CHAPTER 2

The state and the private sector—partners in transformation

From the 1960s to the early 1980s governments in many Sub-Saharan countries pursued overly state-led development, often regarding markets and private businesses with suspicion and at times even trying to suppress them. Then from the 1980s through the 2000s the pendulum swung to the other extreme. Under reforms inspired and financed by the International Monetary Fund, World Bank, and some donors, the state was seen as the impediment to economic efficiency and growth. The goal was to roll it back and give room to markets and to business, which thus unshackled would propel growth and structural change while the state confined itself to setting the rules of the game, acting as an impartial umpire and supplying such public goods as education and health care. Neither approach transformed Africa’s economies, and the failure has engendered a search for new approaches, including a reconsideration of the two previous extremes.

Domestic firms in late-developing countries face difficult challenges in learning about and introducing new technologies, processes, products, and services—and breaking into foreign markets. A favorable business environment helps but seldom is sufficient. The experiences of almost all successful transformers show that the state can help business meet these challenges. But history also shows that state involvement in the economy can block private initiative, introduce inefficiencies, and retard economic progress.

Economic transformation thus requires getting the balance right between the state and private enterprise—and having effective mechanisms for the two to collaborate and support each other in the pursuit of economic and technological learning while paying sufficient attention to economic efficiency. This chapter looks at “market-oriented industrial policy” to promote economic transformation, interpreted broadly as a set of policies that promote the efficient production and export of a diverse range of technologically upgraded goods and services, whether from agriculture, industry, or services.
The right balance between the state and the private sector in promoting economic transformation cannot be prescribed. It will vary depending on each country's history, political system, and institutions—and on the specific economic challenges and opportunities it faces. And for any country the balance will change over time as its underlying conditions change. In light of this, the chapter does not provide a prescription for any one country. Instead, it discusses an agenda that is broadly relevant for a wide range of African countries, but that would have to be tailored to the circumstances of each country.

At the core of that agenda is active collaboration between the state and the private sector. Businesses large and small, primarily in the private sector, lead in producing and distributing goods and services, in upgrading technologies and production processes, in expanding and diversifying production and exports, and in expanding productive employment opportunities. But they can be helped by a capable state, which can also gain much from inputs from business in setting the national economic vision and strategy—and in fashioning policies, institutions, public investments, and incentive packages to support that strategy.

Organized labor and civil society also have roles. While organized labor is a small fraction of the labor force in African countries, it is very important to the modern economic sectors that are likely to spearhead economic transformation. Its cooperation with government and business is key to maintaining industrial peace and to supporting the continuing upskilling of workers to promote competitiveness. And strong third-party accountability mechanisms—involving parliaments, independent media, academics, think tanks, and other parts of civil society—can ensure that close collaboration between the state and business does not degenerate into crony capitalism and corruption.

The discussion here is informed by the experiences of countries that have been economically successful after the Second World War, particularly those in East Asia. It also benefits from much earlier experiences, since in many ways the East Asian countries (including Japan) learned from and modified the approaches of developed Europe and America in their earlier transformations. But it rests on three fundamental assumptions: first, there is peace and security in the country; second, the state is committed to a private sector–led economy; and third, the political leadership sees economic transformation as a top priority. If these conditions are absent, it makes little sense to talk about promoting rapid economic transformation.

Subject to these three assumptions, the state can promote rapid economic transformation by:

- Providing leadership in setting a coherent national economic transformation vision and strategy in consultation with the private sector and other key stakeholders.
- Managing the economy well and providing a business-friendly environment, which entails:
  - Providing a stable macroeconomic environment.
  - Managing public resources honestly and efficiently to provide the public goods and services essential for economic transformation, including infrastructure, education, public health, and port administration.
  - Maintaining a favorable regulatory environment for business.
  - Producing timely and quality economic and social statistics.

- Facilitating the private sector’s access to new technologies, supporting it to upgrade its capabilities to become more internationally competitive in the production of new products and services and facilitating its access to new export markets.

The functions under the second bullet are now widely accepted; at issue is how to perform them better. But those in the other two bullets—setting a national economic transformation agenda and establishing incentives and institutions to facilitate access to technology and markets and to develop capabilities to competitively produce new products and services—are not universally accepted. But developing new capabilities is critical in the early stages of economic transformation, and in most successful transformers the state did help business overcome its many challenges in this regard.

A voluminous theoretical literature discusses the conditions that justify state involvement in the economy and the risks of such involvement—often in terms of “market failure” and “government failure.” The main elements of market failure include information asymmetries, learning spillovers, coordination failures, increasing returns, and capital market imperfections. The main elements of government failure: government officials lack the relevant knowledge to enable them to make the right choices about which activities to promote; many public sector operations are inefficient; and rent-seeking behavior, particularly corruption, can be fueled by greater government involvement in business.

The many elements under market failure and government failure apply to almost all Sub-Saharan countries. So the focus should be on finding pragmatic solutions to both types of failures rather than
on emphasizing one type of failure to the neglect of the other. Note, however, that just because there is a market failure does not mean government intervention will make things better; it could make things worse. And just because government intervention could make things worse does not mean a country is better off living with market failures that shackle its economic transformation. What is needed is a pragmatic middle course that weighs the potential costs and benefits of government inaction against various options for government intervention—in what we call market-oriented industrial policy. The process is difficult and messy, but it is the only real option for economic transformation.

Setting and implementing a national transformation vision and strategy—the institutional framework

How can African countries begin to progress faster with low technology, limited human skills, scarce financial resources, and weak institutional capabilities? By having clear goals and priorities for activities and resources—and a national vision and an explicit strategy to carry it out. A national vision can inspire citizens and mobilize their support for sacrifices in the early stages of economic transformation. A well developed strategy can clarify the interrelationships among government branches and between relevant government and private sector activities—thus improving information, understanding, and coordination among the key players in the economy. And the targets in the strategy—aspirational but realistic—can help citizens and businesses in a democracy to hold government accountable for results.

