty*, (London: Penguin).

43. Chesterton, S. (2008), 'An international rule of law?', *American Journal of Contemporary Law*, Vol. 56, pp. 331-361.

44. International Bar Association, (2009). Resolution of the Council on the Commentary on Rule of Law (2005)

45. The notice principle asserts that no action can be deemed criminal without an enacted law which expressly prohibits it.

46. Cutillo, A. (2012), *Advancing the rule of law agenda at the 67th General Assembly*, International Peace Institute, p.2.

47. The UN Special Rapporteur on the independence of judges and lawyers provides an annual report: <https://www.ohchr.org/EN/Issues/Judiciary/Pages/Annual.aspx>

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*In Indonesia, the Constitutional Court has decided against the government 75 per cent of the time, and its decisions are still upheld.*

Those nations who made most progress succeeded in establishing the integrity of judicial institutions, with governments consistently upholding their decisions. In Indonesia, the Constitutional Court has decided against the government 75 per cent of the time, and its decisions are still upheld.<sup>48</sup> Similarly, Colombia's governments have generally respected the judiciary and its decisions, despite frequent political instability characterized by a brief period of military dictatorship and several contested elections.

Conversely, where there is political subordination of the judiciary, development outcomes are often poor. For example, the Sandinista regime in Nicaragua used the country's courts to actively discriminate against political opponents. Shortly after seizing power in 1979, revolutionaries enacted Laws No. 185 and 186 to create a new system of nine Special Tribunals to enable the trials of former 'somocistas' or supporters of the former Somoza regime. Between December 1979 and June 1980, the tribunals had tried some 367 cases, acquitting only 18 defendants.<sup>49</sup>

In Kenya, Daniel arap Moi's politicisation of the Supreme Court during his first four years in office enabled him to make far-reaching amendments to the country's constitution in 1982, formally establishing a one-party state, and re-enacting a number of colonial-era detention laws which allowed the president to suspend civil liberties. Parliamentary privilege was also abolished, ending one of the last facets of transparency in the Kenyan government.<sup>50</sup>

A further series of reforms in 1986 gave Moi absolute power to appoint and remove judges, including Supreme Court justices.<sup>51</sup> This determination to mould the judiciary to the will of the executive erased public trust in these institutions, and 'directly contributed to the post-election violence of 2007/2008', as many did not believe that it was possible for the courts to fairly resolve the question of the contested election.<sup>52</sup> This legacy of institutional weakness was still evident as late as 2011, with the Kenyan judiciary comprising only 53 judges for a population of over 43 million. That same year, the country's newly-appointed Chief Justice, Willy Mutunga, characterised the judiciary as being "so frail in its structures; so thin on resources; so low on its confidence; so deficient in integrity; so weak in its public

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48. 'Election lawsuit: New research confirms Constitutional Court's fairness, *The Jakarta Post*, 14 June 2019.

49. Fragoso, H. and Artucio, A. (1980), *Human Rights in Nicaragua: Yesterday and today*, International Commission of Jurists, pp. 50-52.

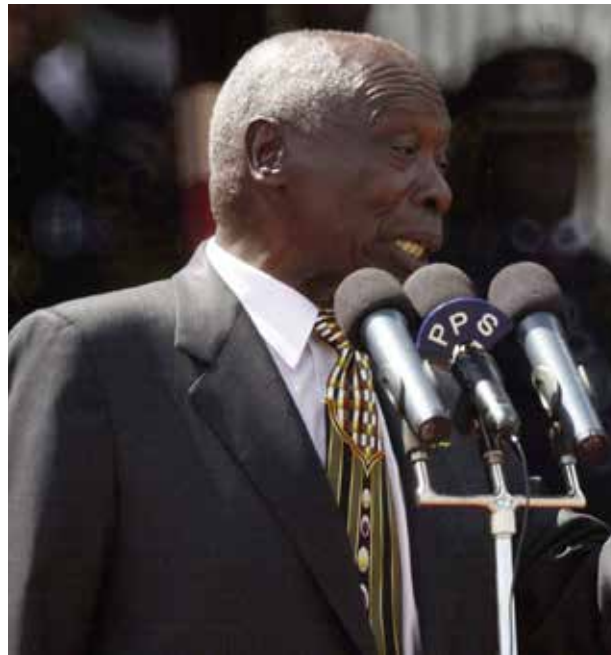
50. Adar, K. and Munyae, I. (2001), 'Human rights abuse in Kenya under Daniel Arap Moi, 1978-2001', *African Studies Quarterly*, Vol. 5, No. 1, p.3.

51. *Ibid.*

52. Mbote, P. and Akech, M. (2011), 'Kenya: Justice sector and rule of law', *Open Societies Foundation*, pp. 1-196.

support that to have expected it to deliver justice was to be wildly optimistic. We found a judiciary that was designed to fail.”<sup>53</sup>

These examples illustrate the importance of a judiciary of sufficient effectiveness and independence that is able uphold the rule of law for both the population and government alike, and is able to enforce due process with relative consistency. The experiences of these nations suggest that this can be enough to give a critical mass of the public sufficient confidence in the rule of law to meet the ultimate test: that they abide by it themselves.



*Kenyan President Daniel arap Moi addresses a crowd gathered at Nyayo National Stadium in Nairobi on the 39th anniversary of Kenya's independence. Moi was in office for 24 years.*

### The transfer of power

A significant test for government legitimacy is whether power can be willingly, consistently, and peacefully transferred.<sup>54</sup> Creating formal mechanisms for the transfer of power and ensuring the continuity of government during the transition promotes institutional resilience. Crucially, such mechanisms also publicise intent: to leave office rather than to stay in power for life, and to govern responsibly, so as to avoid prosecution upon return to

53. Mutunga, W. (2011), "Progress report on the transformation of the judiciary: The first 120 days", speech delivered in Nairobi, Kenya, 19 October.

54. Gilley, B., (2006), 'The Determinants of State Legitimacy: Results for 72 Countries', International Political Science Review, Vol 27, No. 1, pp.47–71

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*In both Botswana and Mauritius, dutifully leaving office at the end of a constitutionally-mandated term was considered a matter of principle for the first generation of post-independence leaders, and became an established and inviolable political convention in both nations.*

civilian life. In addition, they signal a sense of urgency to govern with intentionality, to make the most use of leaders' limited period in office.

For the transfer of power to be deemed legitimate, it must occur peacefully (or, at least, with a minimum of violence). Creating a political culture in which power can be transferred peacefully requires trust – incoming leaders must provide assurances to their predecessors that they will not face vexatious prosecution, nor will they be subject to political harassment. Even more fundamentally, they must be reassured that their lives, and those of their families and officials, will not be jeopardised.

Formal mechanisms for the transfer of power exist in most nations. However, the onus for ensuring peaceful transfer takes place lies, somewhat inevitably, with incumbents. Nonetheless, over time, the transfer of power within developing nations has become more consistent, as well as more peaceful. The percentage of African countries holding democratic elections increased from seven per cent in 1990 to 40 per cent in 2010 according to Freedom House.<sup>55</sup>

The strength and validity of nations' informal mechanisms and norms to ensure the peaceful transfer of power appear to be stronger among the more successful nations reviewed. In both Botswana and Mauritius, dutifully leaving office at the end of a constitutionally-mandated term was considered a matter of principle for the first generation of post-independence leaders, and became an established and inviolable political convention in both nations.

Colombia's political establishment actors proved instrumental in conceiving an innovative mechanism to facilitate the country's transition from military dictatorship. The National Front instituted a form of alternating power-sharing, with the two main parties, the Conservatives and Liberals, taking turns to field a single candidate for the presidency. As a result, the transfer of power was carefully managed every four years between 1958 and 1974, with a minimum of violence. Similarly, Indonesia's military establishment was able to oust the established Sukarno and Suharto in the wake of economic crises in 1966 and 1998, again with the minimum of violence.

Even among successful nations, some leaders had to be cajoled into leaving office with the threat of the removal of aid monies, or through the more innovative use of flattery, as

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55. Puddington, A. (2010), 'Freedom in the world 2010: Erosion of freedom intensifies' *Freedom in the World*.



in the case of American president Jimmy Carter personally persuading Joaquin Balaguer of the Dominican Republic to step aside – resulting in a peaceful, if not altogether voluntary, transfer of power.

Among nations that made less progress in their development, reluctance and failure to cede power were commonplace. In Kenya, Daniel arap Moi served as president for almost a quarter of a century between 1978 and 2002, steadfastly refusing to end one-party rule in the country until 1991 and imprisoning scores of political opponents. Similarly, in Sierra Leone, Siaka Stevens initiated a referendum in 1978 to create a one-party state and thus consolidate his own power, enabling him to stay in office until 1985. In Nicaragua, the consistent failure to transfer power beyond the dynastic Somoza regime proved to be a catalyst for conflict, sparking a revolution that cost an estimated 10,000 lives.

These examples suggest that committing to the peaceful transfer of power is a salient indication of a government's legitimacy, as well as its commitment to upholding the social contract. However, they also suggest that the mechanism for transferring power need not necessarily be democratic for the government's legitimacy to be upheld. Though democratic accountability undoubtedly confers greater legitimacy upon leaders, ensuring that power can be transferred from one leader to another – rather than retained indefinitely – is fundamental. In the absence of free and fair elections, nations are more reliant upon informal mechanisms of power transfer, principally through concerted pressure from establishment actors responding to growing public opposition.

In each case, leaders were willing to acknowledge the scale of opposition, and the detrimental impact their continued premiership would have on the social contract and, ultimately, their nation's development. Within this dynamic, a nation's political and economic establishment actors comprise an invaluable source of leverage. They are uniquely able to make meaningful promises about a leader's safety after leaving office, and to exert significant social pressure upon a leader who is effectively a peer.<sup>56</sup> Where no such individuals existed to exert social pressure, or a group of meaningful peers was absent, leaders often chose to ignore term limits and election results.

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56. Salverda, T. (2015), *The Franco-Mauritian elite: Power and anxiety in the face of change*, (New York: Berghahn), p. 2.

## Summary

The examples of successful nations show how establishing and maintaining legitimacy contributes to the nation's social contract. Though democratic elections and a politically independent judiciary are evidently preferable, these examples suggest that they are not necessarily strict prerequisites for development.

On the other hand, these examples do show the importance of leaders accepting limitations on their power when in office, in the form of both formal and informal executive constraints. They also show that the rule of law cannot be ignored and needs to be applied evenly. There is also a pattern of leaders to demonstrate their willingness to cede power peacefully at the end of their premierships – albeit sometimes with some encouragement. Hence, by embracing a broad-based notion of effective accountability to their populations, leaders can nevertheless establish a sufficient degree of legitimacy.

### To cultivate legitimacy:

- **Establish formal and informal executive constraints** by codifying a series of checks and balances in the constitution, and by encouraging informal constraints upon executive power.
- **Champion the rule of law** by prioritising the creation of an effective judiciary, by maintaining its independence from government, and by abiding by its rulings.
- **Commit to the peaceful transfer of power** by embracing constitutionally mandated term limits and by signalling an intention to leave office peacefully.

### 3. GOVERN COMPETENTLY

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A government's ability to deliver for its people is integral to persuading them of its utility, and thus to upholding the social contract. Successful development outcomes are reliant on the willingness and ability of rulers to govern competently. The scale of the challenge of national socio-economic development is vast, while the resources required to meet it – whether financial or institutional – are often limited within developing nations. Leaders must therefore inevitably prioritise competing demands effectively, enabling them to meet immediate public expectations whilst also laying the foundations for sustained growth.

Much of the recent debate around governance within developing nations has focussed on the issue of institutional capacity-building.<sup>57</sup> Though essential, this trend has arguably placed undue emphasis on underlying structural approaches to governance. Instead, as Francis Fukuyama suggests, 'that there are no globally valid rules for organizational design means that the field of public administration is necessarily more of an art than a science.'<sup>58</sup> Effective administration comprises two key elements: first, having the necessary competence to identify what is needed (and specifically what should be prioritised); second, creating and maintaining an effective mechanism for delivery to ensure that key public services reach the public, as intended.

Doing so successfully requires leaders to adopt a pragmatic approach to governing, making effective use of all available expertise, and matching ambition with capabilities.<sup>59</sup> Crucially, it also requires them to determine national priorities themselves, thus shaping their own agendas. Leaders matter, all the more so in the context of those developing nations, where the wider institutional framework is likely to be weakest.<sup>60</sup>

This chapter examines the relationship between government competence and the social contract. It assesses the importance of two key components. First, the need to prioritise

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57. Hope Sr., R.K. (2009), Capacity Development for Good Governance in Developing Countries: Some Lessons from the Field, *International Journal of Public Administration*, Volume 32, Issue 8, pp. 79-86.

58. Fukuyama, F. (2004), *State-Building: Governance and World Order in the 21st Century*, Ithaca: Cornell University Press, p.43.

59. Andrews, M., Pritchett, L. and Woolcock, M. (2017), *Building state capability: Evidence, analysis, action*, (Oxford: Oxford University Press).

60. Jones, B.F., and Olken, B.A. (2005), Do leaders matter? National leadership and growth since World War II, *Quarterly Journal of Economics*, February, p. 7.

national development above all other policy concerns. Second, the need to build a competent administration as the foundation of effective public service delivery.

### Approaches to national development

Addressing the myriad challenges confronting governments requires leaders to be both pragmatic and inclusive in their approach. In this, the importance of the role of national leaders cannot be overstated. Leaders have a clear causative influence on the economic outcomes of their nations, a pattern that is even more pronounced in autocratic and transitioning nations.<sup>61</sup> Furthermore, it is leaders who are best able to avoid the significant opportunity cost associated with conflict beyond their borders, which is estimated to reduce economic growth by between two per cent and eight per cent, whilst those nations bordering conflict zones typically experience an average decline in GDP of 1.4 per cent, and an average rise in inflation of 1.7 per cent.<sup>62</sup>

Exercising leadership to promote wellbeing and development is therefore integral to national socio-economic development. This poses inevitable obstacles for developing nations, where the number and scale of developmental challenges are daunting, where governments often lack the resources required to address them simultaneously, and where leaders are more reliant upon patronage for support.

For such development to be widespread, leaders must be both willing and able to govern for the whole nation. Showing discreet preference to particular groups on the basis of their religious, ethnic, or tribal affiliation reinforces societal divisions, and thus promotes factionalism. This phenomenon has been characterised as 'the proverbial squeaky wheel' in system breakdown, and a key indication of a wider weakness of the social contract.<sup>63</sup> Moreover, it is especially strongly associated with several of the hallmarks of intra-state instability, with the forceful repression of opposition groups commonly resulting in regime change characterised by violent rather than peaceful means.

Many nations who have made progress in their development have adopted pragmatic and inclusive approaches to governance, including deliberate efforts on the part of the

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61. Jones, B.F., and Olken, B.A. (2005), Do leaders matter? National leadership and growth since World War II, *Quarterly Journal of Economics*, February, p. 26.

62. World Bank (2018), The economic cost of conflict, Discussion Paper.

63. Marshall, M.G. (2008), *Fragility, instability, and the failure of states assessing sources of systemic risk*, Council on Foreign Relations, p.20.

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*One of the remarkable consistencies of Mauritian politics since independence has been its inconsistency; the incessant creation, merging, and disbanding of political parties ensures they remain responsive to, and representative of, the nation as a whole.*

government to form a coalition, where the interests of all major ethnic and religious groups were represented.<sup>64</sup> This mode of governance has helped to ensure that policymaking is used as a tool to unite, rather than divide, the country. In Mauritius, the near-constant process of coalition-forming in early post-independence history provided essential popular legitimacy for its first governments, as nearly every ethnic and religious group was represented. More practically, it safeguarded against factionalisation, by ensuring that the government acted in the interests of the nation as a whole, thus avoiding a damaging ethnicisation of its politics.<sup>65</sup> One of the remarkable consistencies of Mauritian politics since independence has been its inconsistency; the incessant creation, merging, and disbanding of political parties ensures they remain responsive to, and representative of, the nation as a whole. Instead of creating political inertia, this tradition of coalition governments has established an informal system of checks and balances, guaranteeing the prioritisation of national interests, rather than factional ones.<sup>66</sup>

Similarly, in Botswana, Sir Seretse Khama prioritised key bi-lateral relationships with South Africa and the United Kingdom when he became president in 1966. His intentional decision to prioritise pragmatism and Botswana's broader national interest resulted in the government's acceptance of British aid to finance domestic expenditures from the time of independence in 1966 until 1972.<sup>67</sup> Moreover, he chose to keep Botswana in the Southern African Development Community (SADC), a customs union which included South Africa. The decision to maintain an open partnership with both the country's former colonisers and apartheid-era neighbours was politically problematic, but economically sound; it provided Botswana with the time required to establish its medium-term priorities for national development.

Although Sri Lanka's development progress has been significant, its leaders' divisive use of policymaking is nevertheless instructive. The repeated use of legislation to limit or deny minorities citizenship and to exclude them from economic and political activity formalised the country's ethnic fault lines. The 1948 Ceylon Citizenship Act effectively denied

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64. Nooruddin, I. (2010), *Coalition politics and economic development: Credibility and the strength of weak governments*, (Cambridge: Cambridge University Press).

65. Bunwaree, S. and Kasenally, R. (2005), *Political parties and democracy in Mauritius*, EISA Research Report No 19, pp. 23-25.

66. Bunwaree, S. and Kasenally, R. (2005), *Political parties and democracy in Mauritius*, EISA Research Report No 19, pp. 23-25.

67. Eriksen, S.S. (2011), The possibility of state formation: The experience of Botswana in a theoretical perspective, *The European Journal of Development Research*, 23(3), p.446.

citizenship to large portions of the Tamil minority, who were then eligible for deportation. The Sinhala Only Act (1956) made Sinhala the only official language of the country and served to bar Tamil-speakers from serving in government or the civil service. Non-Sinhala were also ineligible for land redistribution programmes which began in the 1960s, after the government nationalised holdings larger than a quarter-acre, thus undermining the principle of property rights.<sup>68</sup> Similarly, a government-led affirmative action scheme established in the 1970s reduced the number of Tamils able to attend university, by awarding places by region rather than results. The inevitable grievances created by such divisive policies were instrumental to the country's thirty-year civil war. Young Tamil men, denied education, employment, property, and citizenship, felt no loyalty to the state. Instead, from the 1970s they began to militarise, laying the groundwork for conflict.<sup>69</sup>

The experiences of nations who made less progress similarly illustrate the consequences of failing to harmonise a political system that reflects ethnic divisions. In both Kenya and Sierra Leone, post-independence leaders have used political patronage excessively as a means of consolidating their authority. Such patronage has been extended almost exclusively to members of their own ethnicity, creating an alternating, zero sum political dynamic. Taking one's turn at the table to 'eat', to profit while one's party is in power, is an entrenched feature of this dynamic in both nations.<sup>70</sup>

Consequently, politics has become a means of reinforcing, rather than resolving, both countries' extant ethnic divisions. For example, the explicit promotion or demotion of individuals based on their tribal affiliation was the norm in Sierra Leonean public service for decades; the Margai brothers, who were the first and second prime ministers of the country, sought to dominate the officers corps with members of their own tribe, the Mende. When Siaka Stevens took power, he deliberately purged the Mende from those ranks, seeking to promote tribes considered to be more loyal to him. Stevens even sought to use the powers of his office to penalise those tribes who had not offered him their support, removing railroad tracks leading to those regions, thus diminishing their access to critical infrastructure. The perpetuation of this trend continues. It is therefore not surprising that voting affiliation has historically been based on one's tribe, to the extent that the 2002

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68. Sri Lankan Ministry of Internal and Home Affairs, Provincial Councils and Local Government (2019), *Environment and social management framework for transport connectivity and asset management project*, June, p. 22.

69. DeVotta, N. (2009), 'The liberation Tigers of Tamil Eelam and the lost quest for separatism in Sri Lanka', *Asian Survey*, Vol. 49, No. 6, pp.1021–1051.

70. Wrong, M. (2005), *It's our turn to eat: The story of a Kenyan whistle-blower*, (New York: Harper Collins).

election results returned a geographic and tribal distribution of votes for the two major parties which mirrored, almost exactly, the results of the 1962 polls.<sup>71</sup>

Kenya's ethnically-divided politics can trace their roots back to the British colonial administration's restriction of nascent Kenyan political organisations to representing a single tribe – virtually ensuring that, at the point of independence, the country would be left with an ethnically-divided political system designed to represent the interests of only one tribe at a time.<sup>72</sup> The country's first post-independence prime minister, Jomo Kenyatta, sought to consolidate his personal power through a system of nepotism in which Kikuyus benefitted disproportionately.<sup>73</sup> Unlike in Sierra Leone, the fallout was felt most not by other Kenyan tribes, but by those perceived to be outsiders, notably non-Kenyans, and especially non-black Kenyans. Though presented artfully as the Africanisation of Kenya's public sector, Kenyatta succeeded in placing loyalists in key positions throughout the public sector, ensuring that 'state power was placed firmly in the hands of those who had direct loyalty to the person of the president.'<sup>74 75</sup>

However, such practices proved detrimental to the broader, socio-economic development of both nations. As well as reinforcing the notion that political and tribal affiliation are intrinsically linked, the excessive use of nepotism prevented the development of the cadre of experienced administrators essential to implement successive governments' programmes for government, or the professionalised military required to uphold national sovereignty and resist intervening in national politics. More fundamentally, it undermined the very notion of the nation state in the eyes of those excluded from benefitting from it.<sup>76</sup>

71. Robinson, J. A. (2008), *Governance and political economy constraints to World Bank CAS priorities in Sierra Leone*, Unpublished manuscript, (Washington DC: World Bank).

72. Morrock, R. (1973), 'Heritage of strife: The effects of colonialist 'divide and rule' strategy upon the colonized peoples', *Science & Society*, Vol. 37, No. 2, pp. 129-151.

73. Odhiambo-Mbai, C. (2003), *The Politics of Transition in Kenya: From KANU to NARC*, Heinrich Boell Foundation, p. 51.

74. Odhiambo-Mbai, C. (2003), 'Public service accountability and governance in Kenya since independence', *African Journal of Political Science*, 113, Vol. 8, No. 1, p. 120.

75. Asingo, P. (2003), 'The political economy of transition in Kenya' in Oyugi, W. O. et al (eds), *The politics of transition in Kenya: From KANU to NARC*, (Berlin: Heinrich Boell Foundation), p. 15.

76. Wimmer, A. (2017), 'Power and pride: National identity and ethno-political inequality around the world', *World Politics*, Vol. 69, No. 4, pp. 605-39.

## Administrative competence

Delivering public services effectively, especially across a large territory, requires considerable administrative capacity. A functioning – and meritocratic – civil service is one of the key institutional foundations of successful nations, providing continuity between governments and professionalised service delivery.<sup>77</sup> Creating and sustaining such an institution is therefore a major challenge confronting developing nations. It requires a steady stream of personnel capable of discharging complex administrative functions, an ability to oversee their training and development, and a remuneration structure which is a sufficient disincentive to corruption.

