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WIDER Working Paper 2015/049

A quest for institutional foundations towards inclusive development in Sub-Saharan Africa

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May 2015

United Nations University World Institute for Development Economics Research

wider.unu.edu

Abstract: The paper explores the paths towards building institutional foundations for inclusive development in Sub-Saharan Africa. Viewing institutional configurations as a system of multiple equilibria, the concepts of *endogenous* institutions and institutional changes are used to address the question of how to build institutional foundations on a self-sustained basis. The paper discusses how institutional configurations have been shaped in Sub-Saharan Africa under prevailing domestic and international conditions. A resulting negative feedbacks loop in public-private interfaces has been detrimental to inclusive development. To overcome this, a strong *coalition* between governments and stakeholders should be developed as a social contract embedded in the taxation-public goods provision nexus.

Keywords: African economies, inclusive development, institutions, institutional changes, public-private interfaces

JEL classification: O43, O55, P43, P48

Acknowledgements: This is a substantially revised version of the paper presented at the UNU-WIDER Conference on 'Inclusive Growth in Africa: Measurement, Causes, and Consequences', Helsinki, 20-21 September 2014. Its earlier, longer version was presented under the title of 'Endogenising Institutional Change for Inclusive Development in Sub-Saharan Africa: A Comparative Perspective', at an international workshop organized jointly by the Japanese International Cooperation Agency (JICA) and SOAS on 15-16 February 2013. The JICA's generous financial support for the research programme on this topic is gratefully acknowledged. The author has benefited from the discussions and comments received at the JICA-SOAS workshop and the UNU-WIDER conference.

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This paper has been presented at the UNU-WIDER 'Inequality—Measurement, Trends, Impacts, and Policies' conference, held 5–6 September 2014 in Helsinki, Finland.

ISSN 1798-7237 ISBN 978-92-9230-938-1 https://doi.org/10.35188/UNU-WIDER/2015/938-1

Typescript prepared by Judy Hartley for UNU-WIDER.

UNU-WIDER gratefully acknowledges the financial contributions to the research programme from the governments of Denmark, Finland, Sweden, and the United Kingdom.

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1 Introduction

The growth performance of countries in Sub-Saharan Africa (SSA) has experienced a sharp turnaround since the dawn of the twenty-first century. With the backdrop of the commodity boom, many SSAn countries have registered an impressive growth in relation to their own historical record as well as relative to many other developing regions, attaining an average growth rate of 6.4 per cent for 2004-08. In addition they have weathered the impact of the global and financial crisis and the subsequent downturn of the world economy relatively well (IMF 2013). Growth rebounded to 5 per cent after 2010, making SSA one of the fastest-growing regions in the world. Importantly, this high growth was not confined this time to a limited number of resource-rich countries, but started spreading across other low-income countries, including resource-poor countries, though it is by no means universal throughout the region.

This has led to a notable sea change in investors' attitudes towards the region's future prospects and raised high hopes that SSA would finally emerge from its perception as a region cursed by perpetual economic and political malaise, as perceived in the past. However, most SSAn countries have not yet made much progress in diversification of their narrowly based, highly commodity-dependent economies and transformation of their socioeconomic structures. Despite hopeful embryonic signs, and the fact that growth has recently spread across more sectors, extending beyond oil and mining to agriculture and services, manufacturing activities still account for a meagre share of gross domestic product. While both foreign and domestic investments have stepped up significantly, and rising domestic demand with the emergence of 'middle classes' is perceived to have become a driving force over recent years, the sustainability of the region's growth is still precariously dependent on the continuation of favourable external factors. In fact, the commodity boom that has triggered a marked shift in investors' perception of Africa's prospects has not yet generated positive economy-wide spillover effects within each country as well as on a region- and continent-wide scale. Notwithstanding hopeful early signs, economic conditions in SSA today still pale in comparison with the experiences of East Asia a few decades ago, where the basis of regional dynamics was laid down by the formation of a dense production network and significant consumption spillovers.

While the SSA region was initially characterized by endemic poverty and high inequality at independence, the growth pattern over the last 50 years has largely failed to be pro-poor, resulting from the combined effects of low and volatile growth in the past and the notable absence of conduits and channels through which growth could be translated into broad-based, inclusive development.[1] Critically, the nature and pattern of integration of African economies into the global economy, the slow rate of structural transformation and neglect of the agricultural sector have not been conducive to generating *virtuous* circles of globalization-induced growth and poverty reduction as observed in East Asia. In particular, in contrast to the earlier East Asian integration experiences, the recent growth pattern observed in SSA has not succeeded in creating stable employment opportunities for a growing working-age population.[2] To date, fragile informal activities remain the mainstay of many SSAn economies.

Indeed, SSA's record in poverty reduction has been dismal until very recently. There was hardly any progress in poverty reduction between 1981 and 2005. The headcount ratio of the extreme

[1] See Thorbecke (2011) for detailed discussion on this topic.

[2] See Nissanke and Thorbecke (2010) for comparative analyses of the globalization-inequality-poverty nexus in Asia, Africa and Latin America. Nissanke (2015) extends the earlier analysis, incorporating the effects of recent growth on poverty reduction in SSA.

income poor (those living below US$1.25 a day) steadily increased from 51.5 in 1981 to the range of 58-59 for most of the 1990s before declining back to 52.3 in 2005—its original level of the early 1980s. Against this historical record, the declining trend in poverty established since the early 2000s is encouraging. The high growth sustained since the early 2000s did start making a difference, and the headcount ratio dropped further to 48.5 in 2010. Yet the challenge facing SSA in poverty reduction is formidable. Measured by the headcount ratio of the poor living under US$2 a day, SSA has made not much progress. It increased from 72.2 in 1981 to 77-78 throughout the 1990s before experiencing a decline to 70 in 2010, making little progress over 30 years. With the high population growth, in terms of the absolute number of the poor living under US$1.25 a day, SSA has seen an increase from 202 million in 1981 to 418 million in 2010—more than doubling, while the number of the poor living under US$2 a day increased from 284 million in 1981 to 603 million in 2010.

As discussed in detail in Nissanke (2015), SSA has fallen far behind other regions in attacking poverty for the last three decades. Still about half of the population live in extreme income poverty and 70 per cent live below the poverty line of US$2 a day. According to the recent World Bank estimate, the growth elasticity of poverty (how much poverty can be reduced with economic growth) in SSA is estimated to be -0.7, a much lower figure than -2.0 for other developing regions, excluding China (World Bank 2013). This low conversion rate of growth into poverty reduction points to the urgency of tackling high inequality in SSA to make the pattern of growth more pro-poor.[3] Thus, though the recent progress in poverty reduction is noteworthy as an embryonic sign of hope and underlines the importance of economic growth in attacking poverty, the prevalence of extreme poverty and high inequality in income and asset distribution remains very visible in SSA today.

According to World Bank estimates (World Bank 2013), the average Gini coefficient for SSA based on household consumption data is 45.1, and 26 countries have a Gini more than 40. This places SSA as the world's second most inequitable region after Latin America, with an average Gini of 50.1 on account of income distribution.[4] Inequalities have not diminished over time. In 2010, six out of the ten most unequal countries worldwide were in Sub-Saharan Africa (African Development Bank 2012). The polarization at extreme ends of the distribution is likely to be striking, since it is known that the richest capture the largest share of income, while the poorest, particularly the rural poor, get a minute share.

Indeed, we have observed rising inequality in assets and income with some extreme polarization worldwide as the pace of globalization has accelerated since the 1980s (OECD 2011; UNCTAD 2012). Consequently, social cohesion is now threatened in many parts of the world, as social and political tension has risen further through the recent global financial and economic crises, with highly volatile prices in basic wage goods such as food and fuels, and in various assets. This trend is evident globally, including in SSA. In responding to this challenge, development policy discussions globally have increasingly turned to the issue of the *pattern* of economic growth, making the understanding of 'shared' or 'inclusive growth' a focal point.

At the same time, there is by now wide recognition in mainstream 'growth' literature that institutions exert significant influence on both the rates and pattern of growth and socioeconomic development across countries (Acemoglu et al. 2002; Acemoglu and Robinson 2008, 2012; Rodrik

[3] See Nissanke and Thorbecke (2006a, 2006b, 2010) for further discussion of the pattern of growth in relation to its 'pro-poorness' arising out of the distribution effects.