Almost all Sub-Saharan countries periodically produce national economic plans, but these have not focused on economic transformation. The plans of the 1960s and 1970s were top-down, bureaucratic, and mostly state-oriented, with little input from business. Those in the 1980s and early 1990s focused mainly on macroeconomic stabilization and economic liberalization. And starting from the mid-1990s they began to focus on poverty-reducing public social expenditures. Called Poverty Reduction Strategy Papers (PRSPs), many of these plans were required for countries to gain access to donor resources.

Producing a PRSP had to involve stakeholder consultations that donors often promoted and funded. In many countries donors also financed consultants to provide technical inputs to the papers. The focus was on setting priorities for public (and donor) expenditures for poverty reduction—not for promoting economic transformation. Whether national leaders owned the process and content of PRSPs is an open question.

Sub-Saharan countries have in recent years begun to take the lead in producing medium- and long-term strategies more focused on the growth and transformation of their economies. In Ghana, Ethiopia, and Rwanda the new strategies result from the countries taking more ownership of the PRSP process (box 2.1). In Kenya and Nigeria they emerge from a separate process, not always related to the PRSP.

Box 2.1 Next-generation transformation plans

Ethiopia launched its Growth and Transformation Plan for 2011–15 to maintain an average real GDP growth rate of at least 11% and to achieve the Millennium Development Goals. Under the plan it would expand and ensure the quality of education and health services, establish suitable conditions for sustainable nation-building through a stable democratic and developmental state, and ensure the sustainability of growth within a stable macroeconomic framework.

The aim is to build an economy with modern, productive, and technologically enhanced agricultural and industrial sectors that lead in the economy. To this end, the plan includes clear targets: for exports of flowers, coffee, meat, and vegetables in agriculture, and exports of sugar, textiles and garments, and leather and leather products in agro-based manufacturing.

The plan also targets pharmaceuticals and medical supplies—and metals and engineering. For pharmaceuticals and medical supplies the target by the end of the plan period is to raise the share of local production to 50% from less than 15%. For basic metals and engineering the target is to raise capacity use in the sector to 95%, raise per capita metal consumption to 35 kilograms from 12, and eventually have local production meet the demand for components and parts by key manufacturing sectors such as leather, textiles, cement, and agroprocessing.

Source: ACET 2012a.
Often, however, the expenditures in the annual budgets bear little relation to the priorities in the medium- or long-term strategies—and even less so when separate government ministries or agencies carry out the two functions of planning and budgeting.

A central agency to coordinate the implementation of transformation strategies

One of the biggest challenges that many Sub-Saharan countries face in promoting economic transformation is coordination within government to produce and implement realistic plans. Many plans are produced by planning agencies using experts from outside government, with little input and commitment from senior staff in other government ministries and agencies. A planning ministry, if separate from the finance ministry, may have little influence in ensuring that expenditures in the plan are actually reflected in the budget—making planning a paper exercise. Having planning and finance under one ministry could solve this problem, but it could also create the problem that the short-term exigencies of finance swamp the long-term studies and reflection needed for planning.

Since almost any serious transformation initiative would cut across several ministries and agencies, close coordination is needed.5 This can be done only by an agency whose authority is accepted by other ministers and by the staff in other ministries and agencies. In some cases, coordination is overseen by a powerful minister—a planning minister, a finance minister (or someone holding both portfolios), or a minister of trade and industry—regarded by colleagues as senior to them. In other cases, coordination is performed by an agency directly under the president, vice president, or prime minister. Perceived as having a higher rank, this agency can convene meetings of various arms of government, assign tasks, monitor implementation, and discharge rewards and sanctions as occasions warrant. In addition to its location in the hierarchy of power, the agency needs to be staffed by top class professionals in order to be up to the tasks required and to earn the respect of other units in government.

Archetypal examples of a central coordination agency include:
- The Ministry of International Trade and Industry in Japan for several decades after the Second World War.
- The Economic Planning Board of South Korea, under a Deputy Prime Minister.
- The Council for Economic Planning and Development and the Industrial Development Bureau in Taiwan (China).
- The Economic Development Board of Singapore, initially under the Ministry of Finance, but later under the Ministry of Trade and Industry.
- The National Economic and Social Development Board of Thailand, under the office of the prime minister.
- The National Development Council of Malaysia, under the prime minister and in charge of coordinating implementation of the development plan at the federal level.
- The Planning Commission of India, with the prime minister as chairman, but run by the deputy chairman, who is of cabinet rank.

Even the United States, that great proponent of free markets, has the National Economic Council under the Office of the President. It is difficult to find institutions playing comparable roles in Africa. But some countries are taking steps to improve coordination of economic policy and implementation in government. Notable examples are Ethiopia and Rwanda, where the heads of governments—the late Meles Zenawi in Ethiopia and Paul Kagame in Rwanda—play very active roles in economic policy coordination. Another example is Nigeria, where the minister of finance is now also the senior minister in charge of the economy.

State-business deliberative mechanisms

While the state should provide leadership in setting and guiding the transformation strategy, it is entrepreneurial firms—that will spearhead the creation of employment and the production and distribution of goods and services that drive economic transformation. That is why government should create mechanisms that bring it into regular contact with business to seek its inputs. State-business engagements should aim at three objectives: to seek business inputs on medium- and long-term national plans, to seek feedback from business on how government policies and programs affect them, and to seek inputs to the design and monitoring of specific transformation initiatives.

Several Sub-Saharan countries have made some progress on the first objective of seeking business inputs on national plans, spurred partly by the PRSP process. But business participation could be deepened beyond consultation. A good example in this direction was the process in Kenya to prepare its Vision 2030 Plan. The National Economic and Social Council that spearheaded its preparation comprised business people and public officials.

On the second objective—seeking feedback from business on the impacts of government programs—several Sub-Saharan countries have public-private forums that meet
periodically (say, once or twice a year) to discuss issues affecting the private sector (box 2.2). A good beginning, but these large meetings are too infrequent, and they tend to be long on ceremony and short on fact-based discussions of issues. And in some countries, various business associations submit presentations to the government during budget preparation time, advancing their particular interests. These exchanges between the government and business are welcome, but they could be improved.