For many developing nations, this can be problematic. Poor standards of education produce too few graduates, while governments are frequently unable to pay them an attractive wage. This poses a major obstacle for the socio-economic development of nations in transition. Reforming public administration thus lies 'at the heart' of state building and requires appropriate prioritisation.<sup>78</sup> The implications of a dysfunctional civil service impact essential areas of public administration, from planning, budgeting, and implementing policy decisions, and can adversely affect all areas of government activity, as well as nations' ability to interact effectively with donors.

There are short- and long-term solutions to the challenge of building a competent administration. In the short term, identifying skill gaps and bringing in external assistance can boost the competency of government and speed up the process of training domestic civil servants. Where governments did not have the domestic competency required to staff an administration, successful nations often identified and engaged suitable external actors capable of designing and overseeing systems to deliver public services, even at very senior levels of the civil service. In certain circumstances, they were even able to convince a bilateral donor to fund the temporary outsourcing of this key government function. This willingness proved essential in enabling them to meet a minimum threshold of administrative competence.

Botswana's exceptional institutional capacity is due, in part, to the early policy of prioritising the hiring and retention of foreign experts in the public service, resisting the

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77. Rothstein, B. and Holmberg, S. (2011). *The Quality of Government: Corruption, Social Trust, and Inequality in International Perspective*, (Chicago: Univ. Chicago Press)

78. Crane, K. (2010), *Building a More Resilient Haitian State*, (Washington DC: RAND Corporation), p.27.



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*Commonwealth-trained judges were also used to bolster the nascent legal system; to this day, South African judges (who must retire at 70) often sit on the Botswanan bench after they have retired in South Africa.*

trend towards immediate Africanisation which swept across most of the continent during the post-independence period.<sup>79</sup> This was, in part, a reflection of reality: at independence, 97 per cent of senior posts, and 63 per cent of all posts in the civil service were held by expatriates. But it was also based on pragmatism. In a 1967 speech to the civil service, Sir Seretse Khama stated that he had been 'quite unequivocal about the fact that we would never sacrifice efficiency on the altar of localization.'<sup>80</sup>

These expatriates were used to bolster everything from the educational system to the roll-out of reforms, and were critical to the success of the government's state-led development strategy, which failed so spectacularly in other African states.<sup>81</sup> Commonwealth-trained judges were also used to bolster the nascent legal system; to this day, South African judges (who must retire at 70) often sit on the Botswanan bench after they have retired in South Africa.

Simultaneously, the government was taking steps to ensure that Botswana would be able to move into public sector jobs. It effectively absorbed the available supply of university graduates for the first few decades of independence and provided additional training and educational opportunities for future civil servants who were in the process of shadowing their expatriate counterpart. A clear and public rubric for the hiring and promotion of civil servants was also established, setting minimum levels of education, which guaranteed that those who were unqualified but well-connected could not become an obstacle to progress. As the population became better skilled and better educated, the government took another radical decision: the first generation of civil servants, who tended to be less well-educated than newer and younger colleagues, were asked to retire at the age of 45.

While the government was highly receptive to external assistance, it retained control over what form that help could take, and where and when it would be given. Even when most government expenditure was funded externally, the Botswanan government dutifully set National Development Plans every two years, and firmly advised donors to conform their funding offers to those NDPs. This display of sovereign control, especially in the years that Botswana was not actually funding its own government, guaranteed that the country did not miss critical years of development prioritising donors' goals over their own. The posture of the Botswanan government during this period, and its mode of interaction with these

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79. Maipose, G. S. (2008), *Policy and institutional dynamics of sustained development in Botswana*, (Washington DC: World Bank).

80. Williams, S. (2007), *Colour bar: The triumph of Seretse Khama and his nation*, (London; Penguin).

81. *Ibid.*

external advisors, is reflected in much of the best-practice literature on capacity-building today.<sup>82</sup>

Indonesia also made use of the technical assistance available to it following independence. Its strategic importance to the Cold War-era United States meant that the new country was in a uniquely privileged position: Washington offered to sponsor the education of new technocrats at doctoral programmes in New York and California, and also paid to send American professors to teach at the University of Jakarta. This experiment bore fruit almost immediately, when poor macroeconomic management led to a balance of payments crisis in the mid-1960s. Suharto came to power in the middle of this crisis, after launching a military coup d'état against Sukarno, which was based largely on concerns over his handling of the economy. Suharto made the extremely prudent decision to leave economic policymaking to civilians, rather than his former colleagues in the military. This led to the hiring of a group of Indonesian economists who had trained at the University of California Berkeley as part of this initiative, who were instructed to remedy spiralling inflation and a situation of general economic collapse. Within three years, these economists had crafted policy which managed to get inflation down to double-digits whilst avoiding recession.



*Suharto, President of Indonesia between 1968 and 1998.*

82. Timmis, H. (2018), *Lessons from donor support to technical assistance programmes*, (Brighton: Institute of Development Studies), pp.1-18,

This preference for efficiency over ideology was seen again in the mid-1980s, when declining oil prices and a concern that the Indonesian economy was uncompetitive led the government to seek high-impact, low-cost reforms: these included reducing trade barriers between islands, but also hiring a Swiss customs firm to replace the ruinously corrupt bureaucrats who had previously been left in charge of collecting tariffs and inspecting goods.<sup>83</sup>

Conversely, less successful nations are often characterised by a lack of administrative competence. Too often, the civil service is seen as a vehicle for political patronage, rather than for public service delivery.<sup>84</sup> Such nations, especially at the point of independence, have often sought to remove foreigners from administrative positions, no matter the lack of similarly qualified nationals, and to marginalise and exclude foreign influence from their administrations.

Kenya's nascent political parties made a virtue of factionalism.<sup>85</sup> Jomo Kenyatta, Kenya's first prime minister (and subsequently president), sought to consolidate his personal power through a complex system of patronage. This was achieved primarily through the Africanisation of public sector jobs, particularly in the civil service. Control of the state apparatus was the explicit aim here:

'the reason the [Kenya African National Unity] KANU ruling elite Africanised the senior positions in the public service mainly with those who were related or close to them, and at the same time transferred most of the state power to the control of this category of public servants, was to ensure that state power was placed firmly in the hands of those who had direct loyalty to the person of the president.'<sup>86</sup>

Kenyatta was also largely successful in securing the loyalty of politicians and public sector workers alike; he "perfected the art of neo-patrimonialism", creating in himself the rationale for the continued existence of the state.<sup>87</sup>

83. Temple, J.R.W. (2001), *Growing into trouble: Indonesia after 1966*, CEPR Discussion Paper, p 25.

84. Shepherd, G.S. (2003), 'Civil Service reform in developing countries: Why is it going badly?', World Bank Conference Paper.

85. Odhiambo-Mbai, C. (2003), 'The rise and fall of the autocratic state in Kenya' in Oyugi, W.O. et al (eds.), *The politics of transition in Kenya: From KANU to NARC*, (Berlin: Heinrich Boell Foundation).

86. Odhiambo-Mbai, C. (2003), 'Public service accountability and governance in Kenya since independence', *African Journal of Political Science*, p. 113.

87. Asingo, D. (2003), 'The Political Economy of transition in Kenya' in Oyugi, W.O. et al (eds), *The politics of transition in Kenya: From KANU to NARC*, p. 15.

## Summary

Responding to the numerous, urgent challenges of national development is a daunting prospect. Limited institutional capability often makes governing an exercise in crisis management, preventing leaders from conceiving and implementing an agenda for long-term transformation. Moreover, the so-called 'good governance' agenda is seemingly endless, and "contains little guidance about what is essential and what is not, what should come first and what should follow, what can be achieved in the short term and what can only be achieved over the longer term, what is feasible and what is not."<sup>88</sup>

The experiences of the successful featured nations illustrate the benefits of adopting both an inclusive and a pragmatic approach. National leadership provides a unique opportunity to act as a unifying agent, demonstrating both the intention and the ability to govern inclusively. The successful examples of Mauritius, Indonesia, and Botswana each provided national leadership, albeit in different ways.

In addition, there is a clear contrast between the administrative competence of these countries and those of others such as Kenya and Sierra Leone. The most effective leaders also adopted a proactive approach to engaging with international partners, using them to provide financial and technical support to national development priorities.

### To govern competently:

- Adopt a pragmatic and inclusive approach to national development by making development the first priority, by avoiding factionalism, and by demonstrating a determination to govern for the good of all.
- Build a competent administration by prioritising the creation of an effective bureaucracy, making use of international expertise where necessary.

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<sup>88</sup>. Grindle, M.S. (2004), 'Good enough governance: Poverty reduction and reform in developing countries', *Governance*, Vol. 17, No. 4, pp. 525-548.

## CONCLUSION TO PART ONE

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The contrasting experiences of the featured nations illustrate how forging a strong social contract is related to successful national socio-economic development. They also illustrate that the onus for maintaining a nation's social contract lies, ultimately, with the government. National leaders must be able to demonstrate to their citizens that the benefits of formal government outweigh the alternatives; by providing security, and by correctly identifying – and delivering – on national priorities.

The experiences of these nations suggest that whilst governments must keep their people safe, it is possible to develop despite bouts of chronic insecurity, providing the government is able to contain them and limit their impact on the majority of the population. They suggest that whilst it is imperative that governments are accountable to their people, this accountability can come in a variety of informal formats. They suggest that whilst competent government is an obvious pre-requisite for public confidence, administrations can make copious use of international support to fill key gaps in their administrative capability.

This is no small task. In each instance, the government has been responsible for nothing short of nation-building, seeking to secure, define, and develop their country. And in each instance, this task has been undertaken by leaders with often limited executive experience, and with often insufficient resources and structures to implement their policy agenda. Within this context, the progress made by many successful nations should serve as a source of inspiration. Though this progress was predictably fitful, many nations have nevertheless succeeded in making significant advances.

These experiences also illustrate the importance of executive intentionality. A notable distinction between the successful and less successful nations reviewed has been the determination of leaders to prioritise their nation's development over everything else – especially their own grip on power. This intentionality proved indispensable to what governments were willing and able to deliver for their citizens. As important, it provided nascent governments with the essential ingredient: legitimacy.

This legitimacy took a variety of forms across successful nations, and often bore little resemblance to western notions of government. However, in each case, it was sufficient to create the all-important minimum threshold for development. Though far from perfect, leaders were considered as legitimate enough to establish a social contract with their people, and thus able to persuade them that they were in power for the national interest, rather than their own.

## INSIGHT: The interrelationship between the social contract and corruption

Arguably the best indication of the health of a nation's social contract is its level of corruption. Commonly defined as the abuse of public office for private gain, corruption presents a significant challenge to many developing nations. Its cost is notoriously difficult to quantify, with the World Bank estimating that illicit payments cost the global economy \$1 trillion each year.<sup>89</sup> However, this conceals the true cost of corruption to national development: the opportunity cost. Each act of bribery, embezzlement, fraud, collusion, extortion, patronage, clientelism, and nepotism weakens government capacity.<sup>90</sup> Children are left unvaccinated and uneducated, the civil service is left understaffed, and public goods are left undelivered.

The presence of corruption is, by any definition, a visible breakdown in state-societal relationship. It is arguably the definitive symptom of a weak – or non-existent – social contract.<sup>91</sup> In a society where institutions are unable to cope with the collective wants and needs of citizens, engaging in corruption is often the most expeditious route to accomplishing a given task.<sup>92</sup> It should not be surprising, therefore, that corrupt behaviours are highly correlated with poor governance and economic outcomes and, conversely, that the ancillary benefits of institutional growth tend to aid the reduction of corruption. Countries with strong political competition, as evinced by the existence of strong issue-based political parties, tend to be less corrupt than countries that remain dependent upon familial, tribal, or ethnic structures for political organisation.<sup>93</sup> Even in otherwise corrupt countries, the level of bribes tends to be lower than in countries with little political competition.<sup>94</sup>

Though all ten of our case study nations experienced severe levels of corruption at various stages of their development, many of the successful examples were able to address it through the gradual strengthening of their social contract, rather than as a result of any

89. UN (2018), 'Global cost of corruption at least 5 per cent of world Gross Domestic Product, Secretary-General tells Security Council, citing World Economic Forum data', Press Release, 10 September.

90. The Department for International Development (2015), 'Why corruption matters: understanding causes, effects, and how to address them', p.12.

91. This view accords with the *collective action* theory of corruption. See Rothstein, B. (2011), 'Anti-corruption: The indirect 'big bang' approach', in *Review of International Political Economy* (May), p.7.

92. Christensen, C. M., Ojomo, E., and Dillon, K. (2019), *The prosperity paradox*, (New York: Harper Business).

93. Huntington, S. (1968), *Political order in changing societies*, (New Haven: Yale University Press), p. 71.

94. Shleifer, A. and Vishny, R.W. (1993), 'Corruption', *The Quarterly Journal of Economics* (August), p. 610.

singular governmental effort to identify and prosecute those profiting from corruption.<sup>95</sup> This often followed an inflection point, such as economic crisis in Indonesia, political violence in Colombia, or civil unrest in Sri Lanka. In contrast, the less successful countries all suffered from persistent corruption, despite the prevalence of regular and high-profile campaigns aimed at eradicating it. Instead, in each case, corruption had become entrenched, and a key feature of the country's weak social contract. This was perhaps best exemplified by the Jordanian culture of *Wasta*, a system of position and privilege which has been found to reduce citizens' belief in their own political agency, in the likelihood of meaningful reform, and in the robustness of their own institutions and political leaders.<sup>96</sup>

The experience of both the more and the less successful examples indicates the caustic impact of systemic corruption on development outcomes. They also suggest that attempts to address collective action variants of corruption through legislative or judicial means are illusory. Corruption of this nature is symptomatic of more than opportunistic criminality; it indicates a more fundamental breakdown of nations' social contracts, which can be reconstituted only through governments and political leaders governing in the exclusive interest of their citizens.

Achieving this requires an ambitious programme of socio-economic reform, and the determination to see it through. As has been found elsewhere, countries that addressed corruption had political leaders who pushed through these reforms, giving a new face to a new way of doing politics.<sup>97</sup> They also tended to evolve towards a reasonably meritocratic civil service (even if the posts at the top remained quite political), established a domestic revenues base, and pushed out the bounds of the colonial-era education system (often religious and insular) to be universal and secular.<sup>98</sup> Anti-corruption policy becomes, in other words, policy for institutional development.

Understanding systemic corruption as the outcome of poor governance and low levels of trust, rather than its root cause, is essential to tackling it successfully. Though the anti-corruption orthodoxy prescribes punitive action against those engaged in corruption,

95. Rothstein, B. (2011), 'Anti-corruption: The indirect 'big bang' approach', in *Review of International Political Economy* (May), p. 23.

96. Jones, D.A. (2016), *Vitamin or poison?: Wasta and politics in Jordan*, Ph.D. thesis (University of New Jersey).

97. Persson, A, Rothstein, B, and Teorell, J. (2013), 'Why anticorruption reforms fail – Systemic corruption as a collective action problem' in *Governance*, Vol. 26, No. 3, July), p.465.

98. These steps closely match those laid out by Rothstein and Tannenber in their 2015 publication, *The quality of government and development policy*.

such an approach can be effective only in cases where corruption is not systemic. Though high-profile cases may signal intent, they ultimately fail to engender the behavioural change required to address systemic corruption. Thus, the solutions suggested by the principal agent theory of corruption (a combination of transparency initiatives and punitive measures) will, on their own, prove insufficient; though they will secure convictions, they fail to address these socio-economic root causes of systemic corruption. Without concerted action to strengthen nations' social contracts and to address the most high-profile instances, corruption will remain a major threat to the process of national development.



# Part Two

Building open  
economies

## INTRODUCTION TO PART TWO

The concept of development has long been synonymous with one thing: economic growth. Although there remains no agreed definition of what it means to be a 'developing' country, the majority of those used by the World Bank, International Monetary Fund (IMF), and other international financial institutions (IFIs) are formulated on gross national income (GNI) per capita.<sup>1</sup> In addition, the rate of growth in gross domestic product (GDP) is used as a key metric for Goal 8 of the United Nations' Sustainable Development Goals (SDGs). As such, while the process of national development is generally acknowledged to be multifaceted, the ultimate measure of progress remains sustained economic growth.

Whilst such measures are invaluable in charting the performance of national economies, they offer little guidance as to how nations can achieve and sustain robust levels of economic growth required for development. One of the most cogent – but controversial – attempts to codify a prescription for sustained economic growth at the national level is the Washington Consensus.<sup>2</sup> First coined by John Williamson in his 1990 book, export-led growth and import-substituting industrialisation it comprised ten policies which Williamson had often observed were used as conditionalities for countries accepting structural adjustment agreements from the IMF throughout the 1980s.<sup>3</sup>

Contrary to the prevailing logic of import-substitution, the Washington Consensus suggested that the method of preventing future crises was not the insulation of the national economy from the fluctuations of global markets, but an open embrace of free trade and competition, combined with fiscal discipline. While this approach was reasonably common amongst OECD countries, it was somewhat unorthodox for developing nations, many of which were characterised by import-substitution industrialisation (ISI) policies, designed

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1. Lyngge, N. (2011), *Classifications of countries based on their level of development: How it is done and how it could be done*, International Monetary Fund Working Paper 11/31.

2. The set of policies described by Williamson has been blamed for high levels of unemployment in Latin America. See Joseph Stiglitz's *Globalization and its discontents* (2002).

3. The ten principles of the Washington Consensus are fiscal discipline; public expenditure focussed on education, health, and infrastructure; tax reform to lower marginal rates and broaden the tax base; interest rate liberalisation; a competitive exchange rate; trade liberalisation; liberalisation of inflows of foreign direct investment; privatisation of state-owned enterprises; deregulation to promote competition; property rights protection.

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*Economic progress is not linear. Nations are confronted with a dizzying array of challenges in their efforts to forge an economy in which every citizen can participate.*

to promote self-sufficiency and the growth of new industries. ISI prescribed heavy state involvement in the national economy, and high levels of protection for domestic industry, using a variety of policy measures to make imported goods uncompetitive or to prohibit their existence altogether.<sup>4</sup>

Although such measures were diametrically opposed views of how economic growth would or could occur, both were rooted in the idea that nothing less than wholesale transformation would be enough to catalyse real change in developing countries. This transformation – from rural, agrarian economies characterised by large-scale subsistence agriculture to those configured towards industrialisation and diversification – underpins the development process.

Economic progress is not linear. Nations are confronted with a dizzying array of challenges in their efforts to forge an economy in which every citizen can participate. The following three chapters examine different aspects of the task of building open economies. The first assesses the importance of maintaining macroeconomic stability, and the role played by effective fiscal and monetary management. The second analyses the need to create a domestic asset base, predicated on an effective system of property rights and a formalised finance sector. The third analyses the centrality of trade and competition to sustainable growth.

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4. Waterbury, J. (1999), 'The long gestation and brief triumph of import substituting industrialization', *World Development*, Vol. 27, No. 2, pp. 323-341.

## 4. DEVELOP MACROECONOMIC RESILIENCE

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Macroeconomic resilience provides the foundation for a strong economy. The entirety of a national economy is impacted by factors such as interest rates, inflation, and budget deficits. The most prominent expression of global macroeconomic orthodoxy focusses on several key features of economic resilience, including small budget deficits, a broad tax base, financial liberalisation, and a unified, competitive exchange rate.<sup>5</sup>

Such measures are essentially defensive: in the face of internal or external economic shocks, nations that have broadly adhered to the principles listed above will have room to manoeuvre in terms of a structural policy response. On the other hand, a nation that is struggling to pay the interest on its debts or using precious foreign exchange to defend the value of its currency, will have fewer options for crisis response; and such options have tended to come with conditionalities.

Developing macroeconomic resilience requires leaders to balance both economic and political imperatives, and to prioritise long-term development objectives. This chapter examines the three key features of macroeconomic resilience: first, it assesses the importance of raising sufficient revenues; second, it analyses the need to prioritise fiscal sustainability; finally, it explores the centrality of monetary stability.

### Revenues

The regularised collection of revenues constitutes a positive step towards establishing fiscal independence and provides the requisite funding for public expenditure, supporting every aspect of state function, from the provision of healthcare and education to infrastructure investment. Setting up a tax system that collects enough to fund government activities is a critical task for developing countries.

However, whilst high-income nations typically collect an average of around 40 per cent of GDP in taxation, low-income nations collect closer to ten per cent.<sup>6</sup> The question of how best to increase taxation to an appropriate level therefore lies 'at the heart of state

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5. Williamson, J. (ed.) (2004), *The political economy of policy reform*, Peterson Institute for International Economics.

6. Besley, T. and Persson, T. (2014), 'Why do developing countries tax so little?', *Journal of Economic Perspectives*, Vol. 28, No. 4 (Fall) pp. 99–120, p.99.

development.<sup>7</sup> Over half a century ago, the economist Nicholas Kaldor suggested that for a country to become 'developed', it needed to collect taxes at between 25 and 30 per cent of GDP. More recently, empirical evidence put the threshold at 36 per cent for high-income, 28.8 per cent for upper middle-income, 16.5 per cent for middle income, and 13.9 per cent for low income.<sup>8</sup>

Typically, progress in revenue raising has been characterised by a broadened base with fewer exemptions. However, developing nations face a plethora of stubborn structural challenges to revenue collection, not least varying degrees of bureaucratic resource and competence. The more apposite question, therefore, is to ask what constitutes 'sufficient' revenues. In other words, where does the minimum threshold lie, and what efficiencies can be achieved towards fiscal capacity in otherwise weak bureaucracies?

The path of development for many countries has involved moving from a widespread dependency on trade taxes (which are the simplest to collect and enforce), to a system based on revenue collection from domestic businesses and individuals. Such countries also tend to work to make compliance with tax systems straightforward, setting reasonable rates and simplifying their tax codes.<sup>9</sup> This helped to ensure that individuals and businesses understood what they were required to pay – and also ensured that government authorities could more easily enforce revenue collection. These patterns are echoed amongst the more successful nations reviewed.

Early governments of Botswana were anxious to reduce their dependence upon the customs revenues generated by the Southern African Customs Union (SACU), of which Botswana is a founder-member. Prior to 1994, SACU was dominated by apartheid governments hostile to the existence of a black majority state in Southern Africa; hence, the desire to find other sources of revenue was understandable. The state consolidated various colonial-era tax laws into the Income Tax Act of 1973, which laid the groundwork for a modern system for revenue collection. This system has undergone successive bouts of reform in the following decades to increase efficiencies and ensure it remains reflective of the nature of the economy. As a result, though mineral revenues still outpace income tax as a source of

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7. Besley, T. and Persson, T. (2013), 'Taxation and development' in Auerbach, A., Chetty, R., Feldstein, M., and Saez, E. (eds.), *Handbook of Public Economics* (Volume 5), (Amsterdam; New York: Elsevier Science).

8. Pessino, C., and Fenochietto, R. (2010), Determining countries' tax efforts, *Hacienda Pública Española/Revista de Economía Pública*, 195, pp. 61–83.

9. Genschel, P. and Seelkopf, L. (2016), "Did they learn to tax? Taxation trends outside the OECD", *Review of International Political Economy* 23:2, pp. 316–344.