[4] Since income distribution is generally more unequal than consumption, World Bank (2013) reckons that the SSA may be as unequal as Latin America.

et al. 2002, among others). Though the focus of these studies has typically been on the role of institutions in producing 'efficiency' gains leading to higher growth, institutional configurations also have decisive influence on distributional outcomes from economic development. Now, the concept of 'shared' and 'inclusive' growth can be discussed from two different policy angles.[5] On the one hand, shared growth can be achieved through mechanisms whereby *gains* from growth are widely shared ex post through various *retrospective* public policies such as fiscal tax-cum-subsidies/transfers or safety nets for redistribution.[6] On the other hand, shared growth can be explicitly defined as the *inclusive* development process, wherein sharing opportunities takes place ex ante, is all-encompassing and is inclusive of poorer segments of population.

In this paper, taking the second perspective as a focal point, our discussion focuses on the role of institutions in 'inclusive development' as ex ante processes, without delving into an analysis of institutions for ex post redistribution of gains from growth. Specifically, inequality and poverty are viewed as an outcome of economic, social and political processes and their interactions, which are mediated through a range of *institutions*. We argue that if institutional environments are the source of wealth and income inequality, institutional transformation is required to address the root cause of that inequality. Hence, in our quest for inclusive development, we aim at gaining understanding of institutional foundations and processes of institutional transformation towards an inclusive society. The prime objective of the paper is to explore the paths towards building an institutional foundation for inclusive development in SSA with a particular reference to the concept of *endogenous* institutions and institutional changes as advanced by Greif (2006) and Aoki (2001, 2007) in their comparative institutional analyses.[7]

The rest of the paper is structured as follows. In Section 2, after introducing institutional configurations as a system, we first present a critical evaluation of the thesis advanced by Acemoglu and Robinson (2012), which uses the concepts of extractive vs inclusive economic and political institutions to understand the differences in poverty and prosperity among nations today in reference to wide-ranging historical experiences with institutional arrangements and changes over centuries. This is followed by our exposition of the concept of *endogenous* institutions and institutional changes, which can shed fresh light on the debates about how to lay an institutional foundation for inclusive development on a self-sustainable basis. Section 3 discusses how institutional configurations have been shaped historically in SSA under influences of both domestic and external conditions. We suggest that these conditions combined have created an institutional trap that is detrimental to shared growth and inclusive development through a loop of negative private-public interfaces for economic development. Section 4 offers concluding remarks.

[5] See Nissanke and Sindzingre (2006) for more detailed discussions on this.

[6] From this perspective, shared growth can be viewed as just another term for the earlier concept of 'redistribution with growth' advocated by Chenery and his associates in the 1970s (Chenery et al 1974).

[7] There are two distinctive schools in approaches to institutional analyses, classified conventionally into *neo-institutionalism* and *old institutionalism*. In his attempts to integrate the two approaches into a unified framework, Grief (2006) advances the concept of *endogenous* institutions and institutional changes. This has prompted us to use this concept in this paper to highlight the institutional challenges facing SSAn countries in building a foundation for inclusive development.

2 Institutions and inclusive development

2.1 Institutional configurations as a system for development

Institutions are very diverse, regulating different domains of human interactions—economic, political and social. There are a variety of approaches to, and definitions of, institutions. A dividing line is often drawn between *old (or evolutionary) institutionalism* and *neo-institutionalism*.[8] The former, dominant in sociology and other social sciences, challenges the neoclassical assumptions of rational agents as a unit of analysis. It emphasizes that institutions are above all socially embedded, and evolutionary forces combined with mutation, imitation, and random experimentation influence the long-run equilibrium of institutional arrangements. In contrast, *neo-institutionalism*, which does not question the methodological foundation of neoclassical economics, is embraced as New Institutional Economics (NIE) in contemporary economic literature. NIE itself is divided into two complementary analytical perspectives: the 'institutions as rules of the game' perspective and 'transaction cost economics'. North (1989, 1990, 1995), representing the first perspective, defines institutions as the humanly devised constraints that shape human interaction, structure opportunities and constrain human exchanges, whether political, social or economic. From this perspective, institutions are viewed as ensuring individuals comply with collective rules through establishing appropriate incentives and sanctions. North further emphasizes that institutions are both formal ones (constitutional, property rights rules and contracts) and informal ones such as social norms and customs.

Noting also that institutions can be statutory laws and rules, informal norms, established organizations, contracts, mindsets, or combinations of some or all these elements, Aoki (2001, 2007) draws our attention to the importance of viewing institutional configurations as a system, composed of *interrelated* but distinct components. Hence, institutional arrangements can be very complex and diverse, involving multiple equilibria. Likewise, Greif (2006) defines institutions as a system of rules, beliefs, norms, and organizations, which together generate a regularity of social behaviour, and social rules. Thus, Greif suggests that institutions provide individuals with cognitive, coordinative, normative, and informational micro foundations, and guide and motivate individuals to adopt specific social behaviours.

Naturally, in a society, individuals act and interact as members of different organizations. In this context, North (1990, 1995) defines organizations separately from institutions, as ongoing interest groups bound by a common purpose to assure the perpetuation of certain institutional structures: institutional arrangements create the framework, but collective action takes place within organizations. In this context, in contrast with institutions defined as the 'rules of the game', Aoki gives a sharper definition of organizations as the 'players of the game', who can act as agents of institutional change. Therefore, there are dynamic interplays between institutions as the overarching rule of the game, and organizations. On the one hand, overall institutional configurations shape the behaviour of collectives as organizations in a society, while alternative sets of organizational responses and modes may affect institutions.[9] On the other hand, organizations are units or channels through which their own rules of the game are refined, structured and administered at different levels of decision-making. Viewed from this perspective, 'transaction-cost-economics', discussed by Coase (1992) and Williamson (1985, 1996), can be seen

[8] See Chapter 1 in Greif (2006) for more detailed discussion on differences in institutional analyses between the two schools.

[9] See Harris et al. (1995) for this position.

to focus on the functional role of organizations, postulating that economic agents, responding to rules, draw up efficient contracts and establish organizations to minimize transaction costs.

Aoki (2007) attempts to reconcile these two perspectives on institutions, placing rules in a sharper hierarchical order: (i) rules exogenously predetermined outside the domain of economic transactions—for example, legal and social norms ('rules of the game' perspective); and (ii) economic institutions such as contracts, markets, organizations, and their hybrids are rational transaction-cost-saving responses within these constrains/rules. In fact, both perspectives in *neo-institutionalism* take largely a 'functionalist' or 'agency' view of the role of institutions, and many take the position that institutions are above all created for efficiency gains. In their writings, the main functions of institutions are often identified as: (i) to protect property rights;[10] and (ii) to reduce transaction and information costs by establishing a stable structure for human exchange and interaction. In contrast, the *old (or evolutionary) institutionalism* takes a 'structural' view on institutions and argues that institutions transcend individual actors and are immutable cultural features of societies that determine behaviour.

Viewing overall institutional configurations as a system, Aoki (2001, 2007) and Greif (2006) use an equilibrium analysis and agency theory, and adopt a strategic game theory as a methodological tool (Aoki 2001, 2007). Institutional configurations can then be analysed as a system either switching around different equilibria, or settling in a specific equilibrium as an outcome of political processes, often dominated by shared beliefs. Institutional configurations thus defined have decisive influences on development performance and potential (Aoki and Hayami 2001). That is, different configurations can lead to very diverse outcomes in terms of efficiency gains as well as distributional settlements. For example, socially beneficial institutions promote welfare-enhancing co-operation and action, while a society with a well-functioning political order that is capable of pursuing beneficial policies such as appropriate public goods provision can facilitate the development of well-functioning markets (Greif 2006). Such an institutional configuration would naturally encourage production by fostering saving, investment in human and physical capital, and the development and adoption of useful knowledge and new technology.