The discussions should be substantive reviews of the impacts of government policies and actions on the general environment for business operations and how it could be improved—not focusing on special favors for particular business subgroups. The meetings should be chaired by the head of government or of the central coordinating agency. A secretariat should prepare analyses and reports to be discussed at the meeting and follow up on decisions taken and monitor their implementation by the relevant agencies.

Kenya’s National Economic and Social Council, with meetings chaired by the president or prime minister, goes in this direction.7 Mauritius also has a well developed consultation mechanism between the government and business through the Joint Economic Council, an umbrella organization for business.

The third objective—deliberating on selected transformation initiatives, on the instruments to promote them, and on the monitoring and compliance mechanisms—is not well developed. This stems in part from the low capacity and organizational weakness in government to translate general objectives in economic plans to specific initiatives to discuss with business. It also stems from the fact that throughout the 1980s and 1990s, Sub-Saharan governments, heavily dependent on donor funding, were encouraged to focus on macroeconomic management and poverty alleviation—and to leave production, exports, and finance to the private sector. In addition, some governments in the region, despite their new pro-business rhetoric, still have not embraced business as a partner with knowledge and expertise that the state can benefit from.

Government technocrats can come up with transformational initiatives that they would want the state to promote. But however smart they may be, they do not live and operate in the business world every day. Businesspeople do, and so can supply the market-informed perspectives that could make the difference between a well designed promotional initiative and an economic disaster. Sub-Saharan governments that want to promote economic transformation should court this knowledge, as governments in Japan, South Korea, and other East Asian countries did regularly in driving their economic transformations.8

**Bringing in organized labor**

Organized labor is another key part of the collaboration, particularly in democracies where labor can exercise the right to strike. Popular support for the economic

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**Box 2.2 Rwanda—business speaks out**

“Work hard,” Rwanda’s president, Paul Kagame, tells businesspeople. But the hundreds gathered at the Amahoro mini stadium have hardly come for a lecture. They have come to speak out. The president encourages them to do that, too: “You must speak up about challenges you face.” The event is Rwanda’s annual public-private dialogue, a structured platform for joint solutions to lift the constraints on business and growth.

Informed by similar platforms in Mauritius and Singapore, the dialogue is a joint initiative of the Rwanda Development Board and the Private Sector Federation. As an integral part of the nation’s 2020 transformation strategy, it fits in a broader framework for state-business collaboration. The state funds 30% of the budget of the joint initiative, with a goal to build capacity and conduct research that feeds back into government policy for removing the challenges to enterprise development.

The dialogue is an improvement on previous mechanisms that did not work as planned. And it takes lessons from other countries’ experiences, including that of Singapore.

Across the globe, public-private dialogues are initiated by governments, entrepreneurs, or third parties. One cross-cutting lesson is that the most tangible outcomes from dialogues are policy reforms. In Rwanda the president’s leadership on the dialogues enhances the chances that they would lead to real reforms and remove the constraints to growth and transformation.

*Source: ACET research.*
transformation vision is also necessary to gain acceptance for the difficult reforms that may be required, and having labor on board could help in this. In some East Asian countries the political regimes either controlled the labor unions (South Korea) or co-opted them into the ruling party (Singapore) in the early parts of their transformation drives. So organized labor was not an independent force that could challenge the transformation process. For several Sub-Saharan countries that are now democracies, independent labor unions exist and their interests should be considered. Organized labor can indeed play very important roles, particularly in skill development programs, including the upskilling and continuing education of the workforce. In 1987 Ireland brought in organized labor as a third partner, along with the government and business, to promote economic transformation—and over the next decades the country’s economic transformation was so dramatic Ireland earned the appellation, Celtic Tiger. Many other countries, particularly in Scandinavia and post–Second World War West Germany, have pursued variants of this approach of engaging organized labor in a partnership for economic transformation.

Third-party transparency and accountability mechanisms

How to ensure that strong collaboration among the government, business, and labor does not degenerate into cronyism among politicians, senior bureaucrats, big business people, and labor bosses? By having academics and staff from independent economic think tanks as members of the deliberative bodies. And by making the decisions and their rationales available to the public (through the secretariat’s website and the media).

The incentive packages to promote the initiatives and the associated eligibility and performance criteria should also be published, along with the beneficiaries and performance assessments. In countries with strong and independent parliaments, the legislature can insist on having such information available, so that it can enforce accountability. Civil groups, including the media, could also demand the information and use it to push for accountability. And foreign donors supporting economic transformation could support competent civil society groups and think tanks to enhance their ability to promote transparency and accountability.

Economic transformation is a long-term process requiring sustained efforts over long periods—30 years or more—before a country really begins to take off. Such sustained efforts are not possible where national visions and strategies change every four or five years with elections. Almost all the East Asian transformers went through decades of single-party rule. Sub-Saharan Africa now has more countries conducting free and fair elections that can change governments. Each new government naturally wants to pursue its own economic program, but if the country keeps changing its vision and strategy every four or five years, it is unlikely to make much headway on economic transformation (box 2.3).

How best to solve the conundrum? Aim for a broad-based process in producing the vision and the strategy, involving the government in power, the major political parties, the private sector, and the key economic policy–oriented civil society groups, including independent academicians and the media. The national vision would be widely shared and the long-term strategy reflecting the vision would have broad goals and a range of targets, but without specific programs or projects. Each government that comes to power would then produce a medium-term economic plan with programs and projects consistent with the long-term strategy.

Adherence by new governments to the vision would be promoted through public discussion, and businesses, academics, media, and other stakeholders that helped formulate the long-term strategy would have an interest in it not being abandoned. The vision and the strategy would be national, but the medium-term implementation plans and annual budgets would reflect the priorities of the government of the day.

Managing the economy well and providing a business-friendly environment

Promoting economic transformation requires the state to support the private sector in overcoming specific challenges related to learning to competitively produce new products and services, upgrading technology, and accessing new markets. But specific state support initiatives must be within a policy and institutional environment conducive to the pursuit of business and entrepreneurship. Otherwise the specific and isolated promotional initiatives are unlikely to lead to economic transformation. The list of state functions that could help provide an environment conducive to business can indeed be very long, but in view of capacity constraints in most African countries, it would make sense for the state to focus on performing a core priority set of functions effectively.

