Globalisation, Institutions and African Economic Development

Proceedings of the African Economic Conference 2008

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The African Development Bank (AfDB) Group and the United Nations Economic Commission for Africa (UNECA).

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Email : economic-research@afdb.org
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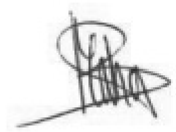
Readers may visit the African Economic Conference website at http://www.afdb.org/aec for further information.

Louis Kasekende
Chief Economist
African Development Bank



Abdoulahi Mahamat,
Acting Director,
Trade, Finance and Economic
Development Division
United Nations Economic
Commission for Africa

Foreword

Since its inception in 2006, the African Economic Conference has filled a critical void, bringing together African economic experts, think tanks and policy makers to debate on strategies for advancing Africa's social and economic development. Under the theme "Globalisation, Institutions and African Economic Development", the Third African Economic Conference presented a unique opportunity for more effective engagement by African countries to address the challenges associated with globalisation. The Conference was held at a time when the world economy was entering its most turbulent times in recent history. Indeed, the crisis turned out to be a formidable challenge for African economies and threatened to erode hard won gains of the last decade. Published in these proceedings, the Conference papers offer valuable insights with useful application in policy making.

Such a broad process of knowledge generation and rigorous analysis on Africa's development problems and opportunities is instrumental for advancing Africa's interests in the global arena. The African Development Bank and the United Nations Economic Commission for Africa expect that the increased interaction between researchers and policymakers will lead to improved quality of policymaking in Africa.

Donald Kaberuka
President
African Development Bank

Abdoulie Janneh
Executive Secretary
United Nations Economic
Commission for Africa

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Globalisation, Institutions and African Economic Development: Introduction and overview

Audrey Verdier-Chouchane, Léonce Ndikumana and Mwangi Kimenyi

Since the early 2000s, Africa has witnessed higher economic growth than in the 1980s and 1990s. This improvement was largely due to high commodity prices (especially oil), better economic policies implemented by African governments, and the end of hostilities in a number of countries. Nonetheless, and as is evident from the articles, although African countries have made remarkable progress, the continent continues to face daunting development challenges. Progress has been made in several areas, such as regional integration, notably with substantial decline in trade barriers. Likewise, there has been marked improvement in the institutions of governance and in human capital investment. However, it is also evident that Africa has not fully exploited the opportunities arising from globalisation. The continent's share of world trade remains relatively low even with preferential market access opportunities. The conference papers reveal that although there are some external constraints that make it difficult for Africa to exploit the opportunities presented by globalisation, a substantial portion of the problems are internal. Africa remains internationally uncompetitive. The structure of production in the continent is still dominated by the primary sector. Some of the internal problems that continue to hinder economic growth and transformation include weak institutions, conflicts, poor investment climate, and infrastructural bottlenecks. Compounding these problems are emerging challenges.

Under the theme "Globalisation, Institutions and African Economic Development", the third Annual African Economic Conference (AEC) was held from 12 to 14 November 2008 in Tunis, Tunisia. This volume contains selected papers from the conference which cover four broad themes: (i) Financial Sector Development; (ii) International Capital Flows; (iii) Trade, Infrastructure and Regional Integration and (iv) Post-Conflict Recovery and Policy Reforms.

1. Financial Sector Development

The role of financial markets in economic development continues to attract great attention in research and policy circles. The emphasis on financial markets is motivated by the realisation that their proper functioning is crucial for promoting market exchange, production, economic growth, and poverty reduction.

A number of conference papers focused on the relationship between financial development and economic growth, and between financial development and total factor productivity in sub-Saharan Africa. These relationships were analysed both theoretically and empirically. **Mohamed S. Ben Aissa, Imed Drine**, and **Mahmoud Sami Nabi,** presented a paper that focused on the merits for gradual (as opposed to instantaneous) removal of financial barriers by benchmarking the performances of four countries of the Mediterranean Basin against those of a group of developed countries. Unlike the so-called East-Asian Tigers, the four countries of the Mediterranean Basin (Algeria, Egypt, Morocco, and Tunisia) have adopted a strategy for gradually removing restrictions on the international mobility of capital. The empirical analysis reveals that compared to the reference group of developed countries, Algeria, Egypt, Morocco, and Tunisia have experienced productivity slowdown, and have thus relatively fallen behind technologically. Ben Aissa *et al*. suggested that the strategy of phasing out financial liberalisation might not be effective in reducing the technological gap between developed and less-developed economies.