2.2 Institutions and inclusive development

While the role of institutions in increasing efficiency tends to dominate the economic policy debate, institutions also have enormous influence on a country's inequality-poverty trajectory. For example, while formal institutions define property rights, how rights regarding the use of assets and resources as well as the income derived from them are determined and interpreted in practice depends largely on settlements induced by prevailing political economy and social norms. Thus, the institutional configurations emerging from the interface of formal rules, social norms and political settlements would determine both efficiency and distributional outcomes. Indeed, a society that fails to develop institutions for the protection of property rights will be characterized by low investment, while a society without proper provision of public goods such as public education would sustain pockets of chronic poor. Conversely, inequality and poverty cannot be reduced on a sustainable basis in the absence of institutions that deter predation and sustain incentives to invest, produce and exchange as well as institutions that encourage distributional settlements that are fair to the socially and politically disadvantaged.

In this context, Bowles (2006) advances the concept of *institutional poverty traps*, defined as institutions that implement a persistently highly unequal division of the social product, while not

[10] Property rights are the bundle of rights to use and dispose of an economic resource and to derive utility (income) from it (Aoki 2001: 5).

offering any efficiency advantages over other feasible, more egalitarian social arrangements either. For Bowles, unequal institutions persist over long periods due to the self-enforcing nature of existing arrangements and due to the difficulty that the poor have in coordinating the *collective action* necessary to 'tip' a population from an unequal to a more equal set of institutions.[11] Thus, poverty traps could persist also due to the collective action problem. As Bowles et al. (2006) note, it is possible that institutions, especially political and social norms, may entrap entire countries in poverty. Indeed, a country's distributional outcome could be analysed as an institutional configuration evolved from political settlements imposed through intensive interactions between political and economic institutions over time.

One can evaluate, in this light, the thesis advanced by Acemoglu and Robinson (2012) on how political and economic institutions interact and give rise to diverging paths of national prosperity and poverty. In view of diverse development experiences spanning over many centuries globally, the two distinctive institutional regimes—*inclusive* economic and political institutions, and *extractive* ones—are defined and used in their thesis.[12] According to them, inclusive economic institutions are those that 'enforce property rights, create a level playing field, and encourage investment in new technologies and skills' (Acemoglu and Robinson 2012: 429-30).

> They are in turn supported by, and support, inclusive political institutions that distribute political power widely in a pluralistic manner and achieve some amount of political centralisation so as to establish law and order, the foundations of secure property rights, and an inclusive market economy (Acemoglu and Robinson 2012: 429-30).

In contrast, extractive economic institutions are

> … those that are structured to extract resources from the many by the few. These are synergistically linked to extractive political institutions, which concentrate power in the hands of a few, who will then have incentives to maintain and develop extractive economic institutions for their benefits and they use the resources they obtain to cement their hold on political power (Acemoglu and Robinson 2012: 429-30).

Applying the concepts of these contrasting institutions, the authors present narratives of: (i) the historical origin of inclusive institutions; (ii) institutional trajectories of different nations; and (iii) their consequences for different development experiences. They emphasize that in the presence of powerful synergies between economic and political institutions, extractive regimes would give rise to a vicious circle of failed development and economic decline, whereas a virtuous circle would be generated under inclusive regimes. They argue that even though extractive institutions can, from time to time, succeed in spurring economic growth, they cannot sustain growth. This is partly because extractive institutions are in essence fearful of innovation and creative destruction, necessary for sustained economic growth, and partly because the extractive regime eventually engenders political instability. Thus, it is argued that nations with extractive institutions fail under

[11] See Nissanke and Sindzingre (2006) for more discussion on the concept of the institutional poverty trap advanced by Bowles.

[12] Similarly, North et al. (2007) explain large variations in economic performance between low- and middle-income countries and advanced countries of the world today in terms of differences in social orders: one with 'limited access orders' and the other with 'open access orders'. Thus, though using another set of concepts and analytical tools, their thesis also emphasizes significant influences of social orders resulting from political settlements on economic development processes.

the weight of the prevalence of poverty, while inclusive institutions are conducive to sustained economic growth and prosperity.

Further, Acemoglu and Robinson suggest that as intense interface between political and economic institutions takes place, institutional drift is constantly observed in a society as the outcome of conflict over income, power, and institutions, and this would create differences in institutional setups across nations. However, major institutional changes take place as a result of the interaction between existing institutions and critical junctures such as the Black Death of the fourteenth century, the opening of Atlantic trade routes or the industrial revolution. In this context, they argue that critical junctures—major epoch-changing events—affect a historical process of institutional drift, which would, in turn, shape and structure the nature of institutional differences developed across nations over time.

In broader terms, their thesis with its focus on the joint determination of political and economic institutions is quite all-encompassing and general enough to be applicable to very wide-ranging historical experiences of producing diverse growth and development outcomes with different sets of institutions and their configurations. While some of the detail in their interpretation of individual historical events can be contested, at a more general level, the overall thrust of their conjecture on the superiority of inclusive political and economic institutions over extractive ones is less likely to be disputed. However, a number of challenges remain about how to utilize their universally defined concepts of inclusive and extractive institutions as a basis for projecting a development strategy towards inclusive development. Furthermore, the acceptance of the desirable general form of institutions does not by itself allow us to understand the processes by which institutional transformation can actually take place in different historical contexts.

In particular, a formal legislation or establishment of inclusive economic institutions that 'enforce property rights, create a level playing field, and encourage investment in new technologies and skills' does not necessarily guarantee a smooth path towards inclusive development. First, to be effective, *formal* institutions thus desired should be underpinned by *informal* ones such as shared beliefs and norms held by constituents and stakeholders, so that the formal 'rules of the game' are accepted and enforced. Second, while these elements of inclusive economic institutions are undoubtedly critical in fostering economic growth, they may be achieved through different transition paths or may take different forms of institutional configurations due to both the contingent nature and the path dependence of institutions and institutional changes. Indeed, inclusive political institutions per se do not necessarily lead to attaching a fair weight to 'equity/equality' considerations in determining the distributional outcome in economic policy-making. In short, the formal establishment of inclusive economic and political institutions as defined by Acemoglu and Robinson may be a necessary but not a sufficient condition to ensure inclusive development.

Third, settled institutional configurations are dictated and determined by political power relationships and conflict resolution mechanisms in place to allow some compromises over distributional outcomes. The latter would result from political settlements of some sort or another, and these would not necessarily always be peaceful processes as those deriving clear privileges from the prevailing political institutions would not easily accept the required institutional changes. Indeed, history indicates that formal acceptance of equality and inclusiveness in basic political and economic rights for everyone regardless of gender, race, ethnicity or any other attributes cannot easily be achieved without enduring processes of political struggle and civil rights movements. This is clearly illustrated by historical experiences worldwide, including the modern history of Great Britain and the United States, which are often taken to represent, at least implicitly, a universal model of inclusive institutions that all other countries should strive to emulate and converge towards.

2.3 Endogenous institutions and institutional changes for inclusive development in a comparative institutional analysis

Since the early 1990s the quality of 'governance' has been increasingly accepted as one of the central attributes that determine the effectiveness of foreign aid.[13] At the same time, there is a tendency in policy debates on the institution-development nexus among the Western donor community to assume that there is only one universally accepted set of institutions that is good for development and that such model institutions can be found in today's advanced countries. Consequently, it is often argued at least implicitly that institutional development would involve convergence towards, or emulation of, the 'best practice' found in Western societies. This is evident, for example, in the dominant literature on 'good governance and development' (see for example, discussions found in Kaufmann et al. 2009; World Bank 1992).

We suggest the need to depart from such a simplistic prescriptive policy position.[14] We argue that: (i) institutions should be *endogenously* developed in a specific local context, so that they are viable and sustainable, backed up by expectations and calculations affecting behavioural patterns of actors and organizations; (ii) formal institutions that are simply supplanted from outside without a careful adaptation to local environments are not enforceable and hence not sustainable over time as well as functionally ineffective, as they are not upheld by local informal institutions, social norms and beliefs;[15] and (iii) since the dynamics between institutions and organizations are critical forces for social change, institutional changes should be initiated and sustained by local organizations and agents found on the ground; and (iv) socially and politically sustainable development involves institutional innovation for a local setting with clearly defined developmental objectives at hand.[16]

From this perspective, it is not surprising to find much diversity in organizational and institutional structures in the history of institutional development and configuration, displaying various national and regional characteristics other than what the monolithic universal model of 'ideal' institutions tends to suggest. Further, it should be recognized that institutional changes towards 'inclusive' development are contingent on many factors, including major exogenous events and local conditions that are to accommodate these events domestically to induce institutional responses.