Among the core set are macroeconomic management that avoids high inflation and high public debt and an exchange rate that is managed to keep exports competitive. After decades of structural adjustment programs and reforms
Expenditures should be allocated in line with the objectives of the economic transformation program—and government projects appraised and selected professionally (box 2.4). They should be undertaken efficiently to ensure value for money. And they should be monitored and reported on in a timely manner.

In many Sub-Saharan countries the capacity for efficient management of public investments has deteriorated severely over the years. This capacity needs to be revived and strengthened if the state is to contribute to investment for economic transformation—or if it wants to ensure that investments financed by external partners are aligned with its transformation agenda. The need for efficiency is especially important for poor countries,
Government efforts to institute efficient and transparent procurement could be worth more to a country’s economic transformation than the efforts deployed chasing external donor finance. Indeed, Africa’s economic transformation is severely constrained by inadequate infrastructure, where the annual gap in funding is estimated to be around $45 billion. In addition to strengthening capacity to use public resources efficiently to provide infrastructure (and other critical public services), there is the need to strengthen capacity to attract and manage private resources for public infrastructure through public-private partnerships (PPPs). In many African countries the legal and government institutional frameworks for PPPs are still very weak. Strong capacity in government for public investment management also enhances the capacity to properly appraise PPPs.

Making public procurement efficient and transparent

Corruption in government has deservedly received much attention in recent years. In promoting economic transformation, a key aspect is reducing the corruption in government procurement. In many Sub-Saharan countries substantial amounts of finance for public investments are siphoned away by corrupt politicians and officials. The result: shoddy projects that deliver poor services. And when officials award projects to the highest bribers, tenders get unduly disputed and prolonged, and projects get abandoned or construction times excessively delayed as contractors struggle to implement the projects after having paid the hefty bribes. Another result is tying up public resources in uncompleted projects, thus holding back economic growth and welfare. Government efforts to institute efficient and transparent procurement could be worth more to a country’s economic transformation than the efforts deployed chasing external donor finance (box 2.5).

Administering customs, seaports, and airports honestly and efficiently

Trade and tourism create jobs and boost foreign exchange to pay for imports, which provide technology, machinery, goods, and services. But the right government policies, institutions, and investments are necessary to fully realize the potential benefits.

Box 2.4 Chile’s system for evaluating public investment

Chile has decades of experience in the systematic appraisal of public investment and discipline in public finances. In 1975 the government established the National System of Investments to appraise every modern public investment project on the basis of cost-benefit analysis. The system improves the quality of public investments by selecting the projects with the highest net social present value. Under the law the capital budget that the Ministry of Finance sends to Congress can include only projects within the National System of Investments, projects that have also been favorably assessed by the Ministry of Planning.

Before the Ministry of Planning starts to appraise a public investment project by performing full-fledged cost-benefit analysis, a policy idea by a government unit or agency is first assigned a project ID and further developed into a project profile subjected to legal, technical, and socioeconomic assessments. The project ID is then entered into the National System of Investments, awaiting further analysis—which includes legal issues, alignment with policy priorities, environmental issues, and stakeholder participation—by the Ministry of Planning for a go or no-go recommendation.

An honest and efficient customs administration facilitates trade and contributes to government revenues, since trade taxes are a big share of government revenues. But the government’s desire to control corruption can lead to cumbersome customs procedures, which impose additional costs on traders and reduce international competitiveness, particularly for exporters. In this age of global supply chains with just-in-time sourcing by foreign buyers in a wide range of products, long delays at ports due to inefficient administration, cumbersome customs procedures, and extortions for bribes reduce the ability of a country’s exporters to compete. Simplifying and expediting port customs procedures and controlling corruption should be key priorities in promoting economic transformation (box 2.6).

**Building statistical capacity**

Timely and high-quality economic and social statistics widely available to the public are critical for the government to formulate realistic plans, monitor implementation, and correct course when necessary. They also help businesses and donors in making investment decisions. And they allow citizens to hold governments accountable for their economic plans and promises. But many Sub-Saharan countries do not regularly collect and publish data on their productive sectors or on employment. Industrial and agricultural censuses as well as labor force surveys are few and far between. So governments do not really know what industrial products their countries produce or could produce. Nor do they know the scope or nature of unemployment. Even for budget data, which should be fairly easy to compile, only a small number of countries produce timely, regular,
Entrepreneurship and competition among domestic firms need to be encouraged, and unnecessary government regulations should not stand in the way. With the support of donors much effort has been put into collecting statistics on poverty, even as national statistical systems have been deteriorating. This needs to be corrected, and the African Development Bank is providing important help in this area (box 2.7).

Streamlining regulation

Economic transformation essentialy involves learning to produce new goods and services competitively, conducting economic activities more efficiently using better technology and processes, and getting into new markets. The learning entails exploration and experimentation, and the more actors engaged in these processes and the faster and cheaper they can implement their planned activities, the greater are the chances that a country will make progress on economic transformation.

Entrepreneurship and competition among domestic firms therefore need to be encouraged, and unnecessary government regulations should not stand in the way. And streamlining regulations does not require much additional government expenditures; if anything, the government could save money by eliminating unnecessary processes. The private sector could also save money as the burden of corruption from excessive and cumbersome regulations is reduced. So a critical requirement for economic transformation—streamlined regulation—can also be cheap and a win-win for the government and for the private sector. The only losers are corrupt public officials.

Hard-pressed for financial resources, a government should extract the maximum benefit from streamlining regulations as it explores what more to do in more complicated and costly areas to speed up economic transformation. Though controversial in some respects, the Doing Business ranking of the World Bank is one source for countries to see how they compare with others in regulation. But policymakers should supplement that information with their own in-country analyses.

Building centers of excellence

The functions at the core of the state’s support to economic transformation have to be performed well, so the institutions responsible for them and their staff have to be first class. These institutions

**Box 2.6 Customs reform in Cameroon**

Customs reform should be comprehensive, based on three principles:

- **Strengthen accountability**—regularly publish revenue collection data and other customs performance data in the media with a strong oversight committee or appoint an external auditor to scrutinize activities.
- **Make information more symmetrical** between the head of customs and the frontline customs officers—have accurate information on economic activities and behaviors.
- **Design new human resource policies**—adopt new reward procedures and structures for frontline customs officers and consistently monitor performance.