Financial market development in Africa can further be promoted by integrating African stock markets with each other and also with global economies. Equity integration plays a crucial role on development because it allows international risk sharing. Integrated stock markets are more efficient than segmented ones, which tend to be more risky. **Paul Alagidede's** paper focuses on the extent of integration of Africa's stock markets with the rest of the world. Alagidede analyses the integration of the stock markets by looking at the dynamic interdependence of the major equity markets in Africa (South Africa, Egypt, Nigeria, and Kenya) using monthly data covering the 1990-2007 period. All the markets are open to foreign investments, have implemented free market reforms, and have changed drastically over the past decade in terms of implementing reforms. The analysis shows that the returns of African stock markets are higher than in other regions. In addition, African stock markets have weak correlations with those of other regions – 13 percent with developed countries and 14 percent with emerging developing countries. The analysis of stock market integration indicates that African assets are attractively valued, and given their low correlations and weak trends with the rest of the world, they can play a significant role in international portfolio diversification (i.e., by widening the investment opportunity set and reducing risk).

Further discussions on the financial markets focused on the evaluation of the financial sector efficiency. **Malak Reda** presented a paper that used Data Envelopment Analysis (DEA) type Malmquist Index to evaluate the total factor productivity change in Egyptian commercial banks during the 1995-2003 period. Some of the issues investigated include change in efficiency (catching up or falling behind) and change in technology (innovation or shock). The study further elaborates on efficiency changes in Egyptian banking by studying its sources: Pure technical efficiency change (improvement in management) and scale efficiency change (improvements towards optimal size). Additionally, the study analyses the returns to scale of Egyptian banks over time by ownership and size. The results of the analysis show that most of the Egyptian banks are facing substantial scale problems. Those banks with increasing returns to scale could achieve significant cost savings and efficiency gains by increasing the scale of their operations. The lack of effective competition allows inefficient banks to continue with slackened efficiency and still remain in business. This means that policies that would encourage competition are crucial for the improvement of efficiency among Egyptian banks. Furthermore, improving the efficiency of the Egyptian banking system requires enhancing and monitoring corporate governance in all banks, allowing new entrants, and undertaking serious steps towards the restructuring of public banks.

Another focus on this topic was on the role of financial markets on poverty. In a paper on financial development in Cameroon, **Sandra Kendo**, **Francis Menjo Baye,** and **Fondo Sikod** analysed the impact of financial sector development on gender-disaggregated poverty. The authors estimate the impact of financial sector development on the reduction of between-gender poverty and inequality, using data from Cameroon's rural areas. The study relates gender disparities in levels of production and income to gender-based discrimination in financial services access. The main finding of the study is that the financial sector development has no positive effect on either gender in the short-term. However, in the long run, financial sector development benefits both men and women living in rural areas, with women making more substantial gains than men. The analysis thus suggests that financial sector development can make a difference for women and contribute to the attainment of the MDGs.

2. International Capital Flows

As interactions between nations increase through the globalisation process, so is the significance of capital flows across national boundaries. Given the relative scarcity of capital characteristic of African countries, capital flows play a crucial role in financing development. Several aspects of international capital flows were discussed, including foreign direct investment, remittances, and capital repatriation.

Ameth Saloum Ndiaye looked at the role of financial development on the impact of remittances on economic growth. The key questions investigated were whether financial development improved the impact of remittances on economic growth and whether remittances promoted growth in a shallow financial system. The study examined these questions, focusing on the case of Senegal for the 1974 to 2005 period. The empirical analysis revealed a significantly positive interaction between remittances and financial instruments. It suggested that remittances promoted economic growth, indicating complementarity of remittances with financial instruments.

Abdelkader Elkhider, Abdelhamid El Bouhadi and **El Mustapha Kchirid** presented a paper that focused on the macroeconomic determinants of overseas remittances from Moroccan migrants, for the 1970-2006 period. Elkhider *et al*. identified agricultural production and the exchange rate as the main determinants of remittances from Moroccan migrants. They established that in the short run, agricultural output had a positive effect on remittances, while the exchange rate had a negative effect. In the long term, both seemed to lose their magnitude as altruism towards family members and other social considerations set in as the main determinants of remittances. To increase the remittances, a number of policy recommendations were suggested, including improvements in the Moroccan financial infrastructures.

The other dimension of international capital flows focused on Foreign Direct Investment (FDI). **Steve Onyeiwu** presented a paper that investigated the role of knowledge and technology in spurring FDI in the Middle East and North Africa (MENA). The specific assumption is that investment in knowledge and technology attracts FDI. The study reveals that most MENA countries have not been able to attract the levels of FDI that correspond with their potential. The results suggest that knowledge and technology do not appear to be a constraint to FDI flows to MENA countries. However, openness of the economy, the level of income, and political risks are more important for FDI flows. The evidence suggests that to attain "front-runner" status in terms of attracting FDI, MENA countries would gain in undertaking gradual opening of their economies.