The analytical framework developed by Greif (2006), Aoki (2001, 2007), and Aoki and Hayami (2001)—the comparative institutional analysis—recognizes explicitly that institutions are not monolithic entities, and emphasizes the need to study institutional dynamics as a historical process in which past institutions influence the timing of institutional change, the manner in which institutions change and the details and implications of new institutions (Greif 2006). In their analyses of institutional dynamics, one can see a trace of their attempts to incorporate into their framework the evolutionary understanding of institutions and institutional changes held by the old

[13] According to the definition used by the World Bank for the Worldwide Governance Indicators, governance is understood as consisting of the traditions and institutions by which authority in a country is exercised. This includes the process by which governments are selected, monitored, and replaced; the capacity of the government to effectively formulate and implement sound policies; and the respect of citizens and the state for the institutions that govern economic and social interactions among them.

See http://info.worldbank.org/governance/wgi/index.aspx#reports (accessed 15 April 2015).

[14] A similar position is found in Booth (2012).

[15] Aoki (2001) also notes that even if good formal institutions are borrowed from outside, tension may be created since indigenous, informal rules are inert and difficult to change.

[16] Rodrik (2004) places an emphasis on institutional innovation in economic development. Acemoglu and Robinson (2012) also firmly reject the modernization theory that projects a linear, unidirectional convergence of institutions.

institutionalism.[17] Their framework allows the examination of diverse outcomes of institutional arrangements across countries, even though they are exposed to the same technological knowledge and linked to common market forces.

The concepts of *endogenous* institutions and institutional changes proposed by Greif (2006) and Aoki (2001, 2007) could be particularly useful for and relevant to understanding how to facilitate the process of institutional transformation towards inclusive development. Greif defines endogenous institutions as those that are *self-enforcing,* in which all motivation, including that for change, is endogenously provided. Further, he suggests '[I]nstitutions can change due to endogenous processes, exogenous shocks, or a combination of both' (Greif 2006: 168).

In the case of exogenous shocks, institutional dynamics, and changes take place in a historical process wherein existing institutions are exposed to exogenous shocks that will lead to institutional failure, as they become no longer self-enforcing in the face of those shocks. When many individuals recognize that maintaining past behaviour is no longer optimal, institutions evolve through endogenous change. Further, Greif argues that by treating institutions and their configurations as equilibrium phenomena, his unified approach to comparative institutional analysis can highlight the ways in which an endogenous institution can *reinforce* or *undermine* itself. From this perspective, one can gain a better understanding of why institutions sometime persist even in a changing environment while it is also possible for endogenous change to occur in a rather stable environment.

In a similar context, adopting a specific definition of the institution as a *self-sustaining system of shared beliefs*, Aoki (2001, 2007) emphasizes that the rules of the game are *endogenously* generated, resulting from an interface of formal and informal institutions, and they become self-enforcing through strategic interactions of the agents, including the enforcer. Further, noting the importance of understanding institutional changes as a shift from one equilibrium to another, Aoki (2007) develops an integrative game-theoretic formal approach to institutional changes as resulting from interactions among four game domains: social norms; political states; economic contracts; and organizational architecture. He then examines changes through the lenses of dynamic processes of institutional complementarities, social embeddedness, and institutional linkages.

Aoki's analysis of different prototypes of the 'state' in the polity domain is of particular interest for our discussion in Section 3 below on the evolving interface between the public-private relationships that engender different outcomes in the institutions-development nexus. First of all, Aoki makes a clear distinction between the government as an organization (and thus as a game player in the political domain), and a state as 'a stable order of relationships between the government and private agents'. A government is thus seen as a strategic player that may pursue its own objectives but be constrained by strategic interactions with private agents. Second, he links the emergence of the 'nation state' to an expansion of market exchanges as these require an effective third party mechanism for protecting property rights and enforcing contracts. Thus, he suggests that the extent of market development and demand for third party mechanisms are interdependent. Third, he presents three prototypes of the state—democratic, collusive, and predatory—and suggests that each of these as a possible stable equilibrium in the polity domain. Which one of three prototypes of the state prevails is contingent on strategic interplays between a government and private agents through taxation vs public goods provision that includes the

[17] Greif (2006) states that his analytical framework reflects his attempts to combine the 'structural' and 'cultural' perspective of the old institutionalism and the 'functional' or 'agency' view of the new institutionalism.

security of property rights and contract enforcement—one of the critical requirements for further market enhancement and development.

In our view, an effective application of the analytical perspectives centred on the concept of endogenous institutions and institutional changes would help us to understand why and how endogenous institutional evolution and changes could take place under globalization, which may be either conducive or harmful to fostering inclusive development.

Ongoing globalization has generated powerful exogenous shocks that shake up existing, often rather insular, institutional setups in many countries, including those in SSA. Previously stable institutional equilibria are disturbed and forced to change, as they become no longer self-enforcing in exposure to new environments, including new technology such as information and communication technology (ICT) or mobile technology, faster information flows, new production and market arrangements and opportunities, or scientific knowledge spillovers. Thus, globalization has undoubtedly unleashed large forces for institutional change, both technological and non-technological. It can be argued that this globalization process, affecting almost all nations across the globe, presents itself as an epoch-making critical juncture for SSAn countries that could be at least as powerful as, if not more so, than previous critical junctures such as the industrial revolution or the opening of Atlantic trade routes, as analysed in Acemoglu and Robinson (2012).

At the same time, the corporation-led and finance-led globalization process as we know it has also engendered an intensely disequalizing tendency in income and asset distribution worldwide, as examined in detail in Nissanke (2015). A new institutional equilibrium brought about purely by globalization-induced market forces is likely to be detrimental to inclusive development. Hence, there should be counteracting institutional innovation so that inclusive development is fostered rather than hindered under globalization. Moreover, newly emerging institutions and institutional configurations should be endogenous—self-enforcing as defined above; that is, all motivations for changes and sustainability should be endogenously created. Hence, we need to gain a deeper understanding of both endogenous institutions, and organizations and agents for change, all of which should be found on the ground in SSA. As institutions are always path-dependent, our analysis of endogenous institutions and institutional changes should be firmly embedded in detailed knowledge of local institutions—those often referred to as 'informal' institutions in the literature—in order to project possible paths of institutional transformation towards inclusive development. Such an endeavour would necessarily also involve a quest for a set of fairer, open and peaceful institutions for orderly resolution of distributional conflicts.

This is naturally a huge task of an interdisciplinary nature, far beyond the scope of this paper. For now, bearing this broad objective in mind, in the next section we present a brief review of the evolution of institutional configurations in SSA, and in particular, how economic and political institutions have evolved under the influences of both domestic and external conditions since gaining political independence. We suggest that these conditions combined have created an institutional trap that is detrimental to nation state-building with corresponding institutional setups. This has resulted in a negative feedback loop in private-public interfaces that has impeded the emergence of inclusive development.

3 Domestic and international conditions that have shaped the institution-development nexus in Sub-Saharan Africa[18]

3.1 Domestic institutional configurations in the early post-independence years

The colonial regimes introduced a distorted set of highly extractive economic and political institutions and structures that blocked indigenous opportunities for autonomous growth while reinforcing some regressive characteristics of traditional institutions (Brett 1995: 203). While any attempt to form autonomous political and social structures as a civil society was severely repressed, traditional values and structures survived at the societal level under the shadow of modern political and economic institutions superimposed by the colonial power, which underpinned the power of those controlling the state and marginalized the interests of the great majority. These conditions discouraged the development of universal value systems that would support a nationally oriented political and economic order.

Thus, the institutional arrangements inherited at independence in SSA were dominated by 'extractive political institutional structures' as defined and discussed by Acemoglu and Robinson (2012). Upon independence, states were often structured around the top political leaders in the executive branch who could act as benevolent social guardians (Teranishi 1996). Even though the development goals set by the leaders of Ghana, Tanzania, Kenya, Zambia, and many other countries were motivated by high aspirations for improved living conditions for the people, there was, in practice, a huge gap between the vision and aspirations for socioeconomic advancement on the one hand, and the state capacity, institutional configurations, and government implementation structures on the ground, on the other.