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*Indonesia made notable progress in expanding its tax base as part of a concerted effort to reduce its reliance upon oil revenues, which comprised some 80 per cent of government revenues in the early 1980s.*

government funding, Botswana nevertheless boasts a simple and fair tax system with high rates of compliance.<sup>10</sup>

Mauritius consolidated its commitment to tax reform with a raft of new initiatives unveiled in 2006, which amended rates of personal and corporate income tax. The measures included the elimination of over twenty types of personal income tax allowances and deductions, a reduction in the number of tax bands and rates, the creation of a single tax rate of fifteen per cent, and the halving of the country's tariffs.<sup>11</sup>

Similarly, Indonesia made notable progress in expanding its tax base as part of a concerted effort to reduce its reliance upon oil revenues, which comprised some 80 per cent of government revenues in the early 1980s. President Suharto introduced the country's first major tax reform in 1984, which repealed pre-independence legislation to drastically broaden the tax base. Individual and corporate tax rates were reduced, whilst companies were required to withhold taxes on wages.<sup>12</sup> These measures proved highly effective, achieving the stated aim of reducing Indonesia's reliance upon oil, which had fallen to around fifteen per cent of government revenues by 2005.<sup>13</sup>

The revenue mobilisation experiences of the less successful nations reviewed paint a contrasting picture. For example, almost 80 per cent of the population of Nicaragua pay no income tax as they fall into the lowest bracket, and tax evasion by those who are meant to pay is considered widespread. Worse still, there is an 'endemic lack of political will to reduce evasion, to broaden the corporate income tax base (by eliminating exemptions, for example), and to align nominal or legal taxes with the taxes that are actually charged'.<sup>14</sup> The 'shadow economy' is consequently estimated to be 45 per cent of GNP in Nicaragua, and only two-thirds of sales are reported to the revenue authority (compared to 98 per cent in Chile).<sup>15</sup>

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10. Ndlovu, T. (2016), *Fiscal histories of sub-Saharan Africa: The case of Botswana*, Public Affairs Research Institute (PARI), University of the Witwatersrand, Working Paper Series: No. 1.

11. Lal, S. (2014), 'Tax incentive reforms: The Mauritian experience', *Commonwealth Growth and Governance*, (London: Commonwealth Secretariat), pp.83-84.

12. Prasetyo, K. (2017), 'Tax administration reform and the society in Indonesia: Some lessons learnt', Conference Paper presented at the 29th Australasian Tax Teachers Association Annual Conference, Masterton, New Zealand.

13. khsan, M., Trialdi, L. and Syahril, S. (2005), 'Indonesia's new tax reform: Potential and direction', *Journal of Asian Economics*, Vol. 16, p. 1031.

14. Itriago, D. (2011), *Owning development: Taxation to fight poverty*, Oxfam Research Report.

15. Alm, J. and Martinez-Vasquez, J. (2007), *Tax Morale and Tax Evasion in Latin America*, International Center for Public Policy, Andrew Young School of Policy Studies, Georgia State University Working Paper 07-04.

Despite various programmes of tax reform, Kenya has failed to address key institutional weaknesses, which have contributed to persistent problems of low compliance and rampant corruption.<sup>16</sup> Tax evasion – mostly from Kenya’s vast informal economy – is estimated to increase the deficit by about five per cent a year, costing the Kenyan government hundreds of millions of shillings per annum in lost revenues.<sup>17</sup> Levels of non-compliance reflect many of the weaknesses inherent within the tax code itself: rates and structures are difficult to administer and are inconsistently enforced, providing opportunities for differential treatment of individuals and businesses in similar circumstances, depending on their ability to circumvent the system.<sup>18</sup> Consequently, levels of compliance to VAT and income tax remain unsustainably low, at 55 per cent and 30 per cent respectively.<sup>19</sup> Furthermore, there is little evidence to suggest the vast array of tax exemptions offered by the government has succeeded in attracting greater levels of foreign investment. Instead, they have simply resulted in the loss of significant tax revenues.<sup>20</sup>

Post-independence governments of Sierra Leone struggled to create an effective tax system. Unlike in Botswana, where the central government assigned itself exclusive soil and subsoil mineral rights, much of Sierra Leone’s revenue collection, including its minerals, was left to the tribal chiefs. This decentralisation of taxation resulted, inevitably, in vastly diminished revenues reaching the central government in Freetown. The situation was further exacerbated by a deeply complex system riddled with internal contradictions: by 2005, a company in full compliance with the national tax code would have paid an effective rate of 236 per cent.<sup>21</sup> This failure to centralise revenue collection, combined with the failure to reform the tax code, has left Sierra Leone unduly reliant on tariffs. By 2005, tariffs represented 40 per cent of all government revenues. More concerning still, those tariff revenues were one-third the size of foreign aid receipts. The Sierra Leonean state, in short, was not capable of funding itself – and its tax policies were serving to suppress what nascent economic activity did exist.

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16. Waris, A. (2007), ‘Taxation without principles: A historical analysis of the Kenyan taxation system’, *Kenya Law Review*, Vol. 1, pp. 272-304.

17. ‘Tax evasion, Kenya’s tragedy of the commons’, *The Daily Nation*, 14 November 2019.

18. Karingi, S., and Wanjala, B. (2005), *The tax reform experience of Kenya*, UNU-WIDER Research Paper 2005/67.

19. *Ibid.*

20. African Development Bank Group, Regional Department East A (OREA) (2010), *Domestic resource mobilization for poverty reduction in East Africa: Kenya case study*.

21. Davies, V.A.B., and Dessy, S. (2012), *The political economy of government revenues in post-conflict resource-rich Africa: Liberia and Sierra Leone*, National Bureau of Economic Research, Working Paper.

While all of the countries reviewed became less tariff-dependent over time, those that made most progress were those who prioritised their efforts to broaden the revenue base. This is perhaps most ably illustrated by Botswana and Mauritius, each of whom have increased their tax revenues more than ten times as much as Nicaragua from the mid-1970s to the present day.<sup>22</sup>

As a result, the crucial transition away from tariff-dependency took place faster, resulting in a more diverse base and a greater increase in overall fiscal revenues. This approach was intentional and predicated on an understanding of the economic imperative behind revenue collection, and the need to create an efficient – and responsive – bureaucracy to administer it. It was also an assertion of fiscal independence; these countries planned, sometimes decades in advance, to stop taking official development assistance (ODA).

### **Fiscal sustainability**

For developing nations achieving an appropriate balance between government revenues and expenditure is a particularly challenging responsibility. Their relatively low rates of revenue collection restricts their scope for sustainable levels of expenditure, despite the innumerable demands for both public spending and public investment.

Nations that fail to exercise such expenditure restraint run the risk of descending into unmanageable levels of debt to bridge unsustainable deficits. Defaulting on such debts has damaging effects on nations' future ability to borrow (and its cost), as well as on private sector confidence in the overall health and management of the economy. Consequently, the level of debt as a percentage of GDP – and particularly the rate of annual increase in that ratio – has long been used as a key indication of fiscal health.<sup>23</sup>

Maintaining fiscal sustainability means making it an underlying priority of any government's programme. Many developing nations have sought to use a combination of fiscal rules and informal practices to manage expenditure to ensure that budget deficits were kept under control, and levels of debt limited, especially avoiding accruing significant levels of commercial debts.<sup>24</sup> However, fiscal management also requires significant bureaucratic capabilities, to enable levels of public spending to remain responsive to variations in

22. Tax revenues less subsidies adjusted to reflect the size of the working-age population.

23. Horne, J. (1991), *Indicators of Fiscal Sustainability*, (USA: International Monetary Fund)

24. IMF (2017), *Fiscal rules dataset 1985-2015*.



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*The adoption of formal fiscal rules limiting the scale of deficits proved key to achieving fiscal sustainability in both Indonesia and Mauritius.*

revenues, and to manage the accumulation and repayment of debt. The more successful of the nations reviewed have broadly followed this pattern.

The adoption of formal fiscal rules limiting the scale of deficits proved key to achieving fiscal sustainability in both Indonesia and Mauritius. Indonesia determined that deficits should not exceed three per cent of GDP, while Mauritius legislated to ensure that debt would not exceed 65 per cent of GDP in any fiscal year, thus effectively limiting budget deficits to less than five per cent of GDP.<sup>25</sup> These measures have had a long-term stabilizing impact on both nations' economies; in Indonesia it enabled the government to more than halve the country's national debt between 2002 and 2010, while it enabled Mauritius to engage in counter cyclical spending to help ease it through the global financial crisis after 2007.<sup>26</sup>

Successive governments in Colombia took a more pragmatic approach to fiscal sustainability. Colombia's power-sharing National Front arrangement (1958-74) helped to keep debt levels low, with neither the Liberal or Conservative parties incentivised to increase spending before or after an election, as is often seen in more electorally-competitive democracies.<sup>27</sup> Successive governments also withstood the temptation to increase expenditures following the windfall resulting from price increases for coffee and oil that formed part of the global price shocks of the mid-to-late 1970s. As a result, Colombia's fiscal position was consistently strong, with debt generally kept to less than 40 per cent of GDP, helping the country mitigate the impact of the Latin American Crisis that rocked the continent in the 1980s.<sup>28</sup>

Conversely, as an example of a less successful development pattern, Kenya found itself in a state of near-constant deficit within fifteen years of independence. The country was still hugely dependent upon the export of a few highly volatile cash crops, particularly tea and coffee.<sup>29</sup> Fluctuations in these prices would prove dangerous, as the favoured import-substitution strategy required a cushion of foreign reserves to pay for imported capital goods.<sup>30</sup> While coffee and tea prices were high (as they were throughout the 1970s), this

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25. 'Budget: Beyond reasonable limits', *L'Express*, 15 June 2019.

26. Frankel, J. (2012), *Mauritius: African success story*, Harvard Kennedy School, Mossavar-Rahmani Center for Business & Government, Faculty Working Paper No. 2012-06.

27. Robinson, J. (2005), *A normal Latin American country? A perspective on Colombian development*.

28. Perez-Reyna, D. and Osorio-Rodríguez, D. (2016), *The fiscal and monetary history of Colombia: 1963-2012*, University of Chicago Working Paper No. 2018-61.

29. Library of Congress Federal Research Division (2007), *Country Profile: Kenya*, p. 3.

30. Nyaga, N.G. (2015), 'The evolution of Kenya's trade policy', *Indian Journal of Economics and Development*, 3(1), pp.120-22.

import substitution strategy was largely viable. However, the first and second oil shocks (1973/74 and 1979, respectively), and breakdown of the East African Community (EAC) in 1977 upended this careful balance.

Within the span of a few years, Kenya had lost its major export markets in Uganda and Tanzania, was expending huge amounts of foreign exchange to pay for fuel and capital goods, and its fiscal reserves had been drained by the optimism which had followed a few boom years for commodity prices.<sup>31</sup> Although tax revenues had increased from 16 per cent of GDP in 1964/65 to 24 per cent in 1973/74, they were still insufficient to cover governmental outgoings, absent the influx of foreign exchange from cash crops.<sup>32</sup>

When the country's foreign exchange earnings dipped, the Kenyan government soon found itself running annual budget deficits equal to ten per cent of GDP; this, in turn, led to its foreign debt stock increasing 'eightfold in dollar terms between 1975 and 1988, and as a proportion of GNP from 19 per cent to 61 per cent.'<sup>33</sup> These perennial government deficits were dominated by two fixed costs – a large public sector wage bill (with civil servant salaries comprising 70 per cent of recurrent spending), and the interest payments on the debt itself (equal to 25 per cent of export earnings by 1988) – which necessitated further borrowing.<sup>34</sup>

In Nicaragua, the 1979 victory of the Sandinistas sparked a sustained period of high government expenditure, averaging around 20 per cent of GDP throughout the early 1980s. Heavy state involvement in the economy, the flight of private capital, and the costs of post-conflict reconstruction quickly resulted in significant budget deficits, exacerbated by an unaffordable system of subsidies for most basic goods. These budget deficits contributed to spiralling debt, which was eventually monetised, leading to annualised inflation rates which doubled from 300 to 600 per cent between 1985-86.<sup>35</sup> Nicaragua's perilous fiscal position quickly evolved into crisis following the campaign against the Contras. By 1987, roughly two-thirds of government expenditure (equal to 30 per cent of GDP) was spent on defence,

31. Gertz, G. (2008), *Kenya's trade liberalization of the 1980s and 1990s: Policies, impacts, and implications*, Carnegie Endowment, p.3.

32. Killick, T. and Mweya, F.M. (1990), *Monetary policy in Kenya, 1967-88*, Overseas Development Institute Working Paper No. 39.

33. *Ibid.*

34. *Ibid.*

35. Irvin, G. and Croes, E. (1987), 'Nicaragua: The accumulation trap', *IDS Bulletin*, Vol. 19, No. 3, pp. 32-39.

whilst the conflict exacerbated critical shortages of skilled labour.<sup>36</sup> Consequently, per capita income declined by over a third between 1970 and 1987, while annualised inflation reached 33,000 per cent in 1988.

Jordan's fiscal position was rendered unsustainable for altogether different reasons to those seen in revolutionary Nicaragua. Jordan's general lack of domestic productivity has left it devoid of revenues and thus largely dependent upon foreign aid and foreign debt.<sup>37</sup>



*Portraits of King Hussein I and his son and successor, King Abdullah II. Hussein ruled Jordan for almost half a century between 1952 and his death in 1999.*

<sup>36.</sup> Conroy, M.E. (1990), 'The political economy of the 1990 Nicaraguan elections', *International Journal of Political Economy*, Vol. 20, No. 3, pp. 5-33.

<sup>37.</sup> Shahateet, M., Habashneh, F., Al Majali, K., and Al-Majali, A. (2014), 'Budget deficit and external debt in Jordan: Causality and co-integration analysis', *International Journal of Economics and Finance*, Vol. 6, No. 8.

Rather than seeking to increase domestic productivity, successive Jordanian governments instead prioritised political stability; high levels of public sector employment, combined with a myriad of generous subsidies for fuel and food were used to bolster Jordan's frail social contract, and attempts to reduce such expenditures have aroused strong public opposition (see, for example, the bread riots of 1989 and 1996). Its fiscal position has deteriorated further in recent years, such that the debt-to-GDP ratio now stands at 96.7 per cent.

Jordan's inflexible labour market is a reflection of its poor business environment and lack of private sector dynamism. More than 40 per cent of the working age population – and over half of all of those with university degrees – are employed in the public sector.<sup>38</sup> The vast majority of Jordan's 800,000 public sector employees are so-called East Bankers; this has served to reinforce social divisions, and also provides disproportionate benefits in the form of job-related healthcare and pensions.<sup>39</sup> Appointment in the public sector is still a main pillar of the patron-client networks which help to sustain the legitimacy of the state. Little progress has been made to reform public administration and introduce merit-based recruitment and payment, which would weaken tribal and family considerations and effectively deny long-established privileges to top-ranking civil servants and politicians in Jordan.<sup>40</sup>

The ability of governments to prioritise their fiscal sustainability thus marked a key distinction between those that succeeded and those that did not. Limiting expenditure and debt to around 40-50 per cent of GDP<sup>41</sup> required both fiscal and political discipline, avoiding excessive spending, especially in the frequent absence of sufficient revenues. It also required a degree of institutional sophistication, to provide governments with sufficient flexibility to amend levels of expenditure in response to changing conditions.

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38. Assaad, R. and Salemi, C. (2018), *The structure of employment and job creation in Jordan: 2010-2016*, Economic Research Forum Working Paper No. 1259.

39. The World Bank Group (2016), *Hashemite Kingdom of Jordan: Promoting poverty reduction and shared prosperity - systematic country diagnostic*, Report No. 103433-JO.

40. Sufyan, A. (2007) *Rethinking Economic Reform in Jordan: Confronting Socioeconomic Realities*, Carnegie Middle East Center, Carnegie Endowment for International Peace, Working Paper No. 4.

41. 40% of GDP is a typical benchmark for debt sustainability for developing nations. See for example, Ncube, M. and Brixiová, Z. (2015), *Public debt sustainability in Africa: Building resilience and challenges ahead*, African Development Bank Working Paper No 227.

## Monetary stability

Effective monetary policy is integral to the management of a nation's economy. By carefully supervising the supply of money into the economy and the interest rates that shape it, central banks are able to navigate between the damaging extremes of high inflation and recession.

High rates of inflation discourage investment and increase the pressure to spend immediately. If inflation rates are left unchecked for too long, or the government attempts to control the prices of goods well away from their market value, a balance of payments crisis can occur, in which a country no longer has the hard currency reserves to continue paying for imports of foreign goods.

Delivering monetary stability therefore requires significant economic expertise and effective reporting. Nations seeking to deliver monetary stability must pay close attention to three separate, but inherently related, aspects of policymaking. First, inflation rates should be kept stable, in order to encourage both saving and investment. Second, a singular, competitive exchange rate should be established to enable the free flow of goods and capital, and to hedge against the risks associated with a fixed exchange rate (which include, but are not limited to, speculative attacks against the valuation of a given currency). Third, a well-functioning – and preferably independent – central bank should be established to manage monetary policy according to economic, rather than political, interests.<sup>42</sup>

As an example of successful development, Mauritius demonstrated an intensely pragmatic approach to achieving monetary stability. The Bank of Mauritius, established as an autonomous entity shortly before independence, maintained essential flexibility over its exchange rate. Until 1972, the Mauritian rupee was pegged to the pound sterling. The decision to discontinue the pegging arrangement came not as a result of a weakening rupee, but a weakening pound. A new settlement saw the Bank of Mauritius establish a central exchange rate with special drawing rights (SDR), while maintaining a second exchange rate for capital transfers. In 1976, this was finessed once again, this time with Mauritius pegging the rupee to the SDR, with a two per cent band, though in practice the exchange rate was a crawling band around the US dollar.<sup>43</sup>

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42. Kentikelenis, A.E., Stubbs, T.H. and King, L.P. (2016), 'IMF conditionality and development policy space 1985–2014', *Review of International Political Economy*, Vol. 23, Issue 4.

43. Minoiu, C. and Imam, P. (2011), 'The equilibrium exchange rate of Mauritius: Evidence from two structural models', *Emerging Markets Finance and Trade*, Vol. 47, No. 6.

Such pragmatism has persisted. Until the early 1990s, Mauritius maintained a multiple currency practice with some capital account transactions being performed at alternate rates. Exchange rate restrictions were lifted in 1992, when the de facto crawling band around the US dollar was narrowed to two per cent, and transactions involving foreign currencies were fully liberalized in mid-1994. Until 2009, Mauritius has maintained a managed float, and the monetary authorities have intervened in the foreign exchange market to smooth exchange rate fluctuations rather than to alter the trend.<sup>44</sup>

Botswana exercised a necessary degree of patience in taking on national responsibility for monetary policy. Sir Seretse Khama waited almost a decade after independence to establish the country's own currency, the pula, in 1976. Until that time, Botswana remained a member of the Rand Monetary Area (RMA), using South Africa's national currency as its own, and benefiting from the resulting ease of trade with other members of the SACU. The patient, incremental introduction of the pula has ensured it has retained its value, resulting in a flexible, but generally stable, currency.

The country's Central Bank, founded as an independent entity in 1975 (before the creation of the pula), has been rightly credited with managing an exchange rate regime which has been sufficiently stable to encourage inward investment, but also sufficiently flexible as to take advantage of opportunities for export. Throughout the period of currency adjustment, the Bank advised successive governments against overvaluing the currency, mindful that diversification would be made more difficult with export opportunities limited by a weighty currency.<sup>45</sup>

Simultaneously, regular adjustments to interest rates and the supply of money kept inflation under control and enabled the creation of a retail banking sector which ensured that ordinary Botswana had access to credit and savings facilities. This patient approach continued, with the pula initially pegged to the US dollar following its introduction, and to a basket comprising rand and the IMF's special drawing rights (SDRs) – an international supply of foreign exchange reserves – from 1980. A crawling peg was introduced in 2005, continuing an incremental approach to monetary liberalisation.

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44. *Ibid.*

45. Siphambe, H.K. (2007), *Growth and employment dynamics in Botswana: A case study of policy coherence*, Policy Integration and Statistics Department, International Labour Office Working Paper No. 82.

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*The 1991 constitution changed the nature and structure of Colombia's central bank, granting it real independence from the central government.*

The evolution in the management of Colombia's monetary policy over the past thirty years was key to the apertura, or opening, of the broader economy. Prior to 1991, Colombia's central bank, Banco de la República, functioned as a currency board composed solely of members of the government. It engaged in heavy financial repression, which helped to keep interest rates relatively low, but limited wider access to cheap credit.

The 1991 constitution changed the nature and structure of Colombia's central bank, granting it real independence from the central government. As well as being given technical independence for monetary policy, the monetary board was replaced by a board of governors in which the minister of finance had only one vote (of seven) and no veto power. The new constitution also prescribed that any direct loan from the central bank to the central government would require unanimous approval by the members of the board.<sup>46</sup> As a result, monetary emission to finance the fiscal deficit, an alarming feature of the 1980s, all but disappeared after 1991.<sup>47</sup>

Delivering monetary stability proved to be an inflection point in Indonesia's development. The advent of Sukarno's programme of 'guided democracy' in 1957 coincided with a prolonged period of macroeconomic mismanagement which proved detrimental to the country's development and was characterised by low revenues and excessive levels of government expenditure. Sukarno's heavy reliance upon military support resulted in major increases in defence expenditure. Sukarno's populist response to the repeated – and growing – budget deficits proved disastrous. Instead of working to reduce his country's growing debt burden by improving its fiscal position and having drained his foreign currency reserves, he opted to borrow.<sup>48</sup> As the economic situation became more precarious, inflation spiralled out of control. Increasingly isolated and unwilling to accept offers of international support, Sukarno withdrew Indonesia from both the IMF and World Bank in August 1965. With agricultural productivity low and with foreign exchange reserves able to cover less than a month's worth of imports, food shortages became widespread.<sup>49</sup> As the situation escalated and with Indonesia no longer able to service its debt, annualised inflation rates hit 1,000 per cent.<sup>50</sup>

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46. Perez-Reyna, D. and Osorio-Rodríguez, D. (2016), *The fiscal and monetary history of Colombia: 1963-2012*, University of Chicago Working Paper No. 2018-61.

47. *Ibid.*

48. Thee, K.W. (2012), *Indonesia's economy since independence*, (Singapore: Institute of Southeast Asian Studies).

49. McLeod, R. H., and MacIntyre, A. (eds.) (2007), *Indonesia: Democracy and the promise of good governance*, (Singapore: Institute of Southeast Asian Studies).