Cameroon customs launched a reform and modernization of its customs administration in 2007—to reduce corruption, long a stain on the reputation of the administration. The reform began with ASYCUDA, a customs clearance system that enables the administration to track the processing of each consignment. It measures the performance of customs officers and criteria relevant to the reform, such as complying with the deadline for consignees to record the manifest.

The first phase yielded good results, but a second phase stalled. So Cameroon customs introduced performance contracts in 2010, signed by the director general and frontline officers in the port of Douala. The contracts focused on speeding up processing and reducing fraud and corruption. The goal was to develop a culture in customs agencies based on positive performance.

After four months of implementation the initial results were encouraging (including lower corruption, higher revenue collection, and shorter clearance times) and pointed to the birth of a new professional culture. For instance, customs revenues, only CFA 324 billion in 2004, rose to CFA 504 billion by 2010. Duties and taxes assessed from Douala Port I were up 6% from the same period in 2009, even though the number of imported containers was down 3%.

Change is possible—and rewarding.

Source: Cantens, Raballand, and Djeuwo 2011.
Appointments to head the core functions should be based on competence and the ability to deliver results—and should not be for repayment of political debts. The same applies to the directors and officials of these ministries and agencies. And these officials should be empowered and supported to run their units professionally. Many African countries now have talent pools—in government, in business, in academia, in think tanks, and in the diaspora—that leaders can tap.

Such implementation bodies as customs, ports management, and investment and export promotion agencies could be made into semi-autonomous statutory bodies with terms and conditions of service different from those in the civil service and set to attract the best. Appointments to these statutory bodies outside the civil service should be based on contracts, and continued employment should be based on performance, as specified in the contracts, not on changes in governments or the whims of political leaders.

Ideally, countries would reform and strengthen the entire public service, not focus on a few core ministries and agencies. Some African countries are now boldly pushing broad reforms. But for many it will take time to change the culture in the public service and to find the resources to provide adequate remuneration to attract top talent. The focus on a few core ministries and agencies is thus a pragmatic first step toward later broad public service reforms. The reformed core ministries and agencies could serve as centers of excellence and beacons for others in the public service to emulate. And if these centers help accelerate economic growth and transformation, resources would be generated to finance and sustain reform in the rest of the public service.

**Helping businesses master new activities, technologies, and markets**

In addition to performing the core functions well to facilitate all economic activities, governments can also support specific initiatives to accelerate economic transformation.

**Promoting private foreign investments and exports**

Most Sub-Saharan governments have agencies to promote investments and exports. Sometimes one agency performs both functions, as with the Rwanda Investment and Export Promotion Agency and the Botswana Export Development and Investment Authority. Sometimes there is a separate agency for each function, as with the Ghana Investment Promotion Center and Ghana Export Promotion Authority and the Uganda Export Promotion Board and Uganda Investment Authority.

Where separate agencies are involved, good coordination is key, particularly when going after foreign direct investment (FDI) to set up in the country to produce manufactures for export, since this combines both investment and export promotion (box 2.8).
FDI, particularly in manufacturing, can facilitate a country’s access to technology, better management practices, and global value chains. But to realize these benefits the country has to have a clear strategy for attracting the right kinds of FDI, developing skills, and promoting links between foreign and domestic firms. An important part of export promotion is providing information on foreign markets to domestic enterprises and facilitating their access to those markets. This function was performed very well by the

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**Box 2.8 Leading transformation—the buck starts here**

In August 2011, late Prime Minister Meles Zenawi went to Beijing, advised by Justin Lin, then chief economist at the World Bank, about the rising wages and pending relocation of the Chinese shoe industry to low-income countries. Zenawi’s mission? Bring a factory back to Ethiopia.

Meeting with Chinese investors on this trip, Zenawi emphasized that Ethiopia’s transformation plan was targeting industrial development to grow its economy. In that spirit, he invited the investors to visit Ethiopia, which they did two months later, to consider prospects for investing in the country in areas that would provide jobs and boost exports.

The investors were enticed by Ethiopia’s low wages, social stability, and double-digit GDP growth over the previous 10 years. They were also impressed by the government’s proactiveness to make FDI attractive, manifested in this visit by the Prime Minister and the appointment of deputy trade minister as the project’s champion.

In January 2012, five months after the Prime Minister’s visit, the Huijan Group opened a shoe factory outside Addis Ababa, Ethiopia’s capital, hiring 550 Ethiopians. With plans for expansion into a multibillion dollar industrial park and projected to create 30,000 jobs by 2016, this factory has become one of Ethiopia’s largest exporters, earning worldwide praise as a promising model for transforming African economies.

The Huijan Group, a large-scale Chinese shoe manufacturer, had seen a win-win formula in the making. Like most African countries, Ethiopia boasts young, abundant, and eager labor at low wages. Besides, Ethiopia’s established cattle industry provided consistent raw material, which, with Huijan’s capital and expertise, promised a winning formula.

The success of the partnership is due in large part to the government’s focused efforts. In addition to attracting Chinese investors, the government offered four-year tax breaks, cheap land for factory development, and low-price electricity to investors who set up in the industrial zone.

Contrary to popular perceptions of Chinese attitudes toward Africa, Huijan’s Vice President and General Manager for overseas investment, Helen Hai explains, “One thing in my strategy is very clear: I don’t want to compete with locals,” she says. “I want to help them grow because when local producers grow, the whole market is growing. If it is just myself growing here in five years’ time, I will leave.”

Zemedeneh Negatu, managing partner at Ernst & Young Ethiopia, applauds Hai’s efforts to transfer skills and build a complete supply chain for the shoe industry. He says, “That should be the goal. You create clusters around one or two major foreign or Ethiopian investors, throughout the country, based on competitiveness and comparative advantages. It should be made clear to investors that they need to help build local capacity.”