In order to achieve their vision, the autocratic governance structures were often favoured and justified on the basis of the ethno-linguistic complexity within a 'nation state'. Indeed, the boundary of most African states that emerged at independence tended to just reflect colonial legacy more than anything else. Furthermore, in many countries the prominent leaders at independence with the vision to build nation states were soon replaced by authoritarian and highly centralized governments, often led by military officers. Governance structures subsequently evolved in such a manner that African states have typically become portrayed as autocratic. The unstable political regimes, which prevented *impersonal* state institutions from emerging, often made the rulers rely upon their own narrow circles, frequently based on kinship affiliations.

Private agents/institutions were typically viewed as nascent and technologically backward and thus incapable of engendering the dynamism needed for development. The state apparatuses were therefore assumed to play a central role in driving the development agenda ahead. Economic policies often expressed a strong bias against the private sector and rural farmers, such as expropriation of private property, the favoured direct allocations of foreign exchange, trade licences and subsidized credit to parastatals and rent-seekers, and the very high taxation of the traditional export sector.

The centralized, authoritarian governments rapidly became overextended in the light of their limited administrative capacity, with its dysfunctional judicial and regulatory systems. Government offices, including many oversight (monitoring and regulatory) agencies for public sector institutions such as parastatals, have been made ineffective due to political appointments,

[18] At the outset, a strong caveat is made regarding some of the statements and analyses in this section that may amount to sweeping generalizations about diverse, heterogeneous institutional conditions found in individual countries with their own histories and path dependence.

politically controlled funding, and multiple and conflicting objectives, or low morale with few incentive schemes in place. The transparency and accountability of these public institutions and government offices left much to be desired, resulting in the lack of effective agencies of restraint on government policies and actions. Under such conditions, governments tend to get engaged in fiscal profligacy, as politically connected private actors forged a 'covenant' with the state to promote the interests of particular factions such as military cliques and ethnic groups (Aron 1996). The intensity of controls increased the opportunities for corruption. Clientelism based on the patron-client relationships was reported to be pervasive and decentralized in almost every form of public sector institution.

Under these situations, one cannot expect much progress towards building an effective 'nation state' which could collectively engage in development agenda with pluralistic representation. It may be worth noting that such autocratic structures with extractive institutions were not rejected or officially condemned by the international community at the time, but rather tacitly acknowledged as legitimate due to the dominance of the cold war rhetoric, when politicians and leaders of many African states were actively courted for geopolitical reasons by both the Western and Eastern power blocks.

Overall, the failure of many earlier development plans can be the result of placing even 'well-intentioned' policies in 'wrong' or 'weak' institutional structures with little accountability to stakeholders. Nor were the development strategies and policies planned in tandem with available resources and existing societal norms and capabilities; above all, the institutional governance structures prevailed. In many countries the overstretched public institutions could not implement development plans and develop an appropriate framework for attracting investment capital and distributing the benefits from investments and growth. Africa, probably more than any other region, failed to adapt formally enacted institutions and policies to locally prevailing conditions. Consequently, it is entrapped in the vicious circle of an institutional trap, which has further intensified the failure of the state.

With regards to the interface between the public sector/government apparatus and private agents, Bates (1981, 1983) and Teranishi (1996) suggest that, compared to other regions, autocratic regimes in those early post-independence years used divisive fiscal instruments more extensively such as subsidies or preferential credits, as the preferred mechanisms to buy political support or to appease various interest groups. Under such circumstances, governments could become hostage to their narrow political support base, often in urban areas, as happens in any *collusive* state, wherein the government colludes with particular private agents for its advantage, as discussed by Aoki (2001: Chapter 6). Distributive conflicts inherent in any society are more likely to be exacerbated by the proliferation of patron-client relationships and patronage arising from the pervasive use of such fiscal instruments, and can even risk descending into *predatory* states. While divisible benefits distributed to fund various political costs could constitute an increasing burden on public finance, SSA governments, with the urban bias in their expenditures, tended to ignore their agricultural sectors and often failed to undertake pro-poor public investment in rural areas. In fact, political preferment of a particular group of urban supporters could make the majority, especially in rural areas, de facto disenfranchised from development processes.

This is in sharp contrast to the earlier experiences in East Asia, where the observed poverty-reducing effect of globalization and integration was not purely a manifestation of market-driven growth effects. In most of East Asia, the pro-poor pattern of public expenditure in favour of the rural poor at early stages of development produced and sustained the 'shared' growth process for some time. Naturally, it is naïve to explain the differences in patterns of fiscal expenditures simply in terms of 'developmental' vs 'predatory' states to characterize the autocratic regimes in East Asia and in SSA, respectively. However, we cannot help but notice that the conditions of institutional trap in SSA discussed here may be related to the dilemma facing predatory states found in the literature of comparative institutional analyses presented in Section 2 above.[19]

For example, defining a government as a strategic agent maximizing its fiscal revenues, Aoki et al (1996: 17) note that 'whether government chooses to act as a predator or to promote the private sector depends critically on the quality of its tax apparatus… A revenue-maximising government with a poor tax apparatus will always choose to act as a predator'. Thus, they suggest that in order to restrain the government from acting as a predator on the private sector, a nation state should be equipped with a high-quality tax collection apparatus and an information-processing capability. Otherwise, with their weak tax base, predatory states have a tendency to hamper private agents—that is, to extract as much extra income as possible from them.

In responding to such government behaviour, the private agents refrain from making risky, forward-looking productive investments. Under a predatory regime, private firms and rural households would have little incentive to carry out investments of their own unless such investments are supported by the government and they are assured that they can keep a substantial portion of returns from undertaking those investments. In fact, politicians in sitting autocratic governments of countries rich in natural resources may have lacked an incentive to develop an efficient tax system for engaging strategically with private agents, as they could get resource rents to their own advantage in non-transparent dealings with foreign mining companies.

While it is certainly too sweeping a generalization to view African states indiscriminately as predatory, given these earlier experiences with political institutional impediments to development, one of the primary causes for Africa's development tragedy is often attributed to the absence of robust, morally anchored public institutions, or 'cumulative institutional impoverishment' as reflecting the path-dependent natures of institutions (Aron 1996). The IFI-sponsored economic reform programmes were supposed to address such institutional conditions.[20]

3.2 Interface of international and domestic conditions under the IFI-sponsored reform process

Diagnosing development failure in the early post-independence years as resulting from pervasive government failure, the solution recommended by the IFIs to the debt crisis in SSA in the 1980s-1990s was an adoption of policies of economic liberalization and deregulation and the need to keep the size of governments to a minimum in exchange for aid money and debt restructuring. In this context, it should not be forgotten that the outbreak of Africa's debt crisis in the early 1980s was closely connected to that of the severe commodity crisis at the time.[21] The collapse of commodity prices in the 1980s amounted to a loss of real purchasing power of 40-60 per cent for many commodity-dependent economies in SSA—a deeper crisis than that faced in many major economies during the Great Depression in the 1930s.

However, the IFIs and major donor countries belonging to the Paris Club in the 1980s and 1990s were reluctant to acknowledge commodity-related developmental issues as one of the main causes for the debt crisis of SSAn countries, heavily dependent on primary commodities for export revenues, and hence for servicing debt (commodity-dependent developing countries [CDDCs]).

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[19] There are always exceptions to all these general statements. Botswana, for example, is known to avoid the institutional trap discussed in this section.

[20] IFI - international financial institution, denoting the two Bretton Woods institutions, the International Monetary Fund and the World Bank.

[21] See Maizels (1992) for a more detailed, excellent exposition on this point.

The resultant failure of the donor community to deal with the problems stemming from the absence of international mechanisms to allow the CDDCs to manage commodity-related exogenous shocks effectively in a timely fashion has been extremely costly in terms of forgone development opportunities of heavily-indebted poor countries (HIPCs) in SSA.

The official creditors kept applying ex post debt relief mechanisms with policy conditionality attached in response to recurrent liquidity crises and the ensuing 'debt overhang' condition. All debt relief mechanisms employed since, including the HIPC initiatives in the late 1990s, failed to pay sufficient attention to the problem arising out of the loss of purchasing power in international economic transactions at times of dwindling real commodity prices, and with it, the capacity to service external debt. A real resolution of the protracted debt crisis had to wait for a comprehensive debt cancellation embedded in the Multilateral Debt Relief Initiative (MDRI) in 2005 (Nissanke 2010a, 2010b, 2013b).