50. Brown, C. (2003), *A short history of Indonesia: The unlikely nation?*, (New South Wales: Allen and Unwin).

The political consequences of this protracted period of mismanagement were severe. Sukarno was deposed in a coup d'état at the end of 1965. Perhaps predictably, his replacement proved determined to learn from the mistakes of his predecessors and made developing macroeconomic resilience a priority. Recognising the lack of economic expertise within Indonesia's central bank and treasury, Suharto adopted an innovative approach, enlisting the assistance of the so-called 'Berkley mafia'. This small group of US-trained Indonesian economists conceived a series of landmark reforms, including a series of new fiscal rules and a dollar-pegged exchange rate. Through these efforts, they managed to bring inflation rates down to fifteen per cent by 1969, and seven per cent by 1970, without seriously constricting productive output, setting the scene for rapid economic development.<sup>51</sup>

Those nations who made least progress viewed the national economy as a resource, rather than a responsibility. For example, the Stevens regime in Sierra Leone was characterised by pernicious levels of kleptocracy and political patronage. Consequently, the independence of the country's central bank was non-existent, and its degree of economic competence extremely limited.<sup>52</sup> The total dominance of the regime over the its central bank was illustrated by the 1979 murder of its governor, Sam Bangura, following his refusal to endorse Stevens' decision to host the Organisation of African Unity (OAU) annual summit.

The implications of this dynamic were severe. From the outset, the government struggled to control inflation, while Stevens' strangulation of private economic activity created the structural pressures for a series of sustained balance of payments crises.<sup>53</sup> These would prove particularly damaging after 1973, when the Organisation of Petroleum Exporting Countries (OPEC) oil embargo and subsequent global recession pushed down prices for iron ore and diamonds, the country's two main exports.

The Stevens regime failed to respond to these balance of payments crises, instead choosing to maintain a high fixed exchange rate while monetising the country's debt, rendering the leone near-worthless and creating a massive shadow economy. Inflation spiralled upwards, peaking at 256 per cent in the late 1980s, as economic growth slowed and then became negative. Real interest rates also went negative, reaching a nadir of -60 per cent in 1987.

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51. Temple, J.R.W. (2001), *Growing into trouble: Indonesia after 1966*, CEPR Discussion Paper, p 25.

52. Harris, D. (2013), *Sierra Leone: A political history*, (London: Hurst).

53. Pham, P.J. (2005), 'Democracy by force?: Lessons from the restoration of the state in Sierra Leone', *The Whitehead Journal of Diplomacy and International Relations*, pp. 129-147.



Unsurprisingly, capital flight sped up through the end of the 1980s and into the civil war, peaking at 60 per cent of GDP in 2000. Such mismanagement was predictably not limited to inflation. Sierra Leone has experienced six exchange rate regimes since 1964, with exchange rates consistently - and grossly - overvalued, creating a sizeable black market throughout the country.<sup>54</sup>

Similarly, Nicaragua experienced a prolonged period of double-digit inflation following the Sandinistas seizure of power in 1979, exacerbated by a highly politicised central bank. The new government chose to maintain the pre-existing multiple exchange rate system, and began rationing foreign exchange, which allowed it to subsidise both producers and consumers (to the tune of roughly ten per cent of GDP).<sup>55</sup> This exchange rate structure amounted to a massive and unaffordable subsidy programme which the government chose to fund by printing money, rather than issuing debt, which led inevitably to inflationary pressures.

The rate of inflation, which had stood at over 35 per cent in 1980, was allowed to spiral out of control, triggering a seven-year hyperinflation crisis between 1985 and 1992. The government's efforts to control inflation waned as the conflict with the Contras became more intense; they were soon printing money to finance the military. A 3,000 per cent devaluation of the cordoba in February 1988 proved inadequate to stem inflation. Another devaluation took place four months later, with the concomitant elimination of price controls, which led to extraordinary increases in the price of basic goods and services. Despite this, by the end of 1988 inflation had reached between 20,000 and 30,000 per cent. These devaluations had a direct impact upon the food supply in Nicaragua, as some of the last goods being imported were fertilisers and diesel fuel.

Maintaining a broadly stable monetary environment has been a common characteristic among those nations who made most progress in their development. Key to this success has been the efficacy and autonomy of nations' central banks, which were empowered to prioritise economic imperatives over political ones, thus avoiding the protracted periods of hyper-inflation and major currency devaluations, which have been the hallmark of those nations that faltered.

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54. Robinson, J. (2008), *Governance and political economy constraints to World Bank CAS priorities in Sierra Leone*, pp. 1-51.

55. Helwege, A. (1989), 'Is there any hope for Nicaragua?', *Challenge*, Vol. 32, No. 6, p. 22-28.

## Summary

Each one of the nations reviewed faltered – many repeatedly – in economic policymaking. However, what distinguished those that made most progress can perhaps best be characterised as executive responsibility. Their respective leaders placed importance on achieving macroeconomic stability, adopting a prudent approach, even when doing so created a constraint on their own power.

These successful nations, such as Botswana, Mauritius, and Indonesia, worked in phases to increase and diversify their tax revenues. Fiscal rules were commonplace, and followed, in the successful nations, in contrast with the experiences of countries such as Kenya and Nicaragua.

Perhaps the strongest contrast between the successful and less successful examples has been in monetary stability, where the latter tended to be hamstrung by bouts of inflation above 50 per cent and by significant currency crises. The successful examples were supported by well-functioning and generally independent central banks. Although they often experienced bouts of double digit inflation, but hardly ever above 50 per cent, currency devaluations were rare.

### To develop macroeconomic resilience:

- **Raise sufficient revenues** and reduce reliance upon tariffs, by creating a simple and equitable system of taxation, and by broadening the tax base.
- **Prioritise fiscal sustainability** by limiting budget deficits to prevent the accrual of debts, by avoiding reliance upon costly commercial debt, and by maximising capital investments while minimising recurrent current expenditures and overheads.
- **Deliver monetary stability** by establishing an effective and autonomous central bank, by keeping inflation low and stable, and by maintaining a singular, stable exchange rate.

## 5. BUILD A DOMESTIC ASSET BASE

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Sustained economic development requires capital to drive innovation and growth. It provides essential liquidity within the economy, enabling the credit required for businesses to be created, and for all sectors of the economy to grow. However, the cultivation of capital is reliant upon the existence of a secure domestic asset base, where the proceeds of economic activity can be deposited or invested. The building of a domestic asset base is therefore contingent on the government's ability to provide essential safeguards for domestic as well as for international investors.

The building of a domestic asset base is therefore as much an exercise in political will as in economic growth. This chapter is divided into three components. The first examines the centrality of property rights and the differing approaches taken to establish them and to resolve disputes. The second assesses the importance of cultivating a domestic finance sector, and the varying extents to which governments enabled its development. The third explores the need to encourage foreign investment, capabilities, and technologies in developing new sectors of the economy.

### Property rights

Property gives individuals a stake in the economy and society. In largely agrarian economies, to be disposed of land is to be excluded from economic opportunity. Protecting property rights provides a guarantee that what has been built or bought as a result of an individual's hard work will not be taken away. Furthermore, as Hernando de Soto highlights, 'you need a property right before you can make money'; such rights are required to catalyse further economic endeavours, giving individuals an asset against which they can borrow.<sup>56</sup> By protecting property rights, governments therefore incentivise widespread participation in the national economy.

In spite of the importance of property rights to economic growth, land titles and systems for managing them are not well established in much of the developing world. The institutionalisation of property rights – and the question of how land should be equitably divided in the modern day – was irrevocably altered by the experience of colonisation. Many of these systems were designed to exclude the colonised population from land tenure.<sup>57</sup>

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56. De Soto, H. (2000), *The mystery of capital*, (New York: Basic Books), p.59.

57. *Ibid.*

Addressing these challenges and creating a settlement which is considered legitimate by the majority of the population is one of the most contentious issues in international development. As there can be no return to the status quo ante, any solution will necessarily involve compromise.

Nations that have made most progress in their development have tended to uphold the protection of property rights and, where necessary, sought to address existing disputes and grievances resulting from internal conflict or pre-existing systems of land ownership. This pattern can be illustrated by contrasting the experiences of countries such as Botswana, Mauritius and Colombia with those of Nicaragua and Sierra Leone.

Successive Mauritian governments have acknowledged the importance of property rights, as well as their role in protecting them. No attempts were made to expropriate the agricultural lands of the Franco-Mauritian minority population in the aftermath of independence, despite their evident ties to the country's former colonial master. This inclusive approach has proved instrumental in avoiding creating social grievances, and key to the willingness of successive Franco-Mauritian-led governments to give up power in the face of electoral defeat.<sup>58</sup> The sanctity of land titles has been honoured, even those denoting land of high agricultural value, notably for sugar cane production. The strength of this commitment has even seen the government commission a review of alleged cases of expropriation dating back to 1721.

Botswana has created an effective body of land law, designed deliberately to incorporate key features of tribal custom.<sup>59</sup> This acknowledgement of the importance of customary law, codified in the 1968 Tribal Land Act, has been critical to perceptions of its legitimacy across Botswana, and illustrative of the government's efforts to adopt an inclusive approach to land reform. The Act made provision for all citizens to receive an allocation of tribal land, and thus served to give the entire population an early stake in the country's prosperity.<sup>60</sup>

Like Mauritius, successive Botswanan administrations have resisted the temptation to expropriate land of significant value. The early discovery of diamonds in the country's central district posed a major test for adherence to Botswana's nascent framework of property rights. Though the government's decision to respect the titles was rightly

58. Frankel, J. (2012), *Mauritius: African success Story*, Harvard Kennedy School, Mossavar-Rahmani Center for Business & Government, Faculty Working Paper No. 2012-06.

59. USAID (2010), 'Property rights and resource governance profile: Botswana'.

60. *Ibid.*

predicated on the expectation of further discoveries, it sent an important signal of executive's commitment to property rights. However, despite such progress, Botswana's San bushmen found themselves excluded from the property protections enjoyed by the rest of the population.<sup>61</sup> The government's decision to deny their hunting rights in the Central Kalahari Game Reserve remains a source of contention, albeit one whose impact on Botswana's economy is negligible.

Colombia has made impressive progress in reaching a viable and equitable settlement to the country's longstanding land disputes. Widespread conflict and insecurity led to dispossession of over eight million hectares and the displacement of close to three million citizens, more than half of whom claimed access to dispossessed land.<sup>62</sup> In response, the Santos government enacted the 2011 Law of Land and Victims to provide compensation for those displaced, as well as to simplify proof of ownership requirements. The Law also required the return of more than two million hectares to those dispossessed, as well as expediting the return of close to a million hectares of land expropriated by non-government forces.<sup>63</sup>

Unlike Botswana, Sierra Leone has failed to navigate the complexity of customary land. The country's dual system of land ownership is complex, opaque, and poorly administered. Despite the existence of a vibrant private property market, only 200 land transactions were recorded in the official land register in 2006. There is no system of registration of titles, few public records, and limited data available about land use.<sup>64</sup> More significantly, the muddled remit of the dual system divides the country, with the Statutory System regnant in the Western Area and the Customary System in the Provinces, ensuring that some 95 per cent of the country's territory is governed by fluid customary laws that vary considerably across regions.

Enforcement is predictably inconsistent; whilst the 1991 Constitution recognises Sierra Leone's dual legal system, it does not address the vesting or ownership of land, whilst parallel legal frameworks governing land delivery contain no fewer than twenty different statutes, many with conflicting provisions.<sup>65</sup> Registration of deeds is not legal proof

61. AUC-ECA-AfDB Consortium (2010), *Land policy in Africa: Southern Africa regional assessment*.

62. Oxfam (2013), *Divide and purchase: How land ownership is being concentrated in Columbia*, p. 3.

63. BTI (2012), *Colombia Country Report*, (Gütersloh: Bertelsmann Stiftung).

64. Sturgess, P. and Flower, C. (2013), *Land and conflict in Sierra Leone: A rapid desk-based study*, pp. 1-27.

65. Kaindaneh, P. (2015), *Sierra Leone: Land governance assessment framework*.

of ownership, which rests with courts that are subject to political interference and corruption.<sup>66</sup> Land ownership for the vast majority of the population in Sierra Leone is therefore gravely insecure, whilst external investment is discouraged altogether.<sup>67</sup>

Lingering disputes over property rights helped fuel the country's descent into civil war in the 1990s. The widespread resentment created by expropriation was compounded by territorial conflict over diamonds, helping to swell the ranks of the Revolutionary United Front (RUF).<sup>68</sup> Almost inevitably, the conflict also served to compound tensions over property rights, with scores of civilians returning to lands that had been razed or occupied.<sup>69</sup> Unlike in Botswana, these challenges have been exacerbated by steps taken after the conflict to increase customary control; the 2009 Chieftaincy Act was designed to empower local chiefs to help stabilise post-conflict communities, but has been abused frequently to increase their own power and resources.<sup>70</sup>

In Nicaragua, the failure to resolve disputed property rights has also proved to be a major source of conflict and instability over the past four decades.<sup>71</sup> During the Somoza regime, there was large-scale displacement of peasant farmers. By the end of the regime the majority of those in the agricultural sector were either landless or small-holders dependent on seasonal migration for wage labour.<sup>72</sup> The widespread programme of expropriation and redistribution that was the hallmark of the Sandinista regime between 1979 and 1990 was politically motivated and economically devastating. As well as targeting lands held by the former Somoza regime for retaliatory expropriation, it placed some 20 per cent of the country's arable land in public ownership, with little consideration given to how to maximise its productivity. Its subsequent transfer into numerous smallholdings sparked a subsequent flight of capital, as investors withdrew, leaving a shortfall of around one-quarter of GDP.<sup>73</sup>

66. Kaindaneh, P. (2015), *Sierra Leone: Land governance assessment framework*.

67. *Ibid.*

68. Sturgess, P. and Flower, C. (2013), *Land and conflict in Sierra Leone: A rapid desk-based study*, pp. 1-27.

69. *Ibid.*

70. USAID (2010), *USAID country profile: Sierra Leone*, pp. 1-24.

71. USAID (2016), *USAID country profile Nicaragua*.

72. Austin, J., Fox, J. and Kruger, W. (1985), 'The Role of the Revolutionary State in the Nicaraguan Food System', *World Development* Vol.13, No. 1. pp. 15-40.

73. Gibson, B. (1987), *Stabilization and adjustment policies and programs: Country study Nicaragua*.

Attempts to reconcile the beneficiaries and the disposed were bungled during the tenure of the democratically-elected government of Violeta Chamorro between 1990 and 1997.<sup>74</sup> Seemingly contradictory pledges promised to restore the rights of some 28,000 dispossessed landowners, whilst guaranteeing rights of settlement to those that had acquired their land. Inevitably, this approach exacerbated tensions, resulting in a multitude of competing claims.



*President Anastasio Somoza Debayle on an official visit in October 1978. The 1979 revolution in Nicaragua brought to an end over four decades of rule by the Somoza regime.*

74. USAID (2016), *USAID country profile Nicaragua*.

The legacy of this prolonged period of mismanagement has been corrosive. Public confidence in the government's willingness and ability to address the issue of property rights has been severely damaged. A quarter of a century after the period of Sandinista expropriations ended, as many as 80 per cent of Nicaraguans still felt their property at risk of repossession. Poor enforcement of property rights has become a feature of Nicaragua's political and legal dynamic, with distrust of government compounded by weak administration of existing claims, and persistent corruption. As a result, by 2005, less than half of all Nicaraguan households held the adequate documentation asserting their titles. This widespread lack of confidence has inevitably impacted much-needed foreign and domestic investment, notably in real estate development and tourism.<sup>75</sup>

Essential land reform in Kenya was effectively thwarted by successive administrations between independence and the turn of the twenty-first century. Though all Kenyans had previously been denied the right to own property during the colonial era, presidents Kenyatta and Moi rapidly became some of the most significant landowners in Kenya during their respective terms in office. Such visible inequity has been a major and persistent form of tension within Kenya; the country's acute housing shortage has condemned generations to slum conditions, whilst forced evictions and the widespread use of land as an object of political patronage played a central role in repeated outbreaks of violence, including during the 2007 election.<sup>76</sup> The overt politicisation of land rights has thus created a widely discredited system, characterised by poor administration, rampant corruption, and entrenched inequality.

However, recent years have seen some modest but notable improvements. The 1999 Njonjo Land Commission and subsequent 2003 Ndung'u Land Commission served as the first wholesale reviews of land rights since independence. Together, they provided a means of investigation of the politicisation of titles and created a framework for the country's inaugural National Land Policy (NLP). Adopted in 2009, the NLP represents the centrepiece of a concerted government effort to overhaul a flawed system, and its role as a major source of conflict. Alongside seeking to address chronic administrative weaknesses, the NLP sought to streamline the country's legacy of often incompatible legislation, protect customary rights to land, and create a framework for a process of restitution and resettlement.<sup>77</sup> These efforts were bolstered by the revised 2010 constitution, which

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75. *Ibid.*

76. USAID (2017), *USAID country profile: Kenya*, pp. 1-44.

77. USAID (2017), *USAID country profile: Kenya*, pp. 1-44..



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*By effectively cultivating a nascent commercial banking sector, governments can also help lay the foundations for a more sophisticated system of capital markets.*

included provisions for the repossession of land seized illegally, as well as 2017 changes to leasehold regulations, designed to prevent land remaining unoccupied and thus unproductive.<sup>78</sup>

These examples illustrate that, whilst the effective codification of property rights is essential, it is the culture of fairness created by a government's simple intention to uphold rights that places confidence in any nascent system. Crucially, this approach must be inclusive if it is to be deemed legitimate; minority groups cannot be denied the right to property ownership, nor be subject to the expropriation of existing property. It is governments that are ultimately responsible for ensuring that property rights are protected, acting jointly as reformer, administrator, and arbiter.

### **The domestic finance sector**

An efficient, independent, and competitive finance sector is critical to building a domestic asset base and also for improving the allocation of such resources.<sup>79</sup> The deposit and loan facilities provided by commercial banks are indispensable features of sustained economic growth, providing a significantly greater proportion of the capital required to fund large-scale investment than foreign direct investment (FDI). This stock of domestic savings also serves as a reliable indicator of the vitality of a nation's economy and plays a role in complementing the capital of international investors.<sup>80</sup>

Governments have a vital role to play in cultivating a finance sector: incentives can stimulate the creation of key foundations, such as deposit insurance schemes, effective regulation can dramatically improve efficiency, whilst an insistence on transparency can significantly reduce the cost of borrowing. Equally, the independence and efficiency of the sector can be maintained most effectively if government ownership of commercial banks is avoided, and mismanaged banks allowed to fail.<sup>81</sup> By effectively cultivating a nascent commercial banking sector, governments can also help lay the foundations for a more sophisticated system of capital markets.

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78. U.S. Department of State. (2019), *2019 investment climate statements: Kenya*.

79. Eatzaz, A. and Malik, A. (2009), 'Financial Sector Development and Economic Growth: An Empirical Analysis of Developing Countries', *Journal of Economic Cooperation and Development*, 30, 1, pp 17-40

80. Aghion, P., Comin, D. and Howitt, P. (2006), 'When Does Domestic Saving Matter for Economic Growth?' NBER Working Paper 12275.

81. Demirguc-Kunt, A. and Levine, R. (2008), *Finance, financial sector policies, and long-run growth*. World Bank Discussion Paper.

The development success of countries such as Mauritius, Botswana, and Colombia were bolstered by the evolution of their finance sectors. Mauritius has capitalised on its long history of finance and banking, which began in the nineteenth century, to become one of the top financial sectors in Africa.<sup>82</sup> The post-independence preference for state-run banks gave way to a major programme of liberalisation in the 1980s.<sup>83</sup> The greater use of indirect policy instruments (including the abolition of credit ceilings) enabled the level of domestic credit available to the private sector to increase from below 50 per cent of GDP in 1990 to above 110 per cent by 2014.<sup>84</sup> This programme was also characterised by a marked increase in commercial competition between banks, resulting in growing concentration of the sector and greater efficiency. Consequently, the ratio of bank deposits to GDP increased from around 20 per cent in early 1960s to 90 per cent by 2011.<sup>85</sup>

Botswana followed a determined policy of non-interference in the financial sector, following independence in 1966, maintaining its reliance upon South Africa's commercial banking sector and currency. Unlike many African nations, its government resisted calls to create a government-owned banking sector or to direct commercial credit to support its programme of development.<sup>86</sup> Instead, the government patiently laid the foundations for a more sophisticated financial services sector, introduced alongside its new national currency some six years later, in 1972.

This approach enabled Botswana to ensure the stable supply of loans whilst gradually increasing the complexity of the sector through the later introductions of a pensions market, insurance market and, in 1989, of a stock market. The banking sector grew at an average annual rate of almost ten per cent between 1995 and 2005. This steady growth has been part of a virtuous cycle, driven by high levels of domestic savings which quadrupled between 1985 and 1990, prompting the creation of six retail banks by 2003.<sup>87</sup> The government's requirement for public sector workers (comprising approximately 40 per cent of the working-age population) to save into a defined benefits plan has also created

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82. Muyambiri, B. and Odhiambo, N.M. (2018), 'Financial development and investment dynamics in Mauritius: A trivariate Granger-casualty analysis', *SPOUDAI Journal of Economics and Business*, Vol. 68, No. 2-3, pp. 62-73.

83. *Ibid.*

84. *Ibid.*

85. Muyambiri, B. and Odhiambo, N.M. (2016), 'The sequencing of financial reforms and bank-based financial development in Mauritius', *Journal of Accounting and Management*, 6(1), pp. 89-114.

86. Harvey, C. (1996), *Banking policy in Botswana: Orthodox but untypical*, pp. 1-30.

87. Moffat, B. (2009), 'The banking environment in Botswana: an overview', *Botswana notes and records*, pp. 95-103.

a vibrant pensions sector, whilst the number of insurers trebled between 1997 and 2002, increasing competition and thus reducing prices for consumers.

Colombia embarked upon a programme of wholesale banking reform in the early 1990s, which served to transform its finance sector away from the repression and state involvement that had been pervasive since the mid-1960s. The reforms resulted in the lowering of reserve deposits, the lifting of restrictions on foreign ownership, and the privatisation of a number of major banks. In addition, the practise of subsidised Central Bank lending to the government was rendered unconstitutional. The impact was profound, with the level of foreign ownership in the country's finance sector increasing from around ten per cent in 1992 to almost 30 per cent by 1998.<sup>88</sup>

Countries with successful development histories such as the Dominican Republic and Indonesia also experienced setbacks, hindering the pace at which they were able to build a domestic asset base. Widespread state interference was a key feature of the Dominican Republic's finance sector. Whilst the number of regulated financial institutions rose from seven to 78 between 1960 and 1985, this steady diversification did not diminish the influence of several key state-owned institutions.<sup>89</sup> Though commercial banks controlled about 64 per cent of the financial system's total assets, over 40 per cent of commercial bank funds were deposited in the state-run Reserve Bank, which operated as a commercial bank as well as the main government fiscal agent.<sup>90</sup> The 2003 collapse of the country's third-largest bank, the privately-owned Banco Intercontinental (more commonly known as Baninter), prompted the government to guarantee all deposits, against the advice of the IMF. The decision cost the government around two-thirds of its total annual budget, prompting a spike in inflation and a sharp devaluation of the peso.