In another study on capital flows, **Ghazi Boulila** examines the capital flow intensity between North African countries as well as the advantages and disadvantages associated with the opening up of capital markets in these countries. In his presentation, Boulila weighed on the positive growth effects of capital market liberalisation against its potential negative effects induced by high volatility of FDI (Foreign Direct Investment) and GDP, as well as the occurrence of financial crises. According to Boulila, such liberalisation is expected to boost capital inflows in each liberalising economy, as gains from diversification are exploited by profit-seeking and risk-minimising portfolio investors. Lessons for capital market liberalisation within North Africa are drawn from a comparative analysis of the liberalisation experiences of East Asian and Latin American countries. Emerging policy recommendations include the observation that reforming economic institutions is essential for harnessing gains from capital market liberalisation and that each country must relate the timing of its liberalisation to its degree of macroeconomic stability.

3. Trade, Infrastructure and Regional Integration

Although Africa's involvement in international trade has increased in absolute terms, concern remains that its share of international trade is extremely low. **Hilary Nwokeabia** presented a paper on problems related to market access. The study looks at how initiatives to improve market access have impacted on exports and competitiveness. According to the presentation by Nwokeabia, since the outset of the Doha Development Agenda, there has been an emergence of market access preference schemes that have seemingly generated limited benefits for developing countries and possibly marginalised them further from the multilateral trading system. A key finding of this study is that preferences are not sufficient to expand Africa's market access significantly. In particular, when one compares exports growth of countries in Africa to those of Asian countries, it is apparent that market access alone cannot generate supply capacity to sustain economic and trade growth in the countries. As such, the Generalised System of Preferences (GSP) initiatives can only succeed in Africa where governments create the necessary conditions for private enterprise to prosper, particularly in manufacturing. Unfortunately, evidence shows that Africa has not succeeded in attracting foreign investment in the manufacturing sector, which would otherwise help improve competitiveness. Policies to attract foreign investment should also help African countries to diversify investment out of primarily natural resource exploitation. The study also emphasised the importance of embedding learning and innovation in the endogenous process of export growth. It was stressed that unless there was a commitment to improve the enabling environment for doing business, countries would not benefit from preferences.

Juliet Elu and Gregory Price examine the effects of regional eurocurrency integration on economic growth in sub-Saharan Africa. Parameter estimates from a Solow growth model show that membership in a regional euro-currency union has an impact on economic growth in sub-Saharan Africa. Relative to sub-Saharan African countries in general, countries in the Central African Economic and Monetary (CEMAC) Union experienced higher growth rates over the 1999-2007 period. In contrast, countries in the West African Economic and Monetary Union (WAEMU) experienced relatively lower economic growth, suggesting that regional euro-currency integration per se is not necessarily beneficial in terms of growth. However regional euro-currency unions, such as CEMAC, are able to induce favourable output dynamics, perhaps as a result of the mitigation of exchange rate risks that reduce the likelihood and severity of shocks to output. As such, there are some benefits from regional currency integration in sub-Saharan Africa.

Afeikhena Jerome discussed the role of private sector in the development of infrastructure. Jerome started by stating that there has been a "policy mistake" founded on the dogma of the 1980s/1990s that infrastructure would be financed by the private sector. For various reasons, mainly involving investment climates and rates of return, private investment has been limited in terms of volume, sectors and countries. Roughly, only one third of the developing countries can count on private sector operators for the delivery of electricity, water, or railways services. In Africa, the private sector has probably contributed less than 10 percent of the needs on average over the last 15 years or so. It appears capable of supplying only a fraction of the estimated US$5-12 billion a year in additional infrastructure finance that Africa needs to meet its Millennium Development Goals for infrastructure. Jerome noted that financial resources required for this task must come from governments, other official sources, and, increasingly, from private capital markets. Private sector participation in infrastructure is not only about financing. It is also more importantly about capacity building, transferring better technologies and innovations, and removing capacity constraints to implementation. It requires fiscal reform and improvements in public sector management.

The presenter noted that regional approaches to infrastructure development are probably more important than previously recognised.

Ochozias A. Gbaguidi presented a paper on the determinants of energy demand within the ECOWAS. The study provides useful insights into factors affecting demand for energy at regional level. First, structural transformation – understood as sustained changes in the relative distribution of GDP across sectors – is positively correlated with the demand for energy, highlighting the effect of increased industrialization on energy consumption. Second, energy consumption is negatively correlated with per capita income, suggesting that poverty is detrimental to environmental conservation. In particular, poverty shifts energy demand from manufactured energy to biomass energy. The overexploitation of the latter in the ECOWAS' countries is an important contributor to environmental degradation in the region. The main policy implication is the advocacy of anti-poverty and growth-enhancing measures, as a long-term solution to environmental degradation in the ECOWAS region.