The debt crisis management by the international donor community in this manner further aggravated the *commodity dependence trap* inherited historically from the colonial era. Economic policies recommended by the IFIs, in the semblance of both Washington and post-Washington consensuses, proved not to be particularly effective in facilitating the process of structural transformation and diversification of CDDC economies, which could be realized only through rigorous productive and social investment on a sustainable basis. On the macroeconomic stabilization front, aggregate demand management of commodity-dependent economies governed by external shocks should be *counter-cyclical* to *commodity price movements*. Yet, at the time of an externally induced balance of payment crisis accompanied by a sharp drop in domestic demand, these countries had to adopt, in the absence of alternative financial facilities, the *pro-cyclical* stabilization programme sponsored by the International Monetary Fund (IMF) that aimed at a further contraction in aggregate domestic demand.[22]

The resulting *low equilibrium trap* of high debt and low growth was evident in CDDCs of SSA throughout the 1980s and 1990s. With the advent of the debt crisis, the repeated dose of large-scale fiscal retrenchment, which was a part of policy conditionality with Structural Adjustment Loans in the first decade of their debt crisis, reduced spending on public goods provision. Governments were generally left with little capacity and dwindling resources to implement development-oriented policies domestically and, in particular, to undertake public investment on a sustained basis. Typically, it is large-scale infrastructure projects that get axed first in fiscal expenditure allocations in times of crises. In reality, the fiscal retrenchment at the height of the debt crisis in the 1980s was so deep that essential public goods provision in social infrastructure such as basic education and health expenditure were also axed and it was assumed that these services could be provided on a fee-paying basis. This has often resulted in a fragile state with a seriously depleted and impaired institutional capability to deliver social services and to build physical and social infrastructure. Under these conditions, the scope and quality of public social services and infrastructure provision progressively deteriorated.

In addition, the aid relationships developed during those decades were unhealthy for nurturing developmental domestic institutions. In particular, the donor-recipient relationships had been severely impaired by the two decade-long experiences with policy conditionality attached to programme aid. There is nothing controversial about sovereign aid and debt contracts specifying conditions that conform to international rules, norms, and codes of conduct as well as procedures for accessing official concessional loans. The issue at stake, however, and what has been debated,

[22] See Nissanke (2010c) for a critical review of macroeconomic adjustment policies over the commodity price cycles in mineral-based developing countries.

is the *nature and content* of *policy* conditionality, which could be resisted on the grounds of being imposition on a recipient government of a particular development model, perceived as universally superior, and the way policy conditionality was practised in one form or another.[23]

Despite efforts to achieve a greater sense of ownership and partnership as in the Paris Declaration, 2005 and the Accra Agenda for Action, 2008 for increasing aid effectiveness, the ways aid relationships have evolved between main traditional donors and recipient countries, and the way the aid effectiveness debate has been conducted since the mid-1990s have cast long shadows on building trust and confidences between donors and recipients. Irrespective of whether policy conditionality is administered ex ante on the promise of policy reform or ex post, on a 'performance-based' selectivity basis, the donor community and recipient governments could position themselves in an 'aid power' game, resulting in an inferior non-co-operative equilibrium (Nissanke 2010a, 2013a). In the absence of mutual trust, the donors often felt compelled to police whether recipient governments adopt, and adhere to, economic policies and institutional governance structures as prescribed by donors. In many cases, better results may have been achieved if donors had taken a much less intrusive position, focusing on providing aid to enhance recipient efforts in building institutional foundations through technical co-operation as a development partner so that national governments could develop their own 'home-grown' strategies, policies, and institutions. [24]

After all, policies adopted by a government may not produce the intended outcome if they are superimposed from outside without due regard to existing institutional configurations so that a *self-sustaining system of shared beliefs* or *endogenous institutions* are not encouraged to emerge, as Aoki or Greif suggested. What is required may be more mutual respect so that the two parties could fully and truly engage in learning from each other's development experiences, taking into account their different institutional configurations. Recipient governments are increasingly required to be accountable to the donor community. This by itself does not pose a problem, but intense pressure from donors on strategic policy design matters could place recipient governments in conflict with their responsibility towards their own citizens. Such situations can easily and unintentionally undermine the democratic credentials of recipient governments, since key decisions on development strategy and policies should evolve out of active dialogues with domestic stakeholders in any democracy.

In fact, the donor community has not necessarily had a credible track record in accurately diagnosing binding constraints for economic development in SSA. For example, it is only in the 2000s that the need for massive infrastructure investment has been officially recognized as critical for accelerating economic and productivity growth as well as progress in poverty reduction.[25] In the 1980s and 1990s the donor community had steadily reduced aid allocation to economic infrastructure projects relative to overall aid *and* to social infrastructures in SSA.[26] This is again in sharp contrast to the experiences in East Asia, where the central role of infrastructure provision in socioeconomic development and overseas development aid (ODA)'s contribution towards it have been consistently acknowledged. This is because the need to finance infrastructure

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[23] Kanbur (2005) makes a similar point in his assessment of the aid allocation adopted in the IDA-14. See Nissanke (2010a, 2013a) for more discussions on this point.

[24] See Nissanke (2013a) and Nissanke and Shimomura (2013) for detailed discussion on this point.

[25] The donor community shifted its main diagnosis for development failure from the 'capital shortage' thesis in the 1960s and 1970s, to the 'policy failures' explanation in the 1980s, and then to the 'institutional failures' in the 1990s (Adam and O'Connell 1997). Taking this further, we argue that the donor community then shifted their position to the 'infrastructure' failure diagnosis in the 2000s.

[26] See Nissanke (2010a, 2013a) and Nissanke and Shimomura (2013) for the main reasons behind this trend.

investment as public goods and strengthen the state capacity to deliver infrastructure services on a sustainable basis has always been regarded as a prerequisite for spurring and sustaining private investment in East Asia.[27]

The belated official recognition of Africa's disadvantages in infrastructure development has entailed a heavy cost in terms of forgone economic growth and poverty reduction. This is because both economic and social infrastructures are essentially 'public goods' that governments and external agencies have a responsibility to provide at the early stages of economic development. In practice, with the severe and deep fiscal retrenchment (hence reduced spending on rural infrastructure) since the advent of the debt crisis, governments were not in a position to undertake public investment on a sustained basis, and hence also failed to crowd-in private investment. In the absence of reliable public goods provisions, transaction costs to engage in productive activities remained prohibitively high. The high degree of uncertainty and instability has had a powerful deterrent effect not only on the rate of private investment but also on the composition of investment in favour of reversible and safe investments that have a self-insurance character. While wealthy segments of the population chose to invest abroad, resulting in substantial capital flight, other private agents chose to put their capital in short-term assets in sectors with relatively lower sunk costs and shorter turnover periods, such as trading, rather than in long-term productive investments (Aryeetey 1994). The resulting low level of both public and private investment combined had severe negative consequences for structural transformation.

The absence of reliable provision of both economic and social infrastructure services as well as other public goods, in addition to the prevailing political and economic environments in the 1980s and 1990s, has kept the economic activities of a significant proportion of private agents away from the 'official' economy. The extremely fragile '*informal*' economy has remained an important source of employment and income for the majority of urban and rural households today. The average share of informal employment in total non-agricultural employment in SSA was 76 per cent in 1990-94 and increased noticeably throughout the 1990s, while in a number of West African countries such as Chad and Mali, the share was about 82-95 per cent (African Development Bank et al. 2010). In the absence of functioning formal institutions, the contract enforcement problem had to be obviated through repeated dealings or relying on cultural and social homogeneity. Hence, economic activities were mostly restricted to small-scale production and local trade within a confined geographical area.

The majority of the poor, particularly the rural poor, have been left behind. At the same time, a largely informal economy leading to a weak and narrow tax base reinforced the fiscal fragility.