Similarly, the government of Indonesia's prominent role in directing commercial lending activity inadvertently created a major banking crisis in the 1980s. During the 1970s, when the Bank of Indonesia was benefitting from high global oil prices, it increased the interest rate available to commercial banks who extended lines of credit to borrowers, effectively subsidising the loan process.<sup>91</sup> This was a specific instruction from the government, which

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88. Aguilar C.L. et al. (2007), *The development of Colombian bond market*, Working Paper (February), No. 34.

89. The Government of the Dominican Republic (2018), *Banking and Finance*, Fact Sheet.

90. *Ibid.*

91. Abdullah, B. and Santoso, W. (2001), 'The Indonesian banking industry: competition, consolidation and systemic stability', *BIS background paper*, p. 80.

saw the Bank's lending function as an opportunity to further shore up popular support. This became infeasible when oil prices declined in the mid-1980s, and so the government began offering discount window facilities, deregulating interest rates, and generally allowing more new entrants into the banking sector. This resulted in an increase in both the number of commercial banks and the number of people to whom those banks were willing to extend credit. The lack of supervision involved in this process resulted in a surfeit of non-performing loans, which would become the basis for the Asian Financial Crisis.<sup>92</sup>

Conversely, an under-developed banking sector can have a more profound, and longer-term, impact. While Sri Lanka's overall development trajectory has been successful, the long delay in cultivating its finance sector undoubtedly constrained it. The nationalisation of the Bank of Ceylon and the creation of the state-owned People's Bank in 1961 marked the beginning of a sustained period of state intervention. By 1970, these two banks accounted for 71 per cent of total deposits and 72 per cent of loans.<sup>93</sup> By the mid-1970s, the government was absorbing some 60 per cent of the total credit extended by all financial market institutions.<sup>94</sup> However, the change of government in 1977 catalysed a major programme of reforms to improve efficiency and competition within the banking sector. Restrictions on foreign banks were eased, interest rates increased, a new lending programme introduced targeting rural regions of the country.<sup>95</sup> These initiatives proved successful, tripling the level of credit between 1977 and 1985, and prompting a major shift towards the private sector, whose share of available credit increased from 28 per cent in 1977 to 60 per cent by 1985.<sup>96</sup>

An under-developed commercial finance sector is a common characteristic of nations on slower development trajectories. For example, successive governments of Sierra Leone treated the sector as a source of government funding rather than a key feature of their domestic asset base. The government monopolised available credit, consuming some 85 per cent between 2002 and 2005. It repeatedly used the national pension scheme as a major lender, with the National Social Security and Investment Trust (NSSIT) holding around a fifth of public debt by 2006. This approach has inevitably hindered the development of

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92. *Ibid.*

93. Amarathunga, H. (2012), 'Finance-growth nexus: Evidence from Sri Lanka', *Central Bank of Sri Lanka Staff Studies*, 40(1-2) 1-36.

94. Athukorala, P. and Rajapatirana, S. (1991), *The domestic financial market and the trade liberalization outcome*, World Bank Working Paper Number 590.

95. *Ibid.*

96. *Ibid.*

a commercial banking sector. Weak infrastructure, obstructive legislation, high treasury bill rates, and high capital adequacy requirements have created a fragmented and largely informal sector.<sup>97</sup> Today, the sector is dominated by the country's two state-owned banks, which account for over 60 per cent of total deposits, but which hold vast quantities of non-performing loans.<sup>98</sup>

Upon coming to power in Nicaragua in 1979, the Sandinista National Liberation Front (FSLN) immediately nationalised the country's few private banks in an effort to promote community banking and support the rural poor.<sup>99</sup> The subsequent National Finance System was an abject failure, with the development bank, BANADES, beset by high losses due to unsuccessful lending programs and low loan recovery rates before its closure in the late 1990s.<sup>100</sup> The 1991 restructuring overseen by the World Bank and IMF led to the reprivatising of the entire insolvent banking sector, but did little to improve credit restrictions, forcing poor families to default on loans.<sup>101</sup> The cumulative impact was profound. Today, Nicaragua's banking sector is underdeveloped and amongst the smallest in Latin America, accounting for only around five per cent of GDP. By the end of 2002, there were only six banks in Nicaragua compared to a regional average of more than 100 in neighbouring countries. As a result, Nicaragua struggles to provide the lending opportunities required to develop the economy. Efforts to incentivise the development of the finance sector have proved ineffective, and access to finance extremely limited.<sup>102</sup> Though the private sector contributes around one third of GDP, it receives less than ten per cent of the lending capital.

The nations featured above who made most progress in cultivating a domestic finance sector were those who left it largely free of political interference, and who avoided monopolising the limited credit available to private sector enterprises. Though several used domestic commercial banks to fund public expenditures, the detrimental impact of such practices – usually in the form of banking crises – prompted regulatory reform to ensure such errors became the exception, rather than the rule.

97. Kargbo, S.M. and Adamu, P.A. (2011), 'Financial development and economic growth in Sierra Leone', *Journal of Monetary and Economic Integration*, Vol. 9 No. 2.

98. UN (2007), *Mobilizing domestic financial resources in Africa: Sierra Leone case study*, Conference on Trade and Development Paper, pp. 1- 22,

99. Foundation for Sustainable Development (n.d.), *Micro-enterprise/Microfinance Issues in Nicaragua*.

100. *Ibid.*

101. *Ibid.*

102. Herrera, C., Ruben, R., and Dijkstra, G. (2014), 'Segmentation, access to finance constraints and the credit monopolistic power of financial institutions in Nicaragua', *Journal of Economics and Development Studies*, Vol. 2, No. 4, pp. 101-123.

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*FDI stimulates the transfer of technologies and capabilities, as investors drive improvements in standards and efficiency.*

## Foreign investment, capabilities, and technology

As well as providing an important source of foreign capital, foreign direct investment (FDI) plays several additional functions that are essential to promoting economic diversification. First, it acts as an external vote of confidence in an economy's potential, and in the strength of its underlying institutions. Second, and perhaps most importantly, FDI stimulates the transfer of technologies and capabilities, as investors drive improvements in standards and efficiency. Thirdly, FDI provides cashflow, providing a stabilising mechanism for a country's balance of payments.

Even for the wealthiest countries in the world, the totality of liquid capital available in other markets outstrips the funds available for investment in-country; put more simply, FDI provides the opportunity to grow beyond the constraints of domestic savings rates. However, capitalising on this opportunity still presents notable challenges for developing nations, where the economic opportunities are frequently less lucrative, and where the risk of investment is often higher.

At a global level, the long-term trend has been towards expanded opportunities for foreign investment, with many countries moving from positive to negative lists (effectively allowing investment into all sectors of the economy unless prohibited in specific sectors), and reducing the number of sectors where foreign investment was banned outright. Despite a slow-down for developed countries, the value of FDI for developing nations has grown over the last decades.<sup>103</sup>

Actively welcoming those who bring in new technologies or new industries is one of the best ways to guarantee high levels of foreign investment, and perhaps more importantly, the best way of guaranteeing that nations will be capable of seizing fast-moving opportunities. For example, the foreign contribution to the success of the textiles industry in Mauritius, Botswana, and Sri Lanka, the coffee industry in Colombia, as well as the sugar and tourism industries in the Dominican Republic have been pivotal to each nation's growth trajectory.

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103. UNCTAD (2013), *World investment report*.

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*Liberalising the sectors in which foreign investment was allowed proved to be revolutionary for the Dominican economy, which had previously been limited to tourism receipts and agricultural products.*

Liberalising the sectors in which foreign investment was allowed proved to be revolutionary for the Dominican economy, which had previously been limited to tourism receipts and agricultural products. The 1996 Foreign Investment Law was a critically important measure for this liberalisation process, and for the attraction of foreign capital into the Dominican Republic. It allowed for the repatriation of profits and accorded foreign corporations 'national treatment'.<sup>104</sup> It also increased the number of industries into which foreigners could invest through the creation of a negative list, and removed the requirement for Central Bank pre-approval of foreign investment. This led to both a shift and an increase in FDI flows into the Dominican Republic; before 1995/96, most money coming in flowed to the Free Trade Zones (FTZs) for textiles and garments production, but post-reform, money flooded into infrastructure and retail in the rest of the country at a rate of \$1 billion per annum after 2005.<sup>105</sup>

This foreign investment served to diversify the Dominican economy away from the primary commodities which had dominated its export mix since the late nineteenth century. The tourism industry has been the single largest recipient of FDI, and has been the most dependent upon that foreign investment (over half of investment in the sector is thought to come from abroad).<sup>106</sup> Perhaps more important than capital is the transfer of knowledge between foreign operators and domestic producers. The United Nations Conference on Trade and Development (UNCTAD) suggests that FDI has been critical in terms of providing the managerial skills necessary to expand into new sectors, exposing local workers to globally-competitive production processes, and creating the opportunity for Dominican entrepreneurs to mimic these behaviours in their own businesses.<sup>107</sup>

Remittances are also an important source of foreign investment for the Dominican Republic, worth upwards of \$1.5 billion per year.<sup>108</sup> The tendency of emigres to maintain close personal ties means that they often send their money (and eventually, themselves) back to the island. This is a stable, countercyclical source of capital which comes with the added benefit of international skills transfer. The open migratory patterns of the Dominican

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104. UNCTAD (2009), *World Investment Report*.

105. *Ibid*

106. *Ibid*.

107. *Ibid*.

108. Ribando, C.M. (2005), *Dominican Republic: Political and economic conditions and relations with the United States*, US Congressional Research Service Report.

Republic have been shown to have statistically significant and positive impacts on the economic growth of the country.<sup>109</sup>

Conversely, case study nations that have made the least progress have tended to be less open to foreign investment and have struggled to retain (or in some cases, regain) investor confidence. This closed posture has often been the legacy of import-substituting industrialisation policies, which sought to safeguard domestic industry, but tended to make any level of foreign involvement in the economy more difficult. In some nations where expropriation occurred, like Nicaragua, foreign capital disappeared virtually overnight. It was noted in 2001, after a decade of centre-right governance which saw the Nicaraguan state explicitly attempting to reform the economy and attract FDI, that foreigners were still reluctant to invest in Nicaragua:

'Foreign investors have... been more reluctant to invest in Nicaragua than in other Latin American countries. For example, in 1997 private foreign capital investment in Nicaragua was a meagre \$113 million, and only twenty-five American companies were doing business there. The lack of FDI may be attributable to Nicaragua's harsh economic circumstances and prospective foreign investors' fears about its 'weak government, corruption, poor markets and massive problems with obtaining legal property titles.'<sup>110</sup>

Remaining open to foreign investment, skills, and technologies is a requirement for economic growth. Those nations that made most progress in their development succeeded in adopting an early and consistent posture of openness across the majority of the sectors of their economies. Consequently, they secured higher levels of FDI over a sustained period, whilst encouraging those from outside of the country to create new enterprises and industries that proved transformative.

The cultivation of at least one major export-ready industry in those successful examples was the direct result of those nations' deliberate efforts to attract inward investment into those sectors. Many of those success stories have also now gone full circle, as these nations have since become a source of foreign direct investment themselves. The Colombian banking sector has branched out across Central America over the past decade, and

<sup>109</sup>. Pozo, S., Sánchez-Fung, J.R., Santos-Paulino, A.U. (2010), 'Economic development strategies in the Dominican Republic' Working Paper, No. 2010/115, (Helsinki: The United Nations University World Institute for Development Economics Research).

<sup>110</sup>. Clark, H.R. and Velazquez, A. (2001), 'Foreign Direct Investment in Latin America: Nicaragua - A case study', *American University International Law Review*, Vol. 16, Issue 3, Article 2.



Mauritian textiles production has largely been outsourced to Madagascar, where labour costs remain low.

### Summary

Though progress was fitful across all countries, those that made most progress in their development succeeded in building a viable domestic asset base. This success was contingent on their government's determination to intervene – or to not intervene – appropriately.

For successful countries, this meant taking active steps to develop and protect property rights, such as in Botswana, and to resolve the grievances caused by periods of expropriation, such as in Colombia. In contrast, unresolved land disputes have contributed to the faltering development of countries such as Nicaragua and Sierra Leone.

An established, if sometimes unstable, banking system has contributed to the development of countries such as the Dominican Republic and Indonesia, in contrast with the underdeveloped finance sectors of many of the less successful examples. For the successful examples, it also included welcoming not just international investment, but moreover the people and technologies associated with it. This included enacting legislation to reduce the number of exemptions to foreign investment through the transition to positive lists.

In summary, progress required governments to signal their intention to provide protections for investors, by actively encouraging FDI, and resolving not to undermine their nascent finance sector by monopolising credit, or by jeopardising their commercial independence.

#### To build a domestic asset base:

- Protect property rights by dealing effectively with tribal and customary rights, avoiding the expropriation of land, and by addressing the grievances caused by the expropriation of land.
- Cultivate a domestic finance sector by adopting a posture of non-interference, and by avoiding using commercial banks as an additional source of government lending.
- Encourage foreign investment, capabilities, and technologies by moving from positive to negative investment lists and by maintaining a posture of openness to external actors.

## 6. PROMOTE TRADE AND COMMERCE

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Creating the conditions for sustained economic growth within developing nations is contingent on being able to develop and sell a diverse range of goods and services within a highly competitive global marketplace.<sup>111</sup> As well as working to improve the environment for business and entrepreneurship, this requires nations to address the myriad issues that can make them uncompetitive. Specifically, this involves ensuring that the distortive impact of state involvement in the economy is minimised, and that businesses can access the talent they need to succeed.

In addition, it requires nations to acknowledge the need to be willing and active participants in global trade. Transformative economic growth requires that nations ensure their economies are able to look beyond limited domestic demand and integrate into the global economy. This requires them to embrace commercial competition, using it to spur greater efficiency, value, and growth – whilst avoiding protectionism. To do so, developing nations must configure their economies towards exporting – signalling their intention to be participants in the global economy. This means prioritising the liberalisation of the economy and the promotion of national exports, which together help accelerate the process of economic diversification.

This chapter is divided into three sections. The first assesses the importance of competition policy to economic growth, and the means by which government action can be pivotal in making national economies more or less competitive. The second explores how Export Processing Zones (EPZs) allow nations to transition towards a more open economy. The third reviews the role played by international trade, and the challenge to configure economies towards exporting.

### Competition

Cultivating an economic environment that can deliver sustained growth requires competition. Private sector competition benefits consumers, increasing the choice available to them, improving the efficiency and quality of products and services, and reducing prices. It delivers a corresponding benefit to the economy as a whole, stimulating greater levels of economic participation whilst increasing potential tax revenues for the state. Conversely, sectors that are monopolised or dominated by state-owned enterprises (SOEs) are often

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111. Hesse, H. (2008), *Export Diversification and Economic Growth*, The World Bank

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*Governments have an integral role to play in maintaining the flexibility and dynamism of the labour market, and thus discouraging informal employment.*

characterised by widespread inefficiency, scarcity, and higher prices. SOEs also tend to place a significant financial and bureaucratic burden on governments.<sup>112</sup>

Widespread competition cannot exist if the state is an active agent in a national economy, as few private sector entities are able to match its resources, and all are beholden to the legislative and regulatory framework it oversees. Encouraging competition within the economy is synonymous with enabling a thriving private sector. Such environments where the private sector dominates are open economies, where there are minimal barriers to entry including the labour market, where monopolies and oligopolies are discouraged, and where the state largely does not interfere with private enterprise, and allows prices to be set by the market.

Few developing countries have avoided subsidies and price controls outright; and for many, these distortive measures remained a key facet of the state's interaction with the national economy – often acting as a form of social assistance for both consumers (e.g. bread subsidies) and producers (e.g. agricultural price support mechanisms). Price controls have been used not simply for imported goods, but also those produced domestically, altering both the supply and demand of basic products. This has depressed domestic production of a range of goods, notably in agriculture, and imposed an enormous fiscal burden upon governments. In many cases, these costs were made more significant by the poor targeting of subsidies and price controls, which were used primarily for political ends.

For the private sector to be a driver of sustained economic growth, its long-term viability also depends on its ability to strike an appropriate balance around labour market dynamism: between providing essential protections for workers, whilst retaining the flexibility to employ and release them to reflect the changing fortunes of the marketplace.<sup>113</sup> The existence of large informal sectors is generally suggestive of labour market regulations that do not support the needs of both employers and employees.

Governments have an integral role to play in maintaining the flexibility and dynamism of the labour market, and thus discouraging informal employment. As well as avoiding onerous employment regulations, governments can influence the size of the labour market by limiting the scale of public sector employment and its contribution to productivity through

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<sup>112.</sup> McPherson, M.P. (1987), 'The promise of privatization', in Hanke, S.H. (ed.) *Privatization and development*, (San Francisco: The Institute for Contemporary Studies), p. 18.

<sup>113.</sup> Esping-Andersen, G. and Regini, M. (eds.) (2000), *Why deregulate labour markets?* (Oxford: Oxford University Press)

investment in education and skills. Furthermore, they can actively discourage employment through the creation of a minimum wage, thus increasing the costs of labour for companies, whilst creating an arbitrary barrier to employment for those workers whose labour is not deemed to be worth that sum.

Encouraging private sector competition, market prices, and flexible labour markets poses particular challenges for developing nations, whose economies are often dominated by state involvement – especially through the widespread existence of SOEs - and whose private sectors are underdeveloped, lacking the skills, finance, and reach to be competitive. Increasing the competitiveness of the private sector – and, ultimately, reducing the role of the state in the economy – is a gradual process, and one not without political risk.

While there are variants of models of successful development, many nations that made significant progress have facilitated private sector, market-based competition: narrowing the role of the state within the economy by reducing the number SOEs; limiting the scope and distortive impact of price controls and subsidies; and reducing the regulatory costs of formal employment.

For example, Colombia's development success has been, in part, due to its competitive market economy. The state's commitment to delivering flexibility within the labour market was a key feature of the apertura in the early 1990s. Law 50, enacted in 1990, ended restrictions on trade unions and increased flexibility in hiring conditions, improved the competitiveness of firms and enabled them to adapt better to international trade. It also enabled more flexible contracting of labour through an innovative system of individual accounts which provided greater consistency and certainty for companies over their severance payment liabilities.<sup>114</sup> A further series of legislative reforms since 2000 has further improved the flexibility of the labour market; Law 789 of 2002 and Law 1429 of 2010 aimed to address the underlying causes of unemployment by reducing hiring costs.

Colombia also succeeded in establishing and maintaining a robust code of competition law, despite persistently high levels of state involvement in the economy and relatively concentrated ownership structures.<sup>115</sup> Although 58 SOEs were privatised between 1986 and 1998, levels of state ownership remain relatively high, with some 70 state-owned

<sup>114</sup> Heckman, J.J. and Pagés, C. (eds.) (2004), *Law and employment: Lessons from Latin American and the Caribbean*, (Chicago: University of Chicago Press).

<sup>115</sup> Gutiérrez, L.H. and Pombo, C. (2009), *Mercados de capitales y gobernanza corporativa en Colombia*, pp. 227–274.

enterprises comprising around a third of Colombia's GDP in 2012, on a par with many other OECD countries.<sup>116 117</sup> But these state-owned enterprises are subject to the 2009 Competition Law, which was based largely on the EU model; any persons or enterprises affecting market functions were rendered fully subject to competition law.<sup>118</sup> This means, in practice, that state-owned enterprises are expected to find financing through commercial markets, and that they are not given any special preferences over private enterprises. The OECD has found that although certain aspects of the corporate governance of SOEs could be improved (especially with regard to ownership structures and responsibilities), for the most part the legal framework establishing a level playing field between SOEs and private enterprise is robust, and has functioned successfully.<sup>119</sup>

Modest levels of price distortions have a less detrimental impact, and some governments would consider that the socio-political benefits outweigh the economic costs. For example, the government of Mauritius historically used price controls and subsidies to provide a degree of protection to both consumers and producers. Price controls on basic commodities such as rice, flour and bread were introduced in the late 1960s, overseen by the Price Control Unit of the Ministry of Commerce and Consumer Protection. Though Mauritius once maintained a more extensive list of items under price control, since 1980 these controls have been steadily removed as part of an effort to improve the government's fiscal position. However, the government continues to subsidise basic foodstuffs, in part to deter the creation of cartels.

Unlike Mauritius, where the use of price controls was limited, Nicaragua struggled to negate the impact of the excessive price controls and subsidies. Both were key features of the management of the economy under the Sandinistas; the regime provided large subsidies to agricultural inputs such as machinery, herbicides, and fertilisers, alongside food subsidies that accounted for some ten per cent of GDP by 1983. The effect of subsidies was to introduce profound distortions in relative prices as well as growing trade deficits. By 1987 it was reported that tractors were cheaper than a pair of oxen.<sup>120</sup> Similarly, price controls for

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**116.** Christiansen, H. (2011), *The size and composition of the SOE sector in OECD countries*, OECD Corporate Governance Working Papers, No. 5.

**117.** Pombo, C. and Ramírez, M. (2003), *Privatization in Colombia: A plant performance analysis*, IDB Working Paper No. 166.

**118.** OECD (2016), *Colombia: Assessment of competition law and policy*.

**119.** OECD (2015), *OECD review of the corporate governance of state-owned enterprises: Colombia*.

**120.** Saravia-Matus, S.L. (2010), 'Agrarian reform: Theory and practice - The Nicaraguan experience' *Encuentro*, Vol. 41, No. 84.

corn and sorghum during the first four or five agricultural seasons after 1979 were so low that no producers were able to recover production costs.<sup>121</sup>

Furthermore, Nicaragua's comprehensive programme of nationalisation after 1979 proved to have a predictably disastrous impact on private sector competition, and its primary legacy has been the creation of oligopolies in key sectors. From 1978 to 1980, the state's contribution to GDP almost trebled from 15 per cent to 41 per cent, with the government taking control of an array of sectors from natural resources to banking to transportation. The state established effective control over what remained of the private sector by nationalising wholesale marketing of some products. The transfer of so many sectors into state ownership resulted in widespread inefficiencies, driven by ideological – rather than profit – motives, with the government expressing its preference for the 'logic of the majority.'<sup>122</sup>

In principle, laws to enhance competition and prevent monopolistic structures and conduct have existed in Nicaragua since the 2000s, but are enforced inconsistently or undermined by state intervention. Monopolistic practices remain prevalent in the market with price-setting and production quota agreements between competitors in the flour, sugar, oil and soft-drinks sectors.<sup>123</sup> In 2007, a competition-promotion and anti-monopoly law came into effect, prohibiting anti-competitive practices and creating a national institute for the promotion of competition (Procompetencia). However, after twelve years of Procompetencia's existence, anti-competitive practices still exist, and many of the most important sectors have one company which controls more than 50 per cent of the sector.

The extensive use of price controls in Sierra Leone helped to create the conditions for recurrent balance-of-payments crises throughout the late twentieth century. The role of the Sierra Leone Produce Marketing Board (SLPMB) in depressing producer prices and reducing the value of exports is particularly notable. Established as a monopsony in 1949, the SLPMB had the exclusive right to export key cash crops (including coffee, cocoa, and palm oil, amongst others), and was the sole purchaser of such crops produced in-country. An official price for purchase was set, which could not be negotiated by producers.