4. Post-Conflict Recovery and Policy Reforms

A particularly challenging development problem in Africa concerns internal conflicts. There are many triggers for conflicts, but in all cases, the conflicts can be explained by institutional weaknesses. This has been a pressing problem in Sudan, which though richly endowed with natural resources, remains quite poor. **Amin Salih Yasin** discussed the issue of institutions of governance in Sudan. The primary objective of the study was to investigate the effectiveness of intergovernmental transfers in reducing tensions that result in conflict. Yasin provided a detailed account of the historical evolution of conflict in Sudan. A common factor in the areas affected by these conflicts was the state of underdevelopment, which led to discontentment among some of the rural communities. By combining both political federalism and fiscal federalism, Sudan started to put in place fiscal arrangements that were supposed to assist in diffusing conflicts and provide direct support to the peace-building process. Yasin argues that promoting fiscal decentralisation should assist in achieving multiple objectives. The transfer systems or the intergovernmental systems correct for fiscal deficits at the regional governments, especially when regional expenditure levels are too high, relative to the levels of their own resources and revenues. Also they may be used to reduce disparities among regions and to insure against asymmetric shocks. They could also be used to provide for fiscal capacity equalisation, which involves transfers from regions with high per capita revenues and low per capita expenditure needs to those regions with low per capita revenues and high per capita expenditure needs. The adopted system of intergovernmental transfers also faces a number of challenges. These include whether economic divergences might be economically unsustainable in the future if not addressed properly, and whether the kind of decentralisation scheme is viable in countries that have very weak institutional capacity and governance.

The paper by **Janvier D. Nkurunziza** focuses on post-conflict reconstruction in Africa in terms of capital accumulation as a crucial step towards economic recovery. A central focus of the paper is on how reconstruction should be financed. Given that domestic savings are the most systematic determinants of investment, one of the priorities in post-conflict countries must be to rebuild their financial systems. Nkurunziza suggests that a specific way to increase domestic savings is to fight against capital flight and try to repatriate the assets already held abroad. Doing away with corrupt practices developed during the war period through the re–establishment of the rule of law and the empowerment of oversight institutions can help to achieve this objective. Aid remains the most important source of funding in the absence of the required level of domestic savings. According to the author, post-conflict countries need large amounts of aid in the early phase of reconstruction to rebuild their financial systems that would eventually allow them to mobilise higher savings in the medium to long-term. If aid is used appropriately to consolidate the process of economic recovery, it could increase the credibility of the transition from war to peace.

The paper by **Mina Baliamoune-Lutz** focuses on policy reforms and aid effectiveness, taking social cohesion into account. It investigates the impact of aid on a group of African countries, but with a focus on ethnic fractionalisation on the impact of aid. The study finds that policy environment has direct positive effects on growth, independent of the level of aid. One implication is the need for donors to develop more effective ways to allocate aid and help in its management in countries with weak social cohesion. They could do this by targeting education and health sectors, and other projects that would reduce the negative effects of ethnic fractionalisation.

Nketcha Nana Pierre Valere presented a paper that focused on the conditions that were conducive for decentralisation to succeed. Valere tests the main proposition of the effectiveness of decentralisation through two hypotheses. One, it is hypothesised that the benefits of decentralisation are greater where there is ethnic fragmentation. The second hypothesis is that the benefits of decentralisation are greater where the local governments control a higher share of expenditures to GDP, compared to the national level. The paper uses panel regressions with infant mortality as the dependent variable. The key determinants are central government share of GDP and local government share of GDP. The paper uses data from 54 low-income countries. The priori expectations of the study are confirmed and the results indicate that decentralisation is better in achieving development outcomes (in this case reduction in infant mortality), especially where there is ethnic heterogeneity and local governments control large shares of the revenues.

Many agriculture-based African countries have recently designed plans to diversify sources of revenue for farmers by promoting the adoption of better farming practices. The paper by **Sabine M. Ntsama Etoundi** and **B. Kamgnia Dia** focused on the determinants of the adoption of improved maize varieties in Cameroon. Etoundi and Dia observed that after wheat and rice, maize was the most cultivated cereal in the world, and played a determining role in food security. Their study focused on the determinants for adopting new maize varieties, specifically the focus on the "Cameroon Maize Series (CMS)" 8704. This new variety was introduced and distributed by the National Cereals Research and Extension (NCRE) project with the objective of increasing output. The authors used a probit econometric model and included 100 farms in Cameroon's Central Province. The results of the estimations show that the most important determinants for the adoption of new maize varieties include learning, membership in a farmer's organisation and market orientation. In contrast, age, farm area, gender, and risk appear not to affect the adoption of improved varieties. The findings suggest a number of important policy lessons. First, farmers' access to policymakers is crucial for better adoption performance. Second, inducing changes in farmers' industrial organisation can also lead to better adoption performances, and so are extension services that provide technical assistance to farmers.