Thus, in the years under the IFIs' sponsored reform programmes, the continuing conditions of poor public goods provision and a fragile fiscal condition maintained a vicious circle condemning an economy to a low equilibrium, leading to a fragile state with a reduced institutional capability to function. Rather, the scope and quality of public social services and infrastructure provision progressively deteriorated in many countries throughout the 1990s. Without addressing the historic institutional trap little progress could be made in building a nation state through mobilizing people's energy and resources for commonly shared developmental objectives. Instead, more often than not, fiscal fragility and retrenchment could aggravate distributional tensions and conflicts in an ethno-linguistically fractured society.

The gradual transition from systems of personal or authoritarian rule to democratic regimes since the turn of the 1990s was an important step towards laying institutional foundations for broad-

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[27] See Nissanke and Shimomura (2013).

based development. However, democracy cannot work in an institutional vacuum. As Aoki (2001) notes, institutional configurations for supporting the democratic state as a stable self-enforcing equilibrium domain can emerge only through an active interface between the government and private agents/domestic stakeholders, and can take different forms.[28] In many countries in SSA, where governments are heavily dependent on the donor community for financial resources as well as development policy designs, there might not have been sufficient focus on domestic resource mobilization through consolidating tax systems in return for 'quality public goods' provision as a means of intensifying a productive interface with the domestic stakeholders. This has in turn seriously undermined progress toward building a developmental 'nation state' and has acted as a critical impediment to the structural transformation of economies in SSA.

3.3 Emerging conditions in the new millennium under accelerated integration into the global economy

The international conditions for economies in SSA have been undergoing radical change on several fronts since the dawn of the new millennium. Commodity prices have experienced a boom on an unprecedented scale with the longest duration of modern times since 2002, driven largely by heightened demand for natural resources from emerging economies in Asia such as China and India.[29] At the same time, the protracted debt crisis of HIPCs-SSA finally ended with debt cancellation under the MDRI in 2005. China and other emerging economies such as Brazil, India, Turkey, South Korea, and capital-rich Gulf States have increased aid-cum-investment in SSA, offering a new kind of development partnership on the basis of South-South co-operation. Their activities have concentrated heavily on infrastructure development along with agriculture technology transfer, both of which are key binding constraints for economic development in SSA. They all offer development co-operation without *policy* conditionality attached, on the basis of a 'coalition' engagement, often taking a collaborative state-business approach through aid-trade-investment as a package. Examples include China's modus operandum, or private sector engagements through foreign direct investment (FDI), and acquisitions in the case of India and others.[30] The availability of new mobile technologies has also had an impact on growth constraints in terms of access to information and remote locations.

The surge in interest in resource-rich Africa from emerging partners has also had other tangible spillovers, hitherto unforeseen in Africa. Together with the commodity boom, it has brought substantial dividends in attracting much-needed investment flows, both in portfolio and direct investment, from other actors around the globe. There is a real sea change in investors' perceptions of SSA, something the region has longed for over many decades, as it desperately requires real investment, not 'handouts' from the rest of the world. Private investors have increasingly started taking Africa seriously as a key destination for their direct and portfolio investments. World Bank Development Indicators report a substantial increase of FDI to SSA from just US$1.2 billion in 1990 to almost US$40 billion in 2010. FDI growth accelerated noticeably from the mid-2000s onwards. While for 20 out of 28 low-income countries in Africa ODA remains the main external source, the prominent role of aid as a source of development finance has been diminishing, as

[28] Aoki (2001) discusses various forms of democratic and collusive states: market-preserving federalist states; liberal democratic states; social compact corporatist states, developmental states; and bureau-pluralistic states.

[29] See Nissanke (2010b, 2012).

[30] See Nissanke and Söderberg (2011) for detailed discussion of China's increased engagement with Africa, including China's domestic imperatives for its drive. Nissanke and Shimomura (2013) provide discussion on South-South Cooperation.

other external financial flows such as FDI and remittances, together with increased tax revenues from resource-based industries, have notably increased.

While a large proportion of FDI is still attracted to extracting natural resources, FDI geared towards the lower end of the vertical integrated global operations of transnational corporations (TNCs) such as simple assembly line operations started to flow in. FDI in the garment industry is one of the latter examples of TNCs' operations in a number of African countries on a footloose basis, attracted by temporary conditions such as preferential market access granted through the AGOA (Africa Growth Opportunity Act) or protections accorded under the Multi-Fibre Arrangement before its expiry in 2005. These activities are characterized by limited dynamic externalities and knowledge and skill spillovers. Only some very recent FDI in new knowledge- and technology-intensive sectors such as telecommunications, ICT or the production of solar panels or bio-technology-based agricultural products raise hope for a new generation of FDI activities that could be local market-based, and hence locked into Africa's future with commitment. Furthermore, private equity funds, venture capital, and other portfolio investors have also become active in some selective 'frontier' market economies such as South Africa, Kenya, Ghana, and Nigeria. Therefore, as long as the prevailing optimism regarding the future prospects for African economies continues with the resource boom, the task facing oil- and mineral-rich countries in SSA is not so much how to mobilize resources but how to deploy newly mobilized resources for structural transformation, diversification of their economies, and broad-based, inclusive development.

However, future resource flows into SSA will still depend on investors' expectations regarding the continuing thirst for natural resources from the rest of the world. The recent considerable softening of commodity prices reminds us of the vulnerability of CDDCs to shocks emanating from commodity markets. Commodity prices remain highly volatile and highly contingent on the growth prospects of the rest of the world, increasingly that of emerging economies. International portfolio capital attracted to SSA on the back of the commodity boom can be very volatile and pro-cyclical to commodity price cycles. It is prone to exit quickly as market sentiments shift, which makes it hard to be counted as a stable source of development finance. With increased private capital flows, Africa's liability-assets position with the rest of the world and its debt profile/dynamics may change significantly over time. In this regard, appropriate, invaluable lessons should be drawn from historical experiences to understand under which conditions debt cannot be growth-enhancing, and what should be done to avoid the repeat of the low equilibrium of low growth with high debt, historically observed in SSA.

Indeed, with deeper integration into the global economy proceeding at an accelerating pace, SSAn countries are confronted with fresh challenges not only in managing cross-border international flows but also in dealing with global actors on multiple fronts. For example, private entrepreneurs and rural farmers face formidable challenges in relation to global actors such as TNCs or financial institutions and investors engaged in cross-border transactions. For instance, TNCs dominate international trade and investment through intra-firm trade under their globally integrated production and marketing strategies, organized horizontally as well as vertically. This is reflected in their dominance in global value and supply chains. As a result, in agricultural production and marketing, there are considerable asymmetries in market power and access to information, technology and marketing know-how between TNCs on the one hand, and local entrepreneurs, farmers, and traders on the ground on the other.

In particular, the withdrawal of institutional support from governments means that access through public bodies and agencies to the provision of necessary inputs such as seeds or fertilizer and new technology is often no longer available to farmers. The institutional vacuum thus created is supposed to be filled by private agents and traders. This has often resulted in geographical fragmentation of marketing activities, and placed smallholders in a weaker position in relation to private traders affiliated with or directly employed by TNCs in both inputs provision and marketing of their produce. Thus, from the perspective of small producers and actors, production and marketing arrangements have become fragmented, as TNCs have hastened the integration of their global operations.

This parallel process of fragmentation and integration has resulted in a hugely skewed distribution of gains from growth in both production and trading activities. Under prevailing market structures, the TNCs and global supermarket chains can easily appropriate disproportionately large gains from productivity improvements, while fragmented producers and farmers are condemned to a meagre share. The governance structures of supply and value chains have become increasingly buyer-driven with a shift in the distribution of value skewed in favour of consuming countries. Farmers and smallholders are often paid a meagre fraction of the prices posted in world markets as well as exposed to risks stemming from volatile prices and insecure marketing arrangements. For example, the waves of domestic market and trade liberalization/deregulation transformed arrangements in the production and marketing of agricultural commodities, including cash crops such as cotton and coffee. Most state-run marketing boards were dismantled or downsized and price stabilization funds or mechanisms ceased to exist.

In mineral sectors, many concerns in SSA were privatized in the 1990s under the IFIs' auspices. Generally, negotiations conducted behind closed doors between TNCs and host governments over fiscal and tax regimes tended to produce outcomes decisively in favour of TNCs, since host countries, too much fearful of losing TNCs' interests in their location, offer unnecessarily generous fiscal concessions such as tax holidays or lower tax and royalty payment regimes. Indeed, in the presence of asymmetric access to information on TNCs' global strategy combined with little transparency in negotiation processes, these negotiations have often led to an adoption of a 'race to the bottom' strategy by competing host governments.