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121. Saravia-Matus, S.L. (2010), 'Agrarian reform: Theory and practice - The Nicaraguan experience' *Encuentro*, Vol. 41, No. 84.

122. Austin, J.E., Fox, J.A. and Kruger, W. (1985), 'The role of the revolutionary state in the Nicaraguan food system', *World Development*, Vol. 13, No.1, pp. 15-40.

123. CUTS International (2007), *Nicaragua*, Country Profile.

This created several deleterious effects. The first was the reduction in producer incomes; a 1974 study estimated the loss of income (from what producers would have been earning at global prices) to be millions of leones per year throughout the first decade of independence.<sup>124</sup> These artificially low prices depressed production, which in turn depressed export income; again, through the first decade of independence, these losses were estimated to be millions of leones per year. In the case of rice production – a particular concern for the early governments of Sierra Leone – an export tax which was designed to boost the domestic supply of rice had the opposite effect, and ended up costing far more than it generated in tax revenues.

Worse still, these misguided policies reduced overall rates of planting. Particularly in the case of coffee and cocoa, which both require several years' tending before they reach maturity, these policies depressed a generation's worth of agricultural productivity in a country where the only other significant form of economic activity was mining, an extractive industry which did little to strengthen the country's already-weak institutions. Between 50-70,000 men are estimated to have left farming for mining between 1956-57 alone.<sup>125</sup>

Kenya adopted a deliberately exclusionary approach to its labour market, severely restricting the participation of foreign nationals as part of its Kenyanisation agenda. Successive governments sought to limit foreign participation in multiple sectors of the economy including agriculture, using a regime of work permits to restrict the employment of emigrants in an effort to boost rates of domestic employment. The government played an active role in controlling wages in the decades after independence, especially during the period between 1970 and 1974 when it was the chief determinant of wages in both the public and private sectors. Alongside imposing wage ceilings in the public sector, the government established a largely unaffordable minimum wage for some sectors of the private sector, which quickly proved to be a major obstacle to increasing formal employment. The need to create opportunities for employment prompted a series of tripartite agreements between the government, employers and workers in 1964, 1970 and 1979 aimed at increasing employment by ten per cent. In addition, Kenyan governments

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124. Levi, J. (1974), 'African agriculture misunderstood: Policy in Sierra Leone', *Food Research Institute Studies*, Vol. 13, No.3, pp.1-24.

125. Wanders, J.A.M., and Sellies, F.P.J. (1997), *Who pays the price? The production and marketing of coffee and cocoa in Sierra Leone under structural adjustment*, Nijmegen Studies in Development and Cultural Change Working Paper.

Successful nations often chose to use export-processing zones (EPZs), or special economic zones (SEZs), to reduce quantitative restrictions which hindered manufacturing

routinely used major capital projects as opportunities for mass employment, most notably in episodic bouts of road construction during the 1960s and 1970s.<sup>126</sup>

The process of opening up economies requires significant political capital to overcome opposition from multiple vested interests. Those nations willing to expend it, such as Colombia, consistently, succeeded in opening their markets to private sector competition. However, those that used statism as a means of building their political capital have paid a high economic price.

### Export processing zones

Building open economies requires that developing nations configure themselves towards exporting - signalling their intention to be participants in the global marketplace. This means prioritising the liberalisation of the economy and the promotion of national exports, which together help accelerate the process of economic diversification.

All developing nations face a common challenge: how best to develop a diverse range of industries that can be steadily integrated into a highly competitive world economy. Many nations have experimented with variations of protectionism, notably import substitution industrialisation, designed to reduce reliance on the import of goods to stimulate domestic production. However, the speed with which they configured their economies towards exporting has tended to be a key determinant of development.

Successful nations often chose to use export-processing zones (EPZs), or special economic zones (SEZs), to reduce quantitative restrictions which hindered manufacturing (e.g., avoiding tariffs which made the import of machinery or tools expensive). They enabled nations to experiment with initiatives designed to gear sectors towards export-readiness.<sup>127</sup> Consequently, they were used to fast track development, insulating nascent sectors of the economy from the legal and political constraints on their development. The primary political benefit of EPZs is their limited scope; given that their liberalisation is limited to a specific geographic area, they tend to encounter less resistance than nationwide liberalisation.

<sup>126.</sup> Balassa, B. (1978), 'Exports and economic growth: Further evidence', *Journal of Development Economics*, Vol. 5, Issue 2, pp.181-189.

<sup>127.</sup> Woldekidan, B. (1992), *Mauritius: an export-led economic success*, Ph.D. thesis (Australian National University).



The Mauritian experience is an exemplar of successful EPZ-led development. At independence, the government sought to reconfigure its economy towards exports through the innovative use of EPZs, modelled on those in operation in Singapore and Hong Kong.<sup>128</sup> The 1970 Export Processing Act made the entirety of the island an EPZ, as well as providing a raft of measures designed to reduce the costs of exporting, thus making them internationally competitive. These included tariff exemptions for imports subsequently used in products for export, a twenty-year corporate income tax holiday for exporters, reduced utility rates and business rates.



*Port Louis port, Mauritius.*

<sup>128</sup>. Woldekidan, B. (1992), *Mauritius: an export-led economic success*, Ph.D. thesis (Australian National University).

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*In Sri Lanka, the creation of the Greater Colombo Economic Commission (GCEC) provided the country with a novel mechanism for the creation of export processing zones.*

The impact was dramatic. The number of exporters increased rapidly; by the end of 1977, nearly 90 enterprises had been established, with an average of 200 employees, creating a total of more than 17,000 jobs.<sup>129</sup> By 1988, this number had leapt to close to 600, located across the country.<sup>130</sup> Importantly, the EPZ programme catalysed the diversification of the wider economy. Though sugar and its by-products still represented about 90 per cent of agricultural output by 1988, it comprised less than a third of total exports, and employed just 15 per cent of the labour force.

Mauritius' creation of an island-wide EPZ enabled it to create widespread exemptions from tariffs. Alongside this, the country worked to address prohibitive non-tariff barriers (NTBs), eliminating quantitative import restrictions and quotas in 1985.<sup>131</sup> Mauritius used EPZs to address the challenge posed by an uncompetitive minimum wage, opting to halve it within the zones.<sup>132</sup> The result was dramatic, with unemployment falling sharply from twenty per cent to five per cent between the mid-1970s and 1990. The effect was particularly pronounced amongst unskilled women, who had previously either worked in the sugar cane fields, or not at all. By the 1980s, four-fifths of workers in the EPZs were women. In 1985, minimum wages for men in the EPZ sector, which were higher than for women but disadvantaged them in obtaining employment in the sector, were eliminated. As a result, male employment in the EPZ increased to 33 per cent in 1986. Workers later transitioned to the service industry as tourism took off. This necessitated the introduction of foreign labourers; by the mid-2000s, they too became too expensive, and production moved to Madagascar.<sup>133</sup>

Similarly, in Sri Lanka, the creation of the Greater Colombo Economic Commission (GCEC) provided the country with a novel mechanism for the creation of export processing zones. These EPZs enjoyed decade-long tax holidays, permitted for 100 per cent foreign ownership of companies, duty exemptions, and access to credit at global prices.<sup>134</sup> These EPZs would

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129. *Ibid.*

130. *Ibid.*

131. *Ibid.*

132. Frankel, J. (2012), *Mauritius: African success story*, Harvard Kennedy School, Mossavar-Rahmani Center for Business & Government, Faculty Working Paper No. 2012-06.

133. Robeck, J., Rosunee, S., and Pattison, J. (2012), 'The Mauritius apparel manufacturing industry: Explorations of the past to the present', *International Journal of Trade and Commerce*, Vol. 1, No. 2, pp. 163-174.

134. Athukorala, P. and Jayasuriya, S. (2004), 'Complementarity of trade and FDI liberalization in industrial growth: Lessons from Sri Lanka', ASARC Conference Paper.

come to provide a critical source of employment during a difficult period for the country, especially for low-skilled women.

Jordan's less successful development experience illustrates why government support for the principles of EPZs must be matched by concerted action. Its economy underwent a period of gradual liberalisation after 1988, characterised by a steady reduction of tariff and non-tariff import restrictions. However, despite adopting an export promotion scheme in 1989, export-led growth has been stifled by ongoing restrictions against foreign investors. Fervent efforts to liberalise after 1997 proved more successful, notably through the introduction of Qualified Industrial Zones (QIZs), which exempted resident companies from customs tariffs and income tax, and which permitted foreign ownership and the repatriation of capital. However, as with the Aqaba Special Economic Zone created in 2000, business conditions did not differ substantially compared to the rest of the country, with the success of ventures often still dependent on relationships with officials. Subsequent initiatives such as the creation of the Jordan Investment Board (JIB) and the Development and Free Zones Commission have been hampered by bureaucratic inertia, with responsibility dispersed across several ministries. While export performance has improved, progress has been limited to a restricted range of products, most of which have limited international market prospects. Meanwhile the manufacturing sector's share of growth has been on a downward trajectory, from around 25 per cent in 2000 to 13 per cent by 2014.<sup>135</sup>

For nations to foster genuine openness in trade policy, the reality had to match the rhetoric. This meant seeking to address all obstacles to trade, whether tariff or non-tariff. It also required leaders to recognise that active participation in international trade negotiations was ultimately a binary choice; without embracing it, nations would be forced to rely increasingly on protectionism, condemning them to limited growth and minimal economic diversification.

### **International trade**

Transformative economic growth requires that nations develop a broad range of goods and services that can be traded. However, for such growth to be sustained, developing nations must ensure their economies are able to look beyond limited domestic demand, and integrate into the global economy. This requires nations to embrace international

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135. The World Bank Group (2016), *Hashemite Kingdom of Jordan: Promoting poverty reduction and shared prosperity - systematic country diagnostic*, Report No. 103433-JO.

competition, using it to spur greater efficiency, value, and growth – whilst avoiding protectionism.

There were two basic schools of thought which governed trade policy in the 1950s and 1960s. Countries and economists tended to either support 'export-promoting' policies, which were designed to make domestically-produced goods competitive on international markets, or 'import-substituting' policies, which were designed to protect domestically-produced goods from international competition, so that a greater proportion of goods could be manufactured in-country. Those favouring import-substitution, who were also known as 'export pessimists', for their belief that exports would not be the key to eradicating poverty in the developing world, won the argument: import-substituting policies became the norm across much of the developing world. Tariffs, quotas, and non-trade barriers went up – and as a result of these policies, so did costs. Developing countries bore these costs and inefficiencies until some point of economic crisis, at which stage most chose to reform.

Given that trading volumes tend to decrease with distance, increasing trading ties with immediate and regional neighbours is integral to strengthening nations' export bases.<sup>136</sup> Those nations that made most progress in their development demonstrated a sustained determination to make themselves attractive trading partners, specifically by reducing tariffs and addressing non-tariff barriers to trade and ending the practice of import-substitution industrialisation. Additionally, they actively sought to negotiate advantageous trade deals with immediate and regional neighbours and demonstrated a determination to integrate themselves into the international trading system. Consequently, they made faster progress than their counterparts, who were passive or reactive participants in global markets.

The experience of Sri Lanka is particularly instructive. The post-independence decision to move the country towards an import-substitution model proved to be disastrous. Sri Lanka had neither the raw materials nor the technical knowledge to produce the intermediate and final goods which it had previously imported. It became even more dependent upon imports during this period, as it became critical to move raw materials and capital goods

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**136.** It is worth noting that this has not historically held true across post-independence Africa; because of the preferential trading agreements available to most African states, they have tended to trade more with the global north than with each other. But these preferential trading agreements (e.g., the African Growth and Opportunity Act (AGOA), Everything But Arms (EBA), Generalised Scheme of Preferences (GSP), GSP+) are essentially impermanent; when they expire, or a country graduates from a given scheme, the economic impact is generally negative.

into the country. The deterioration in the country's terms of trade also dictated reduced imports, to the detriment of consumers.<sup>137</sup> By 1974, manufacturing capacity utilisation was at 40 per cent; this mothballing of most of the country's productive assets had a notable impact on export volume. Sri Lanka quickly fell behind the rest of Asia in terms of exports; where South Korea saw an average of 20 per cent year-on-year growth in exports between 1960 and 1992, Sri Lanka saw an average of 1.6 per cent.<sup>138</sup>

JR Jayewardene, who served as Prime Minister and subsequently President, was brought to power in a landslide electoral victory in 1978, in which his party won five-sixths of the seats in Parliament. His time in office would see significant economic liberalisation and structural adjustment. The new United National Party (UNP) government, which had been handed a mandate to liberalise the economy, set about doing that as soon as it got into office. Import controls were removed, export duties reduced, food and fuel subsidies eliminated, and the currency devalued. These initial steps towards greater trade liberalisation were curtailed by the civil war; the need to raise additional revenues led to increases in import tariffs, whilst the planned reduction of tariffs into a single band was abandoned in the late 1990s. Since the end of the civil war in 2009, the government appears to have recognised the need to liberalise, with the 2018 and 2019 budgets removing protectionist para-tariffs on several items and proposing their eventual removal over a five-year period.<sup>139</sup>

Botswana's embrace of international trade reflected the pragmatism and patience of its early leaders. The country opted to remain in the Southern African Customs Union (SACU), post-independence, even though that meant maintaining close trading and financial links with apartheid-era South Africa. The Botswanan government was an active participant in negotiations on the division of customs revenues between the SACU member states and is today an active participant in the African Continental Free Trade Agreement (AfCFTA) negotiations, taking place under the aegis of the African Union.

The Dominican Republic and Colombia both moved in the early 2000s to negotiate trade agreements with the United States, as well as with regional partners (see, for example, Colombia's associate membership in Mercosur, the Latin American trading bloc, and full

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137. Athukorala, P. and Jayasuriya, S. (2004), 'Complementarity of trade and FDI liberalization in industrial growth: Lessons from Sri Lanka', ASARC Conference Paper.

138. World Bank (1995), *Sri Lanka*, Factsheet.

139. US Department of State (2029), *2019 Investment climate statements: Sri Lanka*.

*Those countries that made the most progress were those whose leaders were willing to expend the political capital required to drive innovation and dynamism, even in the face of significant domestic opposition.*

membership in the Trans-Pacific Partnership (TPP), which is probably the highest-standard free trade agreement ever put into force).

These nations, which have been successful in their development, broadly embraced the concept of international trade, becoming proactive participants in the global economy as a result. They actively sought to negotiate advantageous trade deals with immediate and regional neighbours and demonstrated a determination to integrate themselves into the international trading system. Consequently, they made faster progress than their less successful counterparts, seeing their volume of international trade increase faster.

An important factor appears to be attitudinal. Amongst these countries, trade liberalisation was viewed by domestic leaders as an opportunity for commercial expansion onto the world stage – and not simply the disadvantageous imposition of the World Trade Organization (WTO) framework or the General Agreement on Trade and Tariffs (GATT). This did not necessarily mean that they fully liberalised their trade regimes overnight (or that they have completed the process of trade liberalisation today). Instead, they sought to become an active participant in trade negotiations as early as possible. They also took advantage of whatever preferential trading agreements were available, while also seeking to negotiate permanent, normalised trading relations. In short, they took advantage of the opportunities available to them, and simultaneously worked hard to create their own.

### Summary

All developing nations face a common challenge: how best to develop a diverse range of industries that can be steadily integrated into a highly competitive world economy. Those countries that made the most progress were those whose leaders were willing to expend the political capital required to drive innovation and dynamism, even in the face of significant domestic opposition.

This included privatising state-owned enterprises, abolishing monopolies and marketing boards, as well as establishing competition authorities. In contrast with the less successful nations, they have also removed most distorting price controls and subsidies.

However, the most successful nations went further, towards a more open posture designed to create a pathway towards ultimate integration into the framework of international trade. In each case, this transition was nothing short of transformative. But it required the slow and gradual reconfiguration of national economies towards exporting, making innovative use of EPZs and FTZs as a means of experimenting with policy formulas.

Progress for those nations whose leaders were determined to oversee such a transformation in trade was significant. They demonstrated a sustained determination to make themselves attractive trading partners, specifically by reducing tariffs and addressing the numerous non-tariff barriers to trade, from unnecessary bureaucracy to poor trading infrastructure. Active participation in international trade negotiations became the hallmark of success.

### To promote trade and commerce:

- **Enable competition** by minimising the detrimental impact of monopolies and SOEs, by limiting the use of price controls, and by maintaining a flexible labour market through minimising the formal and informal costs of employment and by limiting public sector employment.
- **Make innovative use of export processing zones** by using them to configure the economy towards exporting, and by experimenting with policy options designed to increase the international competitiveness of key exports.
- **Prioritise international trade** by reducing barriers to trade and ending import-substitution industrialisation, and by bolstering regional trading ties.

## CONCLUSION TO PART TWO

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Building an open economy is a colossal undertaking. In contemporary developed nations, the process of industrialisation and the economic growth and diversification it catalysed took decades to come to fruition. For today's developing nations, the scale of this challenge is no less stark. However, the sustained growth to transform the prosperity of such nations can only be delivered by transforming economies away from subsistence agriculture and towards exporting.

Despite the scale of this challenge, the empirical evidence presented by these sample nations is instructive. Collectively, they illustrate how developing nations can successfully create the pathways from poverty to prosperity, by creating an economy that is well-managed and resilient to shocks, in which people feel they have a stake, and which is internationally competitive.

Specifically, these experiences highlight the centrality of macroeconomic resilience to development outcomes. Those nations who made most progress were those who succeeded in increasing the scale and scope of revenue collection, to limiting spending, deficits and debt, and to managing interest rates effectively. Such an approach proved integral not only to increasing investor confidence but also to ensuring that countries' nascent economic gains were not jeopardised by shocks. Instead, sound management of the macroeconomy enabled those nations to limit both the scope and duration of those crises.

The experiences of the sample nations also demonstrate how an established domestic asset base can catalyse economic growth, by providing security for investments, a crucial source of lending for business, and an attractive environment for foreign investment. Each element represented a key feature of the transition away from subsistence agriculture amongst those nations that made most progress in their development and helped lay the foundation for greater diversification of the economy.

Finally, these examples illustrate the binary choice facing developing nations, namely that between protectionism and an embrace of trade and competition. Those nations that excelled acted decisively to make their economies more internationally competitive as a precursor to their ultimate reconfiguration towards exporting.

In each instance, the onus for initiating, managing, and persisting with such transformations rested with the leaders of each nation. And in each case, those leaders were repeatedly required to subordinate their own political interests to broader economic imperatives. This involved overseeing the withdrawal of unaffordable but popular subsidies, ending protectionism for key but uncompetitive industries, and curtailing key worker protections that made labour unaffordable. As such, the process of building open economies proved to be an exercise in political courage.



# Part Three

Investing in  
human capital

## INTRODUCTION TO PART THREE

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*Governments' commitment to creating a climate of social wellbeing represents an extension of their nations' social contracts, as well as providing an essential precondition of sustained economic growth and diversification.*

The process of national development entails more than GDP growth. For nations to truly succeed, they must create the socio-economic conditions in which their populations are able to fulfil their potential and make their own, unique contribution.

However, across the world, such conditions have been the exception, rather than the rule. Today, around half of the population in developing countries is classified as living in extreme poverty, whilst less than half the global population have access to essential health services, according to the UN. Similarly, literacy rates in some of the poorest developing nations remain stubbornly low, at below thirty per cent in nations such as Burkina Faso, Niger, and South Sudan.<sup>1</sup>

Addressing such profound and entrenched challenges is a daunting prospect. It requires the leaders of developing nations to commit to improving the so-called lived experience of their citizens, despite often limited financial, infrastructural, and administrative capacity. The interrelationship between health, education, and poverty is complex yet fundamental. As such, governments' commitment to creating a climate of social wellbeing represents an extension of their nations' social contracts, as well as providing an essential precondition of sustained economic growth and diversification.

Whilst there is evidently no panacea, nations' ability to catalyse the latent socio-economic potential of their populations is shaped by two key elements: healthcare and education. Put simply, populations that are healthy and educated are less likely to experience extreme poverty and more likely to be prosperous.

As such, improving healthcare and extending education have long been key features of international development and leading priorities for governments, multinational organisations, and NGOs around the world. The following two chapters examine approaches to the task of fostering social wellbeing, assessing the importance of providing effective healthcare and education, and the challenges of increasing both the quality and accessibility of these key public services.

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1. UN (2020), 'About the Sustainable Development Goals – United Nations Sustainable Development'.

## 7. PROVIDE EFFECTIVE HEALTHCARE

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Healthy populations are key to functioning societies. Though life expectancy has increased in every nation and region of the world since 1960, there remains a significant disparity between developed nations and their developing counterparts. Men and women in the world's most developed nations can expect to reach the age of seventy-six and eighty-two respectively, compared to sixty-three and sixty-six in least developed nations.<sup>2</sup> Moreover, developing nations experience as much as ninety per cent of the global burden of disease, while accounting for only twelve per cent of global spending on health.<sup>3</sup>

Sixty years ago, the countries of the developing world generally experienced poor health outcomes resulting from the limited capacity and quality of healthcare, and the population's access to it. Life expectancy ranged from fifty-nine years in Sri Lanka, to just thirty-one years in Sierra Leone. Children suffered disproportionately; one in ten children born in Kenya did not live to see their first birthday, while one in five children born in Botswana did not live to see their fifth. Vaccine-preventable diseases, like whooping cough, measles, and influenza were still leading causes of death, as well as enteric diseases caused by poor sanitation. Similarly, nearly all developing nations suffered from acute shortages of trained medical personnel. For example, just before independence, in 1950, Jordan had 192 government hospital beds and seventy-five doctors, whilst at the point of its independence in 1963, Kenya had 811 doctors, only fifty of whom were African, and the healthcare system was largely limited to mission hospitals.<sup>4</sup>

However, despite such limitations, many nations succeeded in making significant progress in the provision of healthcare. This chapter examines two specific aspects: first, building institutional capacity to ensure healthcare provision is both affordable and sustainable; and second, increasing access to healthcare services, so that the populations is able to benefit regardless of income or location.

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2. Duffin, E. (2020), 'Life expectancy in industrial and developing countries in 2018', *Statista*.

3. Peters, D. H., Garg, A., Bloom, G., Walker, D. G., Brieger, W. R. and Rahman, M. H. (2008), 'Poverty and access to healthcare in developing countries', *Annual of the New York Academy of Science*, 1136: 161–171, p. 163.

4. Republic of Kenya (1965), *African socialism and its application to Kenya*, p.21.

## Institutional capacity and quality

*OECD nations spend an average of almost nine per cent of their GDP on maintaining existing healthcare systems, whilst nations like the UK have some 28 physicians per 10,000 population, compared to 0.25 in Sierra Leone.*

Creating and maintaining the complex healthcare systems required to administer effective primary and secondary care on a national scale is a colossal undertaking. OECD nations spend an average of almost nine per cent of their GDP on maintaining existing healthcare systems, whilst nations like the UK have some 28 physicians per 10,000 population, compared to 0.25 in Sierra Leone.<sup>5</sup>

Developing nations face considerable challenges in increasing capacity within their healthcare systems, constrained by shortages of trained medical personnel, limited expenditure, weak infrastructure, and rapidly growing populations. Despite these challenges, developing nations have been able to take advantage of significant medical advances, taking receipt of life-saving pharmaceutical innovations like penicillin, without the health infrastructure which had enabled their testing and development.