Other African countries can learn from this project, above all the need for leadership at the highest levels to make projects happen. Two other key lessons are to target sectors in the economy’s comparative advantage and to integrate various elements of a transformation strategy. Taxation, power generation, and skills training had to come together to make the project work.

Investors can also learn—that producing and exporting profitably in Africa is possible and that, with government support and citizen motivation, the traditional barriers to business on the continent can be overcome.

Source: ACET research.
China External Trade Development Council of Taiwan (China) and the Korean Trade Promotion Corporation in those countries’ transformation drives (chapter 3).

Generally in Sub-Saharan Africa the agencies responsible for investment and export promotion do not receive high priority. They are not held to targets, their accomplishments are not publicly honored, and their failures are not punished. So they tend to be bureaucratic and passive, going to trade fairs and essentially waiting for investors and exporters to come to them rather than researching, identifying, and aggressively pursuing potential investors and exporters as demonstrated by successful agencies in Ireland (the Industrial Development Agency) and Singapore (the Economic Development Board).

Often, countries use special industrial parks or special economic zones to promote investment and exports. They can provide first-rate power, water, and factory shells and logistics in a localized area, and they can be financed partly or fully by business.

The parks and zones enable piloting simplified regulations and procedures and fiscal exemptions, while also allowing customs exemptions. Because reforms are not easy to introduce rapidly on a national scale, piloting of new approaches and special treatment in the parks and zones may be justified in the short to medium terms. But the aim should be to gradually create a uniform national system by extending good practices in the parks and zones to the whole economy—or by removing the policy distortions that make it necessary to provide the special treatments.

Africa has more than 100 special economic zones. Except in Mauritius, they have not been very successful. The main reasons are lack of government commitment to the program, weak links to a national economic agenda, policy reversals, high cost and unreliable infrastructure, poor locations, ineffective planning and management, and bureaucratic and opaque procedures that investors have to go through to access the incentives.

Providing access to land for commercial agriculture

Africa’s comparative advantage in agriculture and agroprocessing is not being realized because modern commercial farmers have difficulty gaining access to land due mainly to the communal land tenure. In other regions of the world a small number of landlords controlled large tracts of land while many in the rural areas were landless—so the solution was to redistribute land. But communal tenure in Africa is much more complex, so the solutions are correspondingly complex.

Countries need to continue exploring various approaches to finding lasting solutions. In the meantime potential investors in modern commercial farming should get access to land in ways that avoid complicated and prolonged disputes but that also respect the rights of communities and the environment. For example, Ethiopia’s cut flower export industry was greatly facilitated by the government’s helping the first foreign investor obtain land. This is probably easier in Ethiopia where all land is vested in the state. But even in many other countries, the state could acquire (purchase or lease) tracts of land through negotiation with communities, and make them available to potential investors in modern commercial agriculture. At a minimum the state should have a streamlined program that mediates between potential investors and communities—expediting investor access to land in a way that safeguards the interests of communities, just as it has one-stop shops for potential investors in industry.

Conducting R&D to support domestic enterprises in targeted activities

Conducting agricultural research and extension to introduce small-scale farmers to new products, inputs, and practices have long been recognized as a legitimate government role. In many African countries it facilitated the introduction and expansion of agricultural exports during colonial times, as with the cocoa and palm oil research institutes in Ghana and the tea research institute in East Africa, now the tea research foundation in Kenya. Similar approaches can promote the production and export of promising new agricultural products, particularly in processed forms, as Malaysia did in oil palm and Chile in wine and salmon.

The same logic that justifies support to small-scale farmers through research and extension can be applied to small-scale firms in manufacturing, and indeed most domestically owned manufacturing firms in Africa are small. Taiwan’s (China) Industrial Technology Research Institute supported small and medium-size manufacturing firms with research and extension (box 2.9). Such support strengthened the capabilities of Taiwanese firms to become exporters as well as suppliers to FDI firms in the country.

Providing finance

Producing goods and services that are new in a country and entering new export markets are risky. If a pioneer enterprise succeeds, other enterprises can emulate it and benefit, with the whole country also benefiting. But private commercial banks unfamiliar with product innovations or new markets may consider the pioneer
There is a case for facilitating and underwriting some of the costs of pioneers.

Box 2.9  R&D for small enterprises—Taiwan’s Industrial Technology Research Institute

Founded in 1973 to accelerate industrial technology development through pioneering research, the state-sponsored Industrial Technology Research Institute (ITRI) has been a key driver in transforming Taiwan’s (China) economy from labor-intensive to high-tech industries, under the supervision of the Ministry of Economic Affairs.

Over its 40 years ITRI has been dedicated to research, development, and industrial services and to assisting the government in executing industrial technology policies and promoting industrial development by nourishing technological capabilities. Its accomplishments include establishing high-tech industries, applying various technologies in those industries, improving industrial structures, advancing Taiwan’s international market competitiveness, promoting environmental protection, and more generally enhancing the quality of life.

ITRI holds more than 17,659 patents, and many well known high-tech companies in Taiwan—including such leaders in semiconductors as TSMC and UMC, trace their origins to ITRI. As an incubation center, ITRI has spun off more than 162 companies. Many companies in Hsinchu Industrial Park are ITRI spinoffs, and about 50% of the manufacturers have some sort of partnership with ITRI for joint development, technology transfer, or technology services.

ITRI, a nonprofit R&D organization, focuses on six research fields, information and communications; electronics and optoelectronics; material, chemical, and nano technologies; medical device and biomedical technologies; mechanical and systems technologies; and green energy and environment technologies. It has aggressively researched and developed countless next-generation technologies, including WiMAX wireless broadband, solar cells, radio-frequency identification, light electric vehicles, flexible displays, three-dimensional packaging of integrated circuits, and telecare technologies.

Source: www.itri.org.tw/eng/econtent/about/about01.aspx.

In most countries the state has stepped in to complement private banks in providing finance for long-term investment, risky innovations, and small enterprises. Indeed, for financing innovations and small enterprises, even the most developed countries still provide state finance.