These episodes illustrate clearly how important it is to have strong governments who can truly represent the interests of nation states so that benefits from economic globalization would accrue to domestic stakeholders, to whom the natural resources really belong. It is imperative to build a developmental state, in which governments act as a protector of the interests of domestic stakeholders in the integration process. Such a state that is wholly accountable to its domestic stakeholders can emerge as a stable equilibrium only through intensive strategic interactions between the government and domestic stakeholders when *endogenous* institutions function in the national interest as a *self-sustaining system of shared beliefs.*

4 Concluding remarks

In order to explore how to build an institutional foundation for inclusive development in Sub-Sahara Africa, we first presented a review of the two theses in the recent literature on institutional economics. The first thesis, advanced by Acemoglu and Robinson (2012), explains how the two distinctive institutional regimes—*inclusive* economic and political institutions, and *extractive* ones—give rise to diverging paths of national prosperity and poverty. In their thesis, as an intense interface between political and economic institutions takes place, institutional drift is constantly observed in a society whilst major institutional shifts are possible when existing institutions encounter a historical event of an epoch-changing nature. Since distributional outcomes always reflect how political settlements are achieved out of conflicts over income, power, and institutions among different groups, the attention of the thesis to the influence of political institutions is noteworthy. However, their thesis is short of offering a framework for understanding how institutional change towards inclusive development could proceed in practice.

In contrast, the second thesis advanced by Greif (2006) and Aoki (2001, 2007) provides a framework more relevant to our aim of identifying actors and forces behind, and paths towards, institutional change. First, they suggest that since institutions as 'the rules of the game' are composed of *interrelated* components, various institutional *configurations* thus formed could be explicitly treated as a system, involving multiple equilibria. This would allow them to use a strategic game theory as a methodological tool to examine how a system of institutional configurations can either switch around different equilibria, or settle in a specific equilibrium as an outcome of political processes involving main actors as the 'players of the game' such as governments or different organizations bound by a common purpose. From this specific perspective, they define the concept of *endogenous* institutions and institutional changes.

In their analyses, the endogenous institutions are those with a *self-sustaining system of shared beliefs,* wherein institutions are *endogenously* generated resulting from an interface of formal and informal institutions, and they become *self-enforcing* through strategic interactions among various actors and organizations in four game domains: social norms; political states; economic contracts; and organizational architecture. Therefore, motivations for institutional change should also be endogenously provided. Since the interdynamics between institutions and organizations, as the rules and the players of the game respectively, are critical forces for such social change, institutional changes should be initiated and sustained by local organizations and actors found on the ground. This concept of endogenous institutions and institutional changes is set against a simplistic policy perspective of assuming that there is only one universally accepted set of institutions for development and that such model institutions are found in today's advanced countries. Instead, emphasizing the path-dependent nature of institutional configurations and their changes, this framework would explicitly recognize the need for promoting institutional and organizational diversity.

With this analytical framework in mind, the paper proceeded to discuss how institutional configurations have been shaped in Sub-Saharan Africa since independence under influences of both domestic and external conditions. We suggest that these conditions combined together have created an institutional trap that is detrimental to shared growth and inclusive development through a loop of negative private-public interfaces formed between governments and domestic stakeholders for economic development.

Recently, Sub-Saharan Africa has experienced a period of high growth that has attracted increasing attention from global investors since the new millennium. Ongoing globalization has been unleashing large forces for institutional change in the region, both technological and non-technological in nature. Presenting itself as an epoch-making critical juncture, these forces can bring about a shift in norms and behaviour, and hence, change in institutional parameters. However, a new institutional equilibrium generated purely by globalization-induced market forces alone is likely to be detrimental to inclusive development.

In fact, in order to foster inclusive development under globalization, it is necessary to move to a new equilibrium of institutional configuration, conducive to the formation of a truly *developmental state* that is capable of undertaking specific measures such as safety nets and appropriate regulations to protect the poor from the large downside risks associated with globalization. Governments of such a developmental state are also expected to take a pro-active pro-poor stance in enhancing access to information, technology, and knowledge, standing firm in negotiating good deals and protecting workers' and smallholders' rights with transnational corporations and international investors from traditional and emerging partner countries alike.

In reality, however, Sub-Saharan Africa is a region often noted to have a massive institutional deficit, which often manifests itself in poor governance at many levels: local, national and regional.

Despite the formal transition to 'democracy' achieved in many countries, serious concerns persist over slow progress in improvements in governance. These are, for example, reflected in a persistent distrust among stakeholders towards governments on account of pervasive corruption exercised by those in public office at many levels, including at the highest level of national governments. Most African countries rank very poorly in an annual global corruption barometer survey carried out by Transparency International.[31]

Meanwhile, even after more than a decade of the region's impressive economic growth, the 'informal' economy with its fragile activities has remained the mainstay of most African economies today. As most labour forces are absorbed into household-based activities or micro enterprises, the share of wage earners in the labour force (with or without permanent contracts) was around 2-3 per cent in the mid-2000s even in relatively more dynamic SSA economies such as Ghana, Rwanda and Tanzania (Lin 2011). The fragility of these activities is also evident in the very high share of vulnerable employment (82 per cent) and working poor (57 per cent) in total employment as recorded in 2010 (UNDP 2014).

These adverse conditions are associated with the low equilibrium of prevailing institutional configurations that evolved historically after independence. In particular, to overcome the institutional trap, a strong *coalition* between the government and domestic stakeholders/actors is essential. This can be achieved if the former makes concerted efforts to provide the latter with high-quality public goods on a sustained basis, so that domestic stakeholders feel tangible returns from their tax contributions, and a fragile informal economy is gradually mainstreamed into an official economy.

Thus, from an institutional, political economy perspective, the taxation-public goods provision nexus should be treated as an implicit *unified social contract* between the government and stakeholders for advancing a common developmental agenda. In this specific context, we argue for establishing fiscal *legitimacy* on the basis of strategic interplays between the government and domestic stakeholders for development through creating a virtuous circle in the taxation-public goods provision nexus. The scaling up of public investments and public goods provision requires a consolidation of domestic tax revenues on a stable basis. This could be achieved when private agents are assured that their government is accountable to them and it serves their collective interests. For this, the quality of governance at all levels of public institutions should be significantly improved by rooting out corruptive practices that have hitherto led to large-scale illicit financial outflows from the region.[32]

Developmental problems of SSAn countries could be overcome only through rigorous investments in production capacity and physical and social infrastructures, leading to transformation of their trade and production structures towards a broad-based pattern of development. At every step of this process, diffusion of knowledge and technology through 'learning-by-doing' should be encouraged within organizations as well as throughout institutional structures on the ground.

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[31] The indicator on control of corruption is defined in the World Bank Governance Indicators, as 'the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests'. Competition for political rents is said to be very high as such rents enable those holding high public office to amass enormous private wealth.

[32] Illicit financial outflows are not simply a thing of the past and have not been abated to date. Global Financial Integrity estimates that Africa lost US$55.6 billion each year in the decade that ended 2011, with outflows from Sub-Saharan Africa growing at a rate of 20 per cent annually (www.trust.org/item/20140808080141-h5x8o/?source=jtOtherNews1) (accessed 16 April 2015).

For this, Africa requires deeper *institutional transformation* towards building a developmental nation state that keenly recognizes the centrality of the taxation-public goods provision nexus for realizing its dream of transformation of economic and social structures. Building pro-development institutions, including strong nation states with a realistic development vision and strategy that are capable of mobilizing the aspirations of wide-ranging domestic stakeholders, is essential. This goes beyond just utilization of fiscal mechanisms for distributional purposes on an ex post basis. Institutional transformation should entail a shift from a low institutional equilibrium to a new equilibrium that is conducive to inclusive development. Such a shift should involve both the transformation of fragmented institutional structures based on small-scale traditional units and the formation of organizations for *collective action* and the orderly *resolution of distributional conflicts* across diverse and heterogeneous groups at many levels. Naturally, the actual path of such institutional transformation is country-specific, as it would depend upon strategic actions taken by different players of the game with a view to advancing an inclusive development agenda.

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