One model of successful development has been to make judicious use of external assistance to support the provision of primary healthcare, enabling public investment to be directed towards developing a sustainable healthcare system – which Botswana and Colombia have undertaken in different ways. Healthcare formed a key feature of successive Botswanan five-year plans undertaken since independence in 1966. Early plans made concerted use of Norwegian development assistance, which accounted for some ninety per cent of funding for Botswanan public healthcare during the first three decades. This extraordinary budgetary support enabled the Botswanan government to invest in the creation of the Basic Health Services (BHS) programme in 1972, which provided essential capacity and focused upon preventative healthcare, prioritising the provision of clean water, sanitation, and clinics.<sup>6</sup> This approach enabled the government to steadily create a healthcare system that was financially sustainable, increasing spending on healthcare per capita from only \$10 in 1975 to almost \$100 by the mid-1990s. Crucially, as well as creating essential capacity, Norway's development assistance enabled Botswana to address chronic diseases, with smallpox eliminated in just two years between 1972 and 1974.

Colombia benefitted from a less altruistic yet equally pivotal form of external assistance, which helped build its health capacity. At the turn of the twentieth century, American commercial interest in the country's plantations prompted concerted efforts from foreign

5. OECD (2017), *Health expenditure*, Factsheet.

6. WHO (1999), *The development of Botswanan healthcare*, Press Release.

corporations to maintain the health of Colombian agricultural workers, notably those working in key industries such as tobacco production. Such private sector initiatives provided critical capacity, especially in preventative and primary healthcare. As such, they laid an important foundation for subsequent initiatives, such as the rural programmes of immunisation funded by the Rockefeller Foundation and the nationwide campaign against yellow fever funded by the US government.<sup>7</sup> In addition to addressing prevalent illnesses, these externally-funded campaigns helped extend medical expertise, technology and infrastructure to rural parts of the country.

Conversely, Sierra Leone's governance weaknesses meant it failed to make use of external assistance to help it establish sufficient capacity within its healthcare system. Despite being one of five African states to receive technical and financial assistance from the WHO and USAID in the early 1960s, the country's leaders failed to deliver on the multi-year strategic plans developed in conjunction with the WHO. The first five years of the inaugural plan (1965-70) were estimated to cost £100 million, two-thirds of which was meant to be covered by the Sierra Leonean government. But by the very first year of the plan, 'recruitment and capital expenditure had ceased... 'owing to a financial crisis' and only three new health centres had been opened, with donor funding.'<sup>8</sup>



*Siaka Stevens, Sierra Leone's autocratic leader for 18 years between 1967 and 1985*

7. Thorp, R. (1997), *Progress, poverty, and exclusion: An economic history of Latin America in the 20th Century*, (Washington DC: Inter-American Development Bank).

8. Manton, J. and Gorsky, M. (2018), 'Health planning in 1960s Africa: International Health Organisations and the post-colonial state', *Medical History*, Vol. 62, No. 4, pp.425-448.

Building institutional capacity was a challenge common to each nation. External assistance alone was insufficient to create the essential institutional capacity required to develop a nascent healthcare system, however it was sufficient to enable those nations that used it judiciously to do so faster. Moreover, such partnerships resulted in an evident improvement in health outcomes, often for the working poor, and the establishment of the idea that the government could contribute to the health of the public.

### **Access to healthcare**

Healthcare cannot be considered effective if it is accessible to only a minority of the population. Ever since it was formalised in the 1978 Alma Ata Declaration, the right to primary healthcare has been recognised as the first principle of public health in the developing world.<sup>9</sup>

Access to healthcare is contingent on both affordability and locality. Put simply, people will not seek medical treatment if doing so is prohibitively expensive, or if that treatment is located too far away from where they live. If the poorest people in society cannot easily and regularly access medical care, then healthcare will be permanently reactive, treating disease after it has appeared. This presents significant challenges for developing nations, where public funding for healthcare is often limited, and where it is often concentrated in urban areas.

The leaders of nations that made most progress in their development have understood that healthcare must be brought to the poor, and not the other way around, if it is to be effective. This involved the prioritisation of physical infrastructure to enable the localisation of medical facilities, personnel, and equipment, especially in rural areas, and making healthcare affordable.

These nations that sought to significantly reduce the cost of healthcare have used a combination of tax revenues and donor funds to provide services at a subsidised price for consumers, often through national insurance schemes. Following a common East Asian model, these countries provided healthcare which was free or comparatively inexpensive at the point of access, relying upon quality differentials to encourage those who could afford to pay into accessing private healthcare.

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9. WHO (1978), *Alma Ata Declaration*, Press Release.

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*After independence in 1968, the government committed to bringing care within three miles of every citizen's residence, effectively ensuring that distance would not be a barrier to care.*

In Mauritius, successful social development was supported by the establishment of village-level local councils in the early 1950s, which sped up the localisation of healthcare provision. The British colonial government allowed for the establishment of these councils following labour unrest, hoping that more representative government would reduce tensions. These councils were empowered to facilitate public works projects and were tasked with helping to expand health and educational offerings to rural areas. These included child and maternal welfare centres, as well as active efforts to contain infectious diseases, through the draining of marshlands and the use of insecticides. One hundred village councils were set up, comprised mostly of elected officials, to decide how to administer these programmes. From the late 1930s to the eve of independence in 1967, recurrent expenditures for healthcare and education increased eighteen-fold, with both firmly established as priorities of local government. After independence in 1968, the government committed to bringing care within three miles of every citizen's residence, effectively ensuring that distance would not be a barrier to care.<sup>10</sup> Healthcare was also made free at the point of access; the public health system still provides the vast majority of health services in-country (over 70 per cent), but private providers are available.<sup>11</sup>

In the Dominican Republic, the Ministry of Health and Social Assistance set up thousands of rural health clinics in the 1970s and 1980s, staffing them with junior doctors who were required to perform one year of 'social service'. By the late 1980s, around three-quarters of the population had some form of health insurance, through public programmes and those available for the armed forces and the private sector. Despite the well-documented deficiencies of this system, this emphasis on local provision of medicine helped to reduce maternal and infant mortality rates significantly, as well as the spread of infectious diseases.

Conversely those nations that have made least overall progress in their development typically avoided establishing (or enforcing) a universal provision of health care, which hampered usage and coverage of the general population. With little or no government funding available to cover the cost of treatment for the very poor, few public or private hospital administrators would have made the choice to open facilities in rural areas where no one could afford treatment. Consequently, healthcare generally became concentrated in cities, further exacerbating sub-national inequalities.

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**10.** Sandbrook, R. (2005), 'Origins of the democratic developmental state: Interrogating Mauritius', *Canadian Journal of African Studies/Revue Canadienne des Études Africaines*, Vol. 39, No. 3 (2005), pp. 549-581.

**11.** Nundoochan, A. et al. (2019), 'Impact of out of pocket payments on financial risk protection indicators in a setting with no user fees: the case of Mauritius', *International Journal for Equity in Health*, Vol. 18, No. 63.

Healthcare failed to be consistently prioritised by Nicaragua's governments. During the Somoza regime, there was no coordinated policy, and only a small fraction of the population (effectively those close to the regime) were given health insurance. Hospital workers 'reported watching patients die at the emergency entrance because they lacked the admission fee.'<sup>12</sup> The Somozas themselves travelled abroad, sometimes to the US, for their own medical care.<sup>13</sup>

Provision was not much improved under the Sandinistas. Though plans for primary health facilities were not dissimilar to the health units of Sri Lanka or *puskesmas* of Indonesia, increased expenditure to finance the conflict against the Contras had an immediate impact on efforts to increase access to healthcare. Today, access to healthcare in rural Nicaragua remains extremely limited, though the rural population comprises roughly 40 per cent of Nicaragua's total, they account for some 70 per cent of annual deaths.<sup>14</sup> Much of primary healthcare in local areas is left to volunteer midwives and *brigadistas*, a relic of the first Sandinista public health campaigns of the 1980s, who perform basic medical care and disseminate information on public health, while also providing practical services for the central government, like maintaining a census of pregnant women.<sup>15</sup> These volunteers typically have little formal education and no medical qualifications.<sup>16</sup> The facilities in which they work are poor; nationwide, 30 per cent of health facilities lack access to electricity, 45 per cent lack access to running water, and 60 per cent cannot sterilise their instruments.<sup>17</sup> The country's chronic shortage of doctors is made worse by their low pay – the lowest in Latin America.<sup>18</sup> And unlike in Colombia, Indonesia, and several other case study countries with challenging topographies, Nicaragua does not provide financial incentives for doctors to work in remote areas, in spite of the fact that these postings come with a higher cost of living.<sup>19</sup>

12. Slater, G.R. (1989), 'Reflections on curative health care in Nicaragua', *American Journal of Public Health*, Vol. 79, No. 5, pp.646-651.

13. Zaremba, L M., (1992), *Nicaragua: Before and after the revolution*, Honors Theses, Paper 21.

14. Sequeira, M., Espinoza, H., Amador, J.J., Domingo, G., Quintanilla, M. and de los Santos, T. (2011) 'The Nicaraguan health system', Program for Appropriate Technology in Health.

15. Sequeira, M. et al. (2011) 'The Nicaraguan health system', Program for Appropriate Technology in Health.

16. Singh, P. et al. (2011) 'Making healthcare more accessible to rural communities in Waslala, Nicaragua using low-cost telecommunications' Proceedings - IEEE Global Humanitarian Technology Conference, pp. 194-200.

17. Paxton, D. (2017), 'Nicaraguan health care: A post-revolutionary failure', Council on Hemispheric Affairs.

18. *Ibid.*

19. Sequeira, M. et al. (2011) 'The Nicaraguan health system', Program for Appropriate Technology in Health.



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*Though progress has been fitful, successful governments have committed themselves to prioritising healthcare, inviting external financial and technical assistance to help address shortfalls in equipment, capacity, and expertise.*

Salaried, formal-sector workers (roughly ten percent of the population) are covered by the Nicaraguan Social Security Institute (INSS); an equivalent insurer exists for those serving in the military. The remainder are theoretically covered by MINSA, the Ministry of Health, which is both a regulator and a healthcare provider. But, as of 2011, nearly 80 per cent of economically-active adults do not have insurance, and 35-40 per cent do not have access to healthcare at all.<sup>20,21</sup> And even if those people did have access to insurance, it would not necessarily enable them to seek medical care – half of health expenditures are covered out of pocket, by patients, even in public institutions.<sup>22</sup> Moreover, women covered by their husbands' insurance policies are only entitled to seek treatment for pregnancy, childbirth, and postnatal care.<sup>23</sup> Such disparities in access to healthcare in Nicaragua have long been exacerbated by the consistent politicisation of the sector. Officials across the country's healthcare infrastructure are primarily party members and loyal functionaries of the state, who also enjoy preferential access and treatment. This politicisation has also manifested itself in the dismissal of some 250 doctors in the months following the regime's violent crackdown on pro-democracy protests in 2018.<sup>24</sup>

The provision of healthcare is complex and expensive, representing both a point-source problem and a systems problem, which must be solved simultaneously. Those nations that succeeded in doing so managed to solve both of these, using aid to bolster their capacity and training efforts, and extending basic healthcare coverage as quickly as possible. As a result of this localisation of access and increase in cost-sharing mechanisms, the mortality profile of such nations shifted towards non-communicable diseases (cancer, diabetes, etc.), as non-vaccine treatable diseases (HIV/AIDS, malaria, etc.) were better controlled through preventative measures.

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20. *Ibid.*

21. Mathauer, I. et al. (2010), 'Health financing challenges and institutional options to move towards universal coverage in Nicaragua', World Health Report, Background Paper, p.24.

22. Franzoni, J.M. and Koen Voorend, K. (2010), 'The political and social economy of care in Nicaragua: Familialism of care under an exclusionary social policy regime', The United Nations Research Institute for Social Development, Gender and Development Programme Paper No. 8, p.22.

23. Franzoni, J.M. and Koen Voorend, K. (2010), 'The political and social economy of care in Nicaragua: Familialism of care under an exclusionary social policy regime', The United Nations Research Institute for Social Development, Gender and Development Programme Paper No. 8, p.22.

24. Vargas-Palacios, E., Pineda, R., and Galán-Rodas, E. (2018), 'The politicised and crumbling Nicaraguan health system', *Lancet*, Vol. 392, Issue 10165, pp.2694-2695.

## Summary

For healthcare to be effective, it must be underpinned by a healthcare system with sufficient capacity to provide quality interventions, and sufficiently accessible so that patients are not prevented from receiving treatment. In doing so, successful nations have made consistent progress in increasing life expectancy, in addressing chronic disease, and in shifting their disease profile.

Though progress has been fitful, successful governments have committed themselves to prioritising healthcare, inviting external financial and technical assistance to help address shortfalls in equipment, capacity, and expertise. They also focussed on ensuring access to healthcare for all, by localising services, especially in rural areas, and using cost-sharing mechanisms to make it affordable.

### To Provide effective healthcare:

- **Build institutional capacity and quality** by making judicious use of formal and informal external assistance.
- **Improve access to healthcare** by prioritising healthcare infrastructure, especially in rural areas.



*Boys wearing white uniforms, Galle, Sri Lanka.*

## 8. TARGET UNIVERSAL EDUCATION

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Education has long been considered an unrivalled catalyst for effective national socio-economic development. High levels of literacy and numeracy amongst the labour force are essential prerequisites for the long-term diversification and sophistication of national economies. However, equally important is the transformative effect of education on the lived experience of individuals. Those who are educated tend to earn considerably more over the course of their lives and enjoy notably higher living standards and longer life expectancy than those who are not.<sup>25</sup>

Educational attainment is measurably lower in developing countries than in their developed counterparts. Eric Hanushek and Ludger Woessmann have found that standards of attainment in many developing countries are alarmingly low, with less than ten per cent of children in some nations completing secondary school or developing basic literacy.<sup>26</sup>

This is, at least in part, the legacy of limited investment in education during the era of imperialism. For example, in the early 1960s in Botswana, there were nine secondary schools, only two of which offered full, five-year courses. Class sizes were large and drop-out rates high; nationwide, less than 1,500 students were enrolled in secondary school.<sup>27</sup> Less than half of eligible pupils were enrolled in school in mid-1960s Jordan, more than a decade after independence. By 1960, Indonesian literacy rates and primary enrolment figures were already falling behind its East Asian peers.<sup>28</sup> And in Kenya, the colonial government actively denied higher education to Kenyans, preferring to steer them towards agricultural production or vocational training.

These nations were confronted with the daunting task of creating the physical and human capacity to deliver universal education: namely building schools and training schoolteachers. Increasing access to education has therefore comprised a key feature of development policy since the 1960s, albeit with an, at times, inconsistent focus upon school

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25. Patrinos, H.A. and Psacharopoulos, G. (2018), *Strong link between education and earnings*, World Bank Discussion Paper.

26. Hanushek, E.A. and Woessmann, L. (2007), *The role of education quality for economic growth*, World Bank Policy Research Working Paper No. 4122.

27. Mokgwathi, G.M.G. (1992), 'Financing higher education in Botswana', *Higher Education*, Vol. 23, No. 4, pp. 425-431

28. Temple, J.R.W. (2001), *Growing into trouble: Indonesia after 1966*, CEPR Discussion Paper.

construction, the provision of educational materials such as textbooks, and secondary and vocational education.<sup>29</sup>

This chapter examines the differing priority afforded to education, and the impact on national socio-economic development that resulted. It is divided into two sections. The first assesses how nations sought to create essential capacity within their education system, to ensure the adequate provision of school and school places, as well as the requisite number of teachers. The second explores the approaches taken to maximising access to primary, secondary, and tertiary education within developing nations

### Capacity and quality

Each sample nation inherited an education system of limited capacity at independence, a reflection of the exclusionary nature of education, with most of the population unable to access even rudimentary schooling. Those nations that made most progress in their overall socio-economic development were those that prioritised increasing access to education early in their independent history, investing the financial and political capital required to develop an effective system of education.

In Indonesia, educational reform during the Suharto era focussed on increasing the percentage of the country's children in school. Financed largely by revenues from the oil boom of the 1970s, Suharto's government spent huge sums of money to construct schools, at a rate of roughly 10,000 per annum.<sup>30</sup> Combined with state-regulated increases in the number of years of compulsory education, this policy saw net primary enrolment rates increase considerably from 70 per cent in 1971 to almost 94 per cent by 2018. Indonesia's progress was hindered however by the politicisation of the teaching profession. Teachers remained state employees throughout the Suharto era, creating a culture in which teachers were rewarded more for their loyalty to the regime as for their aptitude or attendance.<sup>31</sup> It took until the era of democratisation to address this fundamental issue of quality; all teachers are now required to have a university degree, whilst funding the upskilling of the teaching force now comprises around half of the country's annual education budget.

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29. Masino, S. and Niño-Zarazúa, M. (2016), 'What works to improve the quality of student learning in developing countries?', *International Journal of Educational Development*, Vol. 48, Issue C, pp.53-65.

30. Duflo, E. (2000), *Schooling and labor market consequences of school construction in Indonesia: Evidence from an unusual policy experiment*, NBER Working Paper No. 7860.

31. Rosser, A. (2018), *Beyond access: Making Indonesia's education system work*, (Sydney: Lowry Institute).

The Mauritian educational system was marked by a high degree of innovation in its efforts to increase capacity, particularly in terms of blending private-sector educational support with public delivery mechanisms, with great success. Although 'free education for all' had been promised in the 1940s, it was not actually delivered until the 1950s, when the government began to devote resources to the construction of schools. The 1956 Education Act, passed twelve years before independence, created a new Minister of Education to oversee the construction of new schools and the establishment of new curricula. Aware of its population's potential for ethno-religious unrest, the government created only one criterion for eligibility for new grants to build primary schools: they had to admit students of all ethnic and religious backgrounds to qualify for funding.

Sri Lanka began a similar process as far back as the 1920s under the aegis of constitutional reform, which brought education under the control of local governments. The country succeeded in building capacity by consistently seeking to attract high quality candidates into the teaching profession. Comparatively high wages combined with flexibility over how prospective teachers can train (including placements in teacher training colleges, full time universities, or via distance learning), has cultivated a highly professionalised education system. By 1989, over two-thirds of the country's teachers had completed some form of professional qualification. In addition, successive governments set about building more schools, in order to make universal and compulsory education more realistic.

Conversely, those nations that made least progress in their overall development were those that struggled consistently to provide sufficient physical capacity, and to train and retain sufficient numbers of teachers. In Kenya, poor educational outcomes are still commonplace. A 2017 study found that around 60 per cent of teachers were regularly absent from their classrooms, whilst two-thirds of Kenyan students do not pass their secondary school exams (a prerequisite for university entrance).<sup>32</sup> Perhaps more worryingly, after three years of primary school, almost 20 per cent of Kenyan students could not read a single word in Swahili; and nearly three-quarters could not read a paragraph.<sup>33</sup>

Sierra Leone's education system was predictably devastated by the impact of the country's civil war, in which some seventy per cent of students were estimated to be out of school, and 80 per cent of the country's primary schools were destroyed. Despite significant

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32. Bold, T. et al (2017), *What do teachers know and do? Does it matter? Evidence from primary schools in Africa*, World Bank Group Policy Research Working Paper 7956.

33. *Ibid.*

improvements in rates of enrolment since the end of the war, many children still do not attend school, especially girls and those in rural areas. It was estimated in 2007 that twenty per cent of Sierra Leonean children never enrol in school. Although various intergovernmental organisations have contributed aid monies to rebuild schools, and open new ones, the government has struggled to match supply and demand.

Similarly, in Nicaragua, conflict compounded severe weaknesses in the country's education system from which it has yet to recover. Before the civil war and revolution in 1979, 30 per cent of primary school teachers lacked any qualification; and 90 per cent of rural schools had one teacher – massively amplifying the effects of poor teacher quality. This situation was not greatly improved by the Sandinistas' first decade in power, in which education spending as a proportion of budget expenditures and GDP decreased, and textbooks were rewritten to propagate certain socialist ideals. After the Sandinistas lost power in 1989, the focus of educational reform was not on teacher quality, but getting rid of those textbooks, and retraining teachers in the new curriculum – this would last for a decade.

### **Access to primary, secondary, and tertiary education**

For education to be truly universal, it must be accessible for all school-age children, regardless of their financial resources or location. The question of how to maximise access to education is a central consideration in where schools are located, along with essential transport infrastructure. This presents significant challenges in many developing nations, where rural populations are often sizable, where families are typically without the means to travel even moderate distances, and where suitable transport infrastructure is often limited or absent. A study conducted in association with the University of Cape Town suggested that more than two-thirds of South African children were required to walk to school.<sup>34</sup>

Increasing access to education requires a determined – and consistent – government priority. Nations that have made most progress in their development have succeeded in delivering universal access to primary education, whilst also seeking to maximise access at the secondary and tertiary level. In doing so, they have demonstrated their ability to overcome many of the same obstacles that proved insurmountable to their less successful counterparts.

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34. Hall, K. (2019), 'Children living far from school', *Statistics on children in South Africa*.

Mauritius moved at independence to make primary school universally accessible; universal secondary education followed within a decade. This was a shift from the primarily private educational system, which had flourished pre-independence. Upon independence in 1968, the government redoubled its capital investments, building fifteen secondary schools and several universities in the period to 1981.

In Botswana, improving access has been a consistent political priority of successive administrations, comprising a key feature of a series of reforms between independence in 1966 and the publication of the 'Revised National Policy on Education' in the mid-1990s. The government devised a limited grant system to finance access to international university education for Botswana, the majority of whom were subsequently employed by the country's civil service.<sup>35</sup> This was an important statement of intent: Botswana would have a well-educated people, supported by their government to absorb best practices abroad and then bring them home. It was also reflective of the personal experience of the country's first president: Sir Seretse Khama had been educated at Oxford before he returned home.

Conversely, nations with less successful development experiences have often underemphasised the role of education or, worse still, viewed it with suspicion and an educated population as a threat to the authority of the government, and consequently failed to widen access. For example, the Kenyan government decreed in 1974, a decade after independence, that primary education would be free; enrolment went up 150% in one year. President Moi created a similar initiative after coming to power in 1978, with similar (if less dramatic) results.<sup>36</sup> But under the aegis of IMF restructuring in the late 1980s, the government elected to introduce school fees, which had negative effects on the education of poor people, especially in rural areas, as attendance declined and quality dropped.<sup>37</sup> Even today, cost is cited as one of the main reasons that children drop out of school, as 'many parents cannot afford to continue the higher education of their children.'<sup>38</sup> In addition, tertiary education was subject to a detrimental degree of politicisation, with President Kenyatta the self-appointed chancellor of the country's sole university (the University

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35. Mokgwathi, G.M.G. (1992), 'Financing higher education in Botswana', *Higher Education*, Vol. 23, No. 4, pp. 425-431

36. Somerset, A. (2008), *Access to primary education in Kenya: A case study of the impact of the 2003 FPE initiative at nine schools in Nairobi City and Nyeri District*, Consortium for Research on Educational Access, Transitions and Equity.