Many states have development banks or finance institutions to complement private finance. Interest rates on loans from these banks have sometimes been subsidized or set below market rates. In the decades after the Second World War the Japan Development Bank (JDB) did this for domestic firms. Indeed, a JDB loan often was a seal of approval that crowded in additional private finance, since the project was then seen as a high priority in the national transformation agenda—and viable, given the JDB’s reputation for quality appraisal.

Korea, Singapore, and Taiwan (China) also used development banks to good effect.

Brazil’s Banco Nacional de Desenvolvimento Econômico e Social, now bigger than the World Bank, is a state-owned and professionally run development bank that has supported the country’s economic transformation. More telling, the role of government-owned or supported development banks in providing access to long-term and cheaper finance to promote economic transformation is recognized in the very existence of the World Bank, the African Development Bank, and other regional development banks. So the issue is not whether to have government-owned or affiliated development banks. It is how to ensure they are run efficiently and effectively to pursue economic transformation.

ventures too risky and price their loans too high. The same applies to pioneering efforts to upgrade technology. So there is a case for facilitating and underwriting some of the costs of pioneers. Sometimes, breaking into new products requires coordinated investments in the value chain and in the required infrastructure. Private lenders are unlikely to take this on, except with substantial incentives from the public sector. And almost all domestically owned production firms in Sub-Saharan countries are small and thus have difficulty getting finance from private commercial banks.

So, if domestically owned private enterprises are to be part of the economic transformation process in Sub-Saharan countries, ways need to be found to address their access to finance for going into new products, technologies, or exports.
Many Sub-Saharan countries have, or have had, development banks. But few of them have performed well.\textsuperscript{21} Aside from the severe macroeconomic instability and extreme financial repression once common in the region (but now less so), three main reasons account for the failure. The banks were usually fully owned by the state, which often appointed management based more on political than professional considerations. They operated in an economic environment often heavy with state enterprises and hostile to private enterprises, and therefore lacking entrepreneurial clients. They were not held to account on the basis of clear targets in a national transformation agenda. Most were just another state enterprise doling out money to other state enterprises and well-connected private operators.

Some collapsed and some were justifiably privatized in the wave of privatizations in the 1980s and 1990s. Others remain, but with the possible exception of the Development Bank of South Africa, the Botswana Development Corporation, the more recent continental African Finance Corporation (of Nigeria), and to some extent the Ethiopian Development Bank, they are not doing much to support economic transformation. Correcting this should be a very high priority for institutional and governance reforms (box 2.10).

The rationale for providing domestic firms with access to export finance is similar to that for having development banks provide long-term finance. Exporting is riskier than selling on the domestic market, particularly for new exporters and those exporting to new markets. The time between shipping goods and receiving payment is longer, and credit on favorable terms helps exporters bear this implied financing burden without having to raise prices, which would put them at a competitive disadvantage.

Such help is justified since the country benefits from higher foreign exchange receipts and higher domestic employment. Most developed and rapidly growing developing countries run state export finance facilities. Several Sub-Saharan countries also run export finance agencies (box 2.11), but they have not been very effective. Several of the principles for reforming development banks could apply to reforming export finance agencies.

**Strengthening links with small firms and farms**

Given that the formal sector in many Sub-Saharan countries employs no more than 20% of the labor force, links should be sought between the dynamic transforming subsectors in the formal sector and the informal sector, including small firms and small farms. This will in many cases require raising the capabilities of the small enterprises to become competitive suppliers to large formal firms. One way to raise the capabilities of informal firms is to create very basic industrial parks next to selected technical institutes. Water, electricity, and simple sheds could be provided to qualifying artisans at affordable rates. The technical institutes would provide technical advice and simple solutions and training to artisans in the adjacent industrial park.

Governments should also explore areas where they can increase the capabilities of smallholders as suppliers to commercial farmers and processors and should give commercial farmers incentives to reach out to neighboring smallholders, as in outgrower schemes (chapter 6). They could also facilitate institutions that help smallholders and commercial farmers negotiate and enforce fair contracts in their relationships (to avoid smallholders being cheated in pricing and to avoid commercial farmers being cheated by smallholders who take subsidized inputs from them and sell their outputs to others).

Links should also be explored for extractive resources (oil, gas, and minerals) through upstream and downstream activities in the extractive value chain (chapter 7). The activities could range from the basic (such as catering services) to the more sophisticated (locally owned small firms supplying manufactured inputs and technical services or using extractive outputs to manufacture products).

**The entrepreneurial nation**

Economic transformation entails learning and mastering new technologies, learning to produce new goods and services competitively for global markets, and breaking into new export markets. It thus requires taking risks—making bold, but informed bets. In a sense, it requires the whole nation to become entrepreneurial. The state and the private sector have their respective roles in advancing this goal, and working together they can leverage each other’s contributions for a greater collective impact. The state, given the constraints on human and financial resources, needs to focus on core transformation functions and perform them well. This will require creating centers of excellence in the public service by strengthening the institutions that perform these core functions. Over time, other parts of the public service could also be strengthened progressively.

The government also has to engage more with business, to engage it in formulating economic plans, to listen to its concerns regularly, and to use the information to keep improving the general business environment. Above all, it needs to engage business in designing, implementing, and monitoring specific economic transformation...
Box 2.10 Toward transformational development banks—a nine-point plan

Sub-Saharan countries can learn from their past experiences to create modern transformational development banks to support their transformation agendas. This does not necessarily mean new banks; in several countries it may call for restructuring some existing institutions and possibly closing or privatizing others. While transformational development banks should not be judged on the same profit-making yardstick as private commercial banks, they should nevertheless be financially viable. Here are nine key principles that could inform reform.

First, governments should separate ownership from management. That the state supplies the capital does not mean it should run the bank. Management could be contracted to professionals who should be allowed the freedom to run the bank, consistent with clear directives and targets that reflect the country’s economic transformation agenda. In fact, it would be better for the state not to fully own the bank. It should seek equity participation from private investors (domestic and foreign), including domestic banks, international institutions such as the World Bank/International Finance Corporation and the African Development Bank, successful development banks in other countries, and foreign sovereign wealth funds. Bilateral donors interested in entrepreneurship development could also invest some of their program funds as equity in the banks.