37. Lelei, M. and Weidman, J.C. (2012), 'Education development in Kenya: Enhancing access and quality' in *Quality and Qualities: Tensions in Education Reforms*, p. 154.

38. Mohajan, H.K. (2013), 'Poverty and the economic development of Kenya', *International Journal of Information Technology and Business Management*, Vol. 18, No. 1 p.77.

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*The remarkable progress made by some more successful nations from the same starting point as their less successful counterparts illustrates what can be achieved by governments determined to prioritise capacity-building within their education systems.*

of Nairobi). Rates of enrolment were kept deliberately low and limited principally to the families of loyalists.<sup>39</sup>

In Nicaragua, the FSLN's attempt to institute free and universal primary education proved unaffordable given the country's fiscal constraint, leading successors to encourage private education which was out of reach of the vast majority of the population, especially those in rural areas. Tertiary education also suffered under various regimes; the Somoza family supported the existence of domestic universities exclusively for the use of the children of the establishment actors, whilst more recently, students who are known to support anti-government protests are kicked out of university, and sympathetic professors are fired en masse.

Whilst primary education was typically given precedence, in the more successful examples above, governments recognised the social and economic value of education, thereby making concerted efforts to develop both their secondary and tertiary education sectors simultaneously. They also found a way to provide access to tertiary education for their brightest students. This often involved a combination of bursaries for students to attend foreign universities and building institutions of higher education (including medical and law schools) at home.

### Summary

Providing universal education is integral to the development of diverse and thus resilient economies, whilst ensuring that individuals are able to fulfil their unique potential. However, providing education on the scale and of the quality required places significant fiscal, administrative, and political demands upon governments. Creating an effective system of education requires nations to commit considerable resources consistently, in order to secure the social and economic dividends of a literate and numerate population. The remarkable progress made by some more successful nations from the same starting point as their less successful counterparts illustrates what can be achieved by governments determined to prioritise capacity-building within their education systems.

Those that made most progress were those willing to adopt an innovative approach to capacity-building, working with donors and private educational providers alike to open new schools and rapidly train new teachers, helping to ensure that most children had access

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39. 'On varsity education reforms Mzee Moi has no equal in Africa', *The Standard*, 27 October 2018.



to education. They then sought to improve the quality of those educational offerings, increasing teacher standards and commensurately increasing compensation. Some, like Colombia and the Dominican Republic, were notable for their degree of openness to private educational providers, including foreign education providers; this openness has historically helped to bolster educational capacity in both countries.

Nations that have made most progress in their development have also succeeded in delivering universal access to primary education, whilst also seeking to maximise access at the secondary and tertiary level. The speed with which Suharto built schools and increased enrolment in Indonesia, the willingness of Seretse Khama to invest in tertiary education for Botswana's brightest students, are all examples of what it means to truly prioritise universal education.

These systemic changes – the creating of capacity and the careful fostering of quality, as well as the steady broadening of access have yielded notable advances. The primary and secondary completion rates of more successful nations have steadily risen since the early 1970s, as have their adult literacy rates.

#### **To target universal education:**

- **Create essential capacity and quality** by prioritising both the building of schools and by incentivising teacher training.
- **Maximise access to primary, secondary, and tertiary education** by addressing the need for schooling in rural areas and by preventing exclusionary access.

## CONCLUSION TO PART THREE

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Creating the conditions whereby individuals can thrive – becoming healthier and better educated - is the mark of a well-functioning society. The systems that underpin that reality are expensive and bureaucratically complex; while health and education are necessary components of development, the nationwide provision of health and educational services is also a sign that some degree of development has already occurred.

Among the countries reviewed, each inherited health and education systems which were designed exclusively for the use of a small fraction of the population. These systems required significant reform in order to be of use to the population and tended to evolve inorganically: they improved only when major and concerted steps were taken to alter the funding and operating models.

The provision of healthcare and education is complex and expensive, representing both a point-source problem and a systems problem, which must be solved simultaneously. Successful countries managed to address both, using aid to bolster their capacity and training efforts and extending access as quickly as possible in line with their respective development plans. Less successful nations have tended to get stuck on that second hurdle, only managing to provide healthcare and education to a small fraction of their populations and leaving the rest to pay for what they could privately.



*Two children play at sunset on a pier in Punta Cana, Dominican Republic*

## IMPLICATIONS FOR THE ROLE OF AID

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Aid is often provided for disaster relief or longer-term humanitarian assistance, both of which seek to mitigate the impact of extreme suffering to ensure some minimum standard of living for citizens. More recently, the international community has sought to extend the role of aid beyond immediate poverty alleviation to the development of nations. But, if development is a fundamentally domestic project, what are the implications for the use of aid? In this final section of the report, we review the role of aid in providing relief, supporting domestic development agendas, and the limitations on the ability of aid to be a catalyst for change.

### **Aid as a means of providing immediate relief**

Aid has been found to be effective at providing interventions to address discrete needs for humanitarian purposes. The timing and quantity of aid will have an effect on its helpfulness; it is especially efficacious post-conflict environments, particularly in the first few years of reconstruction.<sup>1</sup> Indeed, the utility of ODA in ‘addressing short-term, gap-filling needs’ has been noted elsewhere.<sup>2</sup>

A similar brand of unflashy, but empirically cost-effective interventions, which can be implemented without fundamentally undermining in-country systems has been highlighted by Bill Easterly. These include: “deworming; dietary supplements like those for iron, vitamin A, and iodine; education in using condoms and treating other sexually transmitted diseases to slow the spread of AIDS; indoor spraying to control malaria; fertilizer subsidies; vaccination; and urban water provision.”<sup>3</sup>

Early examples of such an approach included the U.S.-led public health campaigns in the early twentieth century, which benefited both Colombia and the Dominican Republic. This was rational self-interest on the part of American firms who had invested across Latin America and the Caribbean. These interventions resulted in the hemisphere-wide eradication of yellow fever and helped to kickstart the evolution of the Dominican Republic and Colombia’s mortality profiles to that of wealthy nations.

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1. Collier, P. and Hoeffler, A. (2004), ‘Greed and grievance in civil war’, *Oxford Economic Papers*, Vol. 56, No. 4, pp.563–595.

2. Riddell, R.C. (2007), *Does foreign aid really work?*, (Oxford: Oxford University Press).

3. Easterly, W. (ed.) (2008), *Reinventing foreign aid*, (Cambridge: MIT Press).

Indonesia, too, has been the beneficiary of this sort of relief. When Sukarno was deposed in the mid-1960s, the country was economically and socially fragile in the extreme, and President Suharto spent his first years in office coordinating a massive influx of international aid, encouraging donors to pick one or two areas of interest apiece. This influx of aid facilitated, amongst other things, the mass vaccination of children, at a point when Indonesia was behind most of East Asia in critical indicators of health and wellbeing.<sup>4</sup>

Easterly notes the common theme across the sort of interventions available for immediate relief which we have discussed here (a theme that has been echoed in much of the aid effectiveness literature of the past decade): 'None of these are keys to development according to some utopian scheme; they are modest interventions, but they make people's lives better.'<sup>5</sup>

### **Role of aid in reinforcing domestic institutional development**

External assistance that supports existing domestic institutions can accelerate national growth. The form of this assistance matters a great deal. Technical assistance tends to improve outcomes following a policy turnaround (but is unable, on its own, to generate the impetus for that turnaround).<sup>6</sup> This would appear to make sense: technical assistance is not cash, and cannot be used to reverse unpopular tax increases or subsidy cuts. It can, however, provide much-needed expertise. While the primary obstacle to policy reform in a developing country may be political will, perhaps the equally great secondary obstacle is a lack of governmental capacity to implement reform once it has been decided upon.<sup>7</sup>

Providing technical assistance is, therefore, a useful gap-filling measure, providing both immediate capacity and the opportunity to train domestic civil servants to fill future capacity gaps. Only once the political will and capacity problems have been solved does cash become helpful, rather than a source of harm. In short, the sequence matters.

On the other hand, infusions of donor money too soon after a reform process begins can end up delaying incipient reform. The theory goes that, once a country's establishment

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4. Temple, J.R.W. (2001), *Growing into trouble: Indonesia after 1966*, CEPR Discussion Paper.

5. Easterly, W. (ed.) (2008), *Reinventing foreign aid*, (Cambridge: MIT Press).

6. Chauvet, L. and Collier, P. (2008), 'What are the preconditions for turnarounds in failing states?', *Conflict Management and Peace Science*, Vol: 25, No. 4, pp. 332-348.

7. Andrews, M., Pritchett, L., and Woolcock, M. (2017), *Building state capacity: Evidence, analysis, action*; (Oxford: Oxford University Press).

*Like Indonesia under Suharto, aid donors have been encouraged by the Botswanan government to select one or two areas of priority that fit within the current five-year national development plan.*

actors no longer feel the immediate financial pressure to implement reform, they will be discouraged from doing so; this has certainly been the case for Jordan, which has (until very recently) tended to use its aid dollars to avoid raising income taxes or reducing subsidies. A certain amount of constructive stress is thus helpful in inducing policy change.

Botswana is, in many ways, the model for what this sort of cooperative, capacity-building aid can produce over decades.

Like Indonesia under Suharto, aid donors have been encouraged by the Botswanan government to select one or two areas of priority that fit within the current five-year national development plan.

Norwegian assistance, for example, was critical for the creation and maintenance of Botswana's public healthcare system. Norway sent technical experts in the form of civil servants as well as cash, providing 90 per cent of the funding for the healthcare system in the 1970s. By the mid-1990s, the Government of Botswana's own healthcare development fund was ready to cover the vast majority of the country's outlays. Government expenditure on healthcare per capita was approximately \$10 in 1975 and had increased tenfold by the mid-1990s. By the end of the period of Norway's involvement, the Botswanan government were engaged in setting up advanced medical care by OECD standards, including the sort of oral surgery centres which are difficult to find in rural parts of the United States.

### **Limitations of aid in initiating systems change**

Nowhere is the inability of external pressure to build good domestic institutions more apparent than in politics. Governance conditionality often results in aid being granted or withheld in exchange for holding elections (or not), rather than for policy outcomes (ex-ante, rather than ex-post conditionality). Particularly during the Cold War, the United States was quite explicit in terms of the quid pro quo expected in exchange for its aid dollars. For example, the Dominican Republic saw several autocratic leaders in the twentieth century; the most notable was Rafael Trujillo, who was in power for thirty years before being assassinated by his own soldiers on the road to Cristobal.

His successor, Joaquin Balaguer, spent twelve years in office himself, before losing the 1978 elections. He was reluctant to leave office and had to be cajoled by President Jimmy Carter that he would have to go, or risk his country losing its USAID funding. Similarly, Nicaragua, which found itself impoverished after several years of socialist revolution under the Sandinistas, agreed to hold early elections in exchange for the promise of the return

of USAID funding. US aid policy was successful insofar as it facilitated the end of the Sandinistas' time in power. However, like the Dominican Republic, it failed to improve the country's brittle governing institutions, or to broaden political participation.

The failure of aid to initiate systems change goes beyond simple political conditionalities. The extraordinary influx of grant aid and technical assistance into West Africa to deal with the Ebola crisis in 2014 managed to arrest the spread of the virus, until it could be contained and eliminated. But this investment and know-how was still not enough to strengthen the broader healthcare systems of the affected countries.

Institutions require years of continual, steady improvement and, most importantly, support from the local population. Attempts to expedite that process by inserting externally-modelled institutions or relying heavily upon external financing are unlikely to lead to the creation of trusted - or effective - institutions. Indeed, Pritchett and Woolcock point out the potentially deleterious effects of such an approach:

'The strategy of 'skipping straight to Weber' – seeking to quickly reach service delivery performance goals in developing countries by simply mimicking (or adopting through colonial inheritance) the organizational forms of a particular 'Denmark' – has in fact been a root cause of the deep problems that developing countries encounter as they seek to deliver key public services to their citizens.<sup>8</sup>

Institutions – the outcropping of individual, familial, and communal efforts to organise for self-betterment – are by their very definition, local solutions to local problems. Aid (and its conditionality) cannot generate a systems-change in political or economic institutions, nor can it supplant the process of internal systems change. But it can support reform already underway.

## Summary

External assistance is just that: assistance. It can, in most cases, help a government or a nation to do something it already wanted to do, but there is limited evidence that it can induce behaviour change. It is not a replacement for domestic initiative or institutional capacity. This is a misconception about what can be accomplished with the infusion of external funds into a domestic policy setting.

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8. Pritchett, L. and Woolcock, M. (2008), 'Solutions when the solution is the problem: Arraying the disarray in development', in Easterly, W. (ed.), *Reinventing foreign aid*, (Cambridge: MIT Press).

External assistance is undoubtedly useful for providing immediate relief to a focussed set of social challenges. We have seen that external assistance can help in providing discrete humanitarian support. Aid money is capable of rebuilding homes after a hurricane and vaccinating children against polio. External intervention in the form of emergency loans can also provide essential liquidity, and keep government-run utilities operational, at least in the short-term.

However, there are limits to what aid can accomplish. Nowhere, perhaps, is this truer than in the case of the broader challenge of national development. Bringing an individual's consumption up to a minimum standard, or providing basic, ad-hoc services is not a task of the same magnitude as creating institutions where none presently exist. Put simply, it is simpler to build a school or to inoculate children against a extant disease than to create a functioning education or healthcare system.

So, what does good practice from donors look like?

- Donors tend to specialise, in terms of the countries where they work and the sectors which they choose to target (see, for example, the historic Norwegian, Swedish, and Dutch specialisation in healthcare, education, and roads, respectively, in Botswana).
- They tend to give in block grants or loans, directly to other governments, rather than fragmenting aid through charitable organisations (as with the Australian aid transfer, which made reform of the Indonesian subsidy system possible).
- They tend to give technical assistance in addition to cash, facilitating capability transfers where possible (as seen directly with the introduction of Dutch civil servants in Botswana, and indirectly, through the creation of nursing schools and medical colleges in Colombia through private American philanthropy).

And for recipients?

- Recipients are interested in developing their own institutions and have a clear, internally-agreed plans for where the resources should go.
- They are willing to walk away from the promise of funding if it does not align with those internal priorities.
- They are good managers of how donors operate in their countries, selecting donor partnerships carefully and establishing strict guidelines for how those non-specialist donors would operate. They therefore create the conditions for targeted intervention.



*The experiences of these countries highlight the development dividend in reach for those nations that succeed in making steady, if unspectacular, progress over the course of decades.*

There is, in summary, really no substitute for a domestic vision of national development. Where that vision is absent, the utility of external assistance is likely to be limited to humanitarian relief and may well exacerbate unproductive state practices.

The process of national development remains the best available mechanism for rapidly lifting large numbers of people out of poverty. However, such prosperity was neither inevitable nor indeed predictable for any of the ten nations profiled in this report. Within the past few years, Colombia and Sri Lanka have ended decades-long civil wars, which had earned them both the label 'failed state'. Nobel laureate James Meade famously forecast that Mauritian independence would prove catastrophic. Instead, the country has confounded expectations, emerging as Africa's most prosperous nation. Until the late 1960s, there was little to suggest that the Dominican Republic's path would diverge from Haiti's. At independence, Botswana had twelve kilometres of road and less than two dozen university graduates among its citizens; Indonesia, a vast archipelago, had little shared identity beyond a common coloniser.

Collectively, the experiences of these countries highlight the development dividend in reach for those nations that succeed in making steady, if unspectacular, progress over the course of decades. The progress made by the most successful of the examples proved transformative, beyond increasing GDP per capita incomes and extending life expectancy. The leaders of those nations succeeded in establishing a degree of trust in the enterprise of national socio-economic development, persuading a wide range of foreign and domestic stakeholders of the viability of their nations.

These countries could easily have remained poor and fractured societies, but their leaders made many individual choices, which cumulatively freed them from that fate. In doing so, they succeeded in catalysing a process of national development that was nothing short of transformative. Specifically, they helped forge a strong social contract with their citizens, based upon a shared identity and security, and underpinned by a government viewed as both legitimate and competent in the eyes of the majority of the population. They built open economies, developing macroeconomic resilience by avoiding disastrous cycles of debts and hyperinflation, building a domestic asset base and aiding their nations transition from subsistence agriculture to participants in the competitive global economy. Finally, they invested in the human capital of their people, enabling them to fulfil their unique potential by providing essential healthcare and education. And in each case, those actions delivered significant ancillary benefits, in the form of reduced levels of corruption, economic diversification, and a reduced reliance upon international aid.

## CONCLUSION

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*The experiences of these nations also suggest that successful development is contingent on more than the simple executive competence of leaders. Instead, it is equally dependent upon the character of leaders.*

The experiences of these ten nations over sixty years serve to illustrate the profound influence of national leadership on the trajectory and rate of national development. Specifically, this manifests itself in the willingness of an individual (or set of individuals) to place long-term, national priorities over immediate personal or political gain.

Regardless of its challenges and opportunities, a nation cannot and will not develop until a cadre of internal leadership is prepared to take up the mantle of reform. The leaders of the more successful countries profiled here have, in their own way, aligned these challenges and opportunities with their own internal political imperatives. The formation of institutions, of trust, and the fostering of economic growth are ultimately the function of this internal processes.

The experiences of these nations also suggest that successful development is contingent on more than the simple executive competence of leaders. Instead, it is equally dependent upon the character of leaders.

Their determination to prioritise their nation's prosperity over their own, to govern to unite rather than to divide, and to set out a vision for their nation, is key to the robustness of the institutions which underpin the social contract. To enforce a judicial ruling against one's own government, to resist the temptation to favour one's own tribe, or to deny oneself the comforts of ideology in favour of pragmatism – these are the sort of selfless decisions which strengthen institutions and trust in government.

Furthermore, stakeholders in development should be concerned with making it easier for leaders, good and bad, to leave office safely. This is the genius of the Mo Ibrahim Award, which offers a \$5 million grant to any African leader who is democratically elected, provides an exceptional standard of leadership while in office, and leaves once their constitutionally-mandated term expires. Given the often-violent history of the transfer of power across post-independence Africa, leaders may legitimately fear for their own security, and that of their family and property, after leaving office. De-risking that proposition will be critical to the future prosperity of the continent.

The process of national development can be a messy and often non-linear process. The varied experiences of the nations profiled serve to illustrate the sheer complexity of prosperity. Their histories also shine a spotlight on the inherently holistic and interrelated nature of prosperity: isolated improvements in one area of policymaking can easily be undone by the neglect of others. Trade-offs in policymaking are inevitable, especially in the resource-constrained environments which characterise most developing nations.

Not only have the weaker performing examples each had a number of policy successes, the successful examples have all had areas of weakness. For example, Colombia and Sri Lanka have contented with significant civil conflict, Indonesia and Dominican Republic experienced banking crises, and Botswana's health system was overwhelmed by the impact of HIV/AIDS in the nation. But in all these cases, these nations have rebounded, not least because of broader institutional resilience. The contrast with the less successful nations is that their challenges and crises were more frequent, if not recurring – and they did not serve as triggers for transformation and improvement.

The examples of the countries studied help to illustrate the pattern that getting most things roughly right most of the time is the basis for building a pathway to prosperity. However, further research is required to ascertain where the thresholds of good enough may lie, and the relative importance of these different areas.

We have sought to re-examine some of the priorities and assumptions which have underpinned modern-day development policy. We have observed that national leadership matters; that development is an internally-driven process of mass behaviour change; that presidents and prime ministers are not simply enforcers of policy, but agents of change themselves; and that the nature and quality of leadership are indelibly linked to the experiences of the individual.

Because of the variable nature of leadership, it is unlikely that the development process can be fully determined. There is too much left to personality, and to pure luck, to pretend that it is possible to predict the long-term trajectory of a nation with any certainty. Nonetheless, the adoption of a minimum viable policy in the key areas of development will probably, over the course of decades, result in a pathway to prosperity.

## FORGING A STRONG SOCIAL CONTRACT

### Establish Statehood

- **Promote a national identity** by identifying opportunities to unify the country whether through shared language, culture, or icons.
- **Maintain control over the key parts of your territory** by seeking to immediately contain – rather than eradicate – insecurity.
- **Maintain internal order without resorting to violence** by investing in the cultivation of a politically independent, well-trained security sector.

### Cultivate Legitimacy

- **Establish formal and informal executive constraints** by codifying a series of checks and balances in the constitution, and by encouraging informal constraints upon executive power.
- **Champion the rule of law** by prioritising the creation of an effective judiciary, by maintaining its independence from government, and by abiding by its rulings.
- **Commit to the peaceful transfer of power** by embracing constitutionally mandated term limits and by signalling an intention to leave office peacefully.

### Govern Competently

- **Adopt a pragmatic and inclusive approach to national development** by making development the first priority, by avoiding factionalism, and by demonstrating a determination to govern for the good of all.
- **Build a competent administration** by prioritising the creation of an effective bureaucracy, making use of international expertise where necessary.

## BUILDING OPEN ECONOMIES

### Develop Macroeconomic Resilience

- **Raise sufficient revenues** and reduce reliance upon tariffs, by creating a simple and equitable system of taxation, and by broadening the tax base.
- **Prioritise fiscal sustainability** by limiting budget deficits to prevent the accrual of debts, by avoiding reliance upon costly commercial debt, and by maximising capital investments while minimising recurrent current expenditures and overheads.
- **Deliver monetary stability** by establishing an effective and autonomous central bank, by keeping inflation low and stable, and by maintaining a singular, stable exchange rate.

### Build a Domestic Asset Base

- **Protect property rights** by dealing effectively with tribal and customary rights, avoiding the expropriation of land, and by addressing the grievances caused by the expropriation of land.
- **Cultivate a domestic finance sector** by adopting a posture of non-interference, and by avoiding using commercial banks as an additional source of government lending.
- **Encourage foreign investment, capabilities, and technologies** by moving from positive to negative investment lists and by maintaining a posture of openness to external actors.

### Promote Trade and Commerce

- **Enable competition** by minimising the detrimental impact of monopolies and SOEs, by limiting the use of price controls, and by maintaining a flexible labour market through minimising the formal and informal costs of employment and by limiting public sector employment.
- **Make innovative use of export processing zones** by using them to configure the economy towards exporting, and by experimenting with policy options designed to increase the international competitiveness of key exports.
- **Prioritise international trade** by reducing barriers to trade and ending import-substitution industrialisation, and by bolstering regional trading ties.

## INVESTING IN HUMAN CAPITAL

### Provide Effective Healthcare

- **Build institutional capacity and quality** by making judicious use of formal and informal external assistance.
- **Improve access to healthcare** by prioritising healthcare infrastructure, especially in rural areas.

### Target Universal Education

- **Create essential capacity and quality** by prioritising both the building of schools and by incentivising teacher training.
- **Maximise access to primary, secondary, and tertiary education** by addressing the need for schooling in rural areas and by preventing exclusionary access.



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