Second, the investors should have representation on the boards. This governance structure would make it easier to select professional managers and hold them to professional standards. Given the improved business environment in many countries, the chances of professionally managed development banks being successful are now much greater.

Third, governments should explore borrowing long-term from the World Bank or African Development Bank (say, through “budget support” credits) to fund additional equity participation in their transformational development banks. (This is different from the lines of credit these institutions extend to the development banks.) In this way, governments would further leverage their access to cheap and long-term funds to directly benefit the private sector. In many cases, passing the money on to the private sector in this way is likely to produce much better results for economic transformation than the amounts governments borrow from international institutions for “poverty reduction” projects that the public sector implements could.

Fourth, the development banks should develop first-class technical expertise in project appraisal and in the key areas in the national economic transformation agenda, so they can provide advisory services to their clients. Governments should regard these functions as being as important as the provision of funds, and they should monitor results.

Fifth, the World Bank/International Finance Corporation, the African Development Bank, and donors interested in entrepreneurship development should target technical assistance to the reformed development banks to raise their technical expertise. This would complement their financial support and oversight of the banks through their representation on the boards.

Sixth, the banks should lend only to businesses that have a majority and controlling private stake. In particular, the banks would not lend to enterprises in which the state holds the controlling stakes. They could, however, lend to a business in which the state has a minority equity stake and whose board has majority private membership.

Seventh, the banks should follow a graduation policy in their support to enterprises. For example, there could be an initial period (such as five years) for supporting an enterprise that qualifies, according to objective and transparent criteria, with subsidized loans (up to a capped amount). After that initial period, if the enterprise has performed well, it would graduate into a class that does not receive subsidized loans, but instead receives the bank’s guarantee for loans from private lenders. If the enterprise has failed to perform well in the initial period, the bank would discontinue its support (no more funding and no guarantees). The period for providing a guarantee would also be limited (say, to five years).

Eighth, senior managers of the bank should have personal stakes in its success and in the success of its clients. One way to do this would be to have the bank take equity stakes in the firms it finances. Part of the pay or bonuses of senior managers could be linked to the performance of those equity stakes.

Ninth, the development banks should operate in a way that develops the capital market, so that the country becomes less reliant on them over time for financing transformation. To this end, they should over time increase their funding through the issue of domestic bonds (with the monetary and financial authorities taking measures to facilitate the development of the domestic bond market). They should also periodically sell their equity stakes in firms on the stock market. These measures would also increase the number of citizens outside government with financial stakes in the banks, further increasing accountability.

Source: ACET research.
Box 2.11 Export finance in Ghana

Ghana’s Export Development and Agricultural Investment Fund provides export credit, export insurance, refinancing, and credit guarantees. It also supports products for export, capacity building, market research, development of infrastructure, and other export-oriented activities.

The institution has two main facilities: one for export development and promotion and another for credit. The export development and promotion facility supports activities of groups and institutions in the development and promotion of export products and provision of services to the export sector. The credit facility offers concessory loans that individuals, corporate exporters, and producers of export goods access through designated financial institutions.

To boost nontraditional exports, the fund has signed a marketing partnership agreement for the supply of mangoes with a British produce-buying company Minor, Weir & Willis. The agreement ensures a ready market for mango farmers. And the fund supports farmers with credit facilities for the cultivation of mangoes to meet the demand. The agreement is expected to generate export revenue of GH¢46 million (about $23 million) in 2013 and to grow to about GH¢184 million (about $92 million) by 2017, when the project closes.


initiatives (the bold informed bets). Organized labor also needs to be brought to the table as a key partner to articulate the interests and perspectives of labor—and to ensure that labor is committed to the transformation agenda and works in a way that supports it. And to keep the state-business-labor engagement honest and guard against rent-seeking, information on their deliberations has to be made available to the public—to the media, civil society organizations, and economic think tanks—so they can demand accountability and complement the monitoring by parliaments.

Notes

1. In addition to ideology, in some countries the unfriendly attitude to the private sector also stemmed from the fact the sector was dominated by ethnic minorities.


3. Hamilton 1791; List 1885; Lewis 1955; Chang 2002; Lin and Monga 2011.

4. We use the term “public goods” loosely to include both pure public goods that are nonexcludable and nonrivalrous in consumption (clean air or climate change mitigation) as well as quasi-public goods that are not strictly so but have large externalities (health, education, and much physical infrastructure).

5. Lewis 1966.

6. For example, to build and smoothly operate an industrial park or special economic zone requires coordination with municipal and regional authorities for land; ministries responsible for power and water; ministries of finance and of trade and industry (for fiscal and trade exemptions), and ministries and agencies responsible for permits for health, environment, and so on. Many countries talk of operating a “one-stop-shop” in this regard. In reality, this often fails to work, since the various agencies, even if they co-locate in the industrial park or special economic zone, still insist on separate procedures that are not harmonized. Another example is promoting commercial agriculture and agricultural processing. This would involve the ministry of land and agriculture (which are sometimes separate), the ministry of finance, perhaps the central bank (to address credit issues), and the ministry of trade and industry.

7. The statement refers to the period from 2009 to 2012 when Kenya had both a president and a prime minister.


10. The structure of the tax system is also important, since it affects incentives for savings, investments, and the relative profitability of various economic activities. We do not discuss this issue directly here, although it comes up when we discuss export promotion in chapter 3.

11. The successful East Asian/comparator countries maintained an average investment to GDP ratio of more than 30% for decades. Average investment rates in Sub-Saharan Africa are now around 25%, but a substantial share of it is externally financed (mainly by donors) since savings rate are around 10%. This cannot provide the basis for economic transformation. Government should thus also aim to increase government savings for investment and should...
adopt policies to promote domestic private savings for investment.


15. Dinh and others 2013.


17. This is “coordination failure.” For example, see Lewis (1966) and Rodrik (2007).

18. On promoting innovation recent examples include the U.S. Department of Energy’s funding for alternative energy technology development and the U.K. Treasury’s funding for the establishment of the “Green Energy Bank.” On financing small and medium-size enterprises, almost every developed country has its version, including the Small Business Administration of the United States and the Business Development Bank of Canada.


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