Featured article

Guest authored by Professor Stefan Dercon

Private investors and the gamble on growth and development in Africa

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Biography

Professor Stefan Dercon, CMG, is Professor of Economic Policy at the Blavatnik School of Government and the Department of Economics of the University of Oxford, and the Director of the Centre for the Study of African Economies at the University of Oxford. He combines his academic career with work as a policy adviser. Between 2011 and 2017, he was Chief Economist of the UK Department of International Development. Between 2020 and 2022, he was the Development Policy Adviser to successive Foreign Secretaries at the UK's Foreign Ministry.

His research interests concern what keeps some people and countries poor: the failures of markets, governments and politics, mainly in Africa and South Asia, and how to achieve change.

His latest book, "Gambling on Development: Why Some Countries Win and Others Lose", was published in 2022. It was selected as one of the best books in economics by the Financial Times, and referred to as an "urgent… and important book".

Please note that the opinions expressed in this article are those of Professor Dercon. They do not purport to reflect the opinions or views of Savannah Energy.

Africa is the future of global growth

With risk comes opportunity. Mo Ibrahim, the Sudanese-British businessman and philanthropist put it well: "Africa is the future of global growth, and those who invest in Africa today will reap the benefits for years to come." (The Africa Report, 2021)[1]. With its young population and ample natural resources, there is little doubt that the potential is there. The most basic of economic insights tell us that with ample natural and human resources, unlocking that potential will require capital, a scarce commodity on the African continent. Private investors are key. But they will not part with their capital incognisant about risk.

The latest data on the fragility of states across the world, an index combining economic, social and political stability indicators, suggests that 13 of the 20 most fragile places in the world are in sub-Saharan Africa (Fund for Peace, 2023)[2]. The last year of the World Bank's Doing Business indicators, measuring things like business registration, regulations and contract enforcement, implied that of the 20 most difficult places to do business in across the world, 12 were in sub-Saharan Africa (World Bank, 2021)[3].

The failure in predicting failure

Fortunately, expert predictions of risk and failure are often not correct. The late Henry Kissinger, the former US Secretary of State, is said to have referred to Bangladesh as a "basket case" not long after the country had become independent in 1971. A famous economist, James Meade, writing in 1961, thought that Mauritius would find it very hard to develop, as it was an economy largely built and structured around sugar exports (Meade, 1961)[4]. In writings in the 1950s and 1960s, another economist, Gunnar Myrdal, wondered whether Indonesia could achieve economic growth, in particular in the face of entrenched political and economic elites leading to inefficiencies and corruption (Myrdal, 1956 and 1967)[5]. Both economists won Nobel Prizes in economics for the quality of

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Table 1

Countries with the lowest score in the World Bank Doing Business Survey (2020)		Countries with the highest score on the Fund for Peace Fragile States Index (2023)	
Lowest	Somalia	**Highest**	Somalia
	Eritrea		Republic of Yemen
	Venezuela		South Sudan
	Republic of Yemen		Democratic Republic of the Congo
	Libya		Syrian Arab Republic
	South Sudan		Afghanistan
	Central African Republic		Sudan
	Democratic Republic of the Congo		Central African Republic
	Chad		Chad
	Timor-Leste		Haiti
	Republic of the Congo		Ethiopia
	Haiti		Myanmar
	Equatorial Guinea		Mali
	Angola		Guinea
	Syrian Arab Republic		Nigeria
	Liberia		Zimbabwe
	Guinea-Bissau		Libya
	Afghanistan		Ukraine
	Iraq		Eritrea
	Sudan		Burundi

The World Bank Doing Business Survey programme has been discontinued after a scandal involving data manipulation under political pressure for a relatively small number of countries. For the purposes of this article, none of this controversy is likely to have affected the scoring of the African countries listed here. Other ways of assessing fragility are available, but similar countries are ranked by others in the lowest group. For example, the OECD (2022) lists the 15 most fragile contexts, of which 10 are in sub-Saharan Africa.

their insights, and Kissinger the Nobel Peace Prize, but none won it for their predictive powers as reality proved their scepticism wrong. Between 1980 and 2020, with their economies growing at around 5% per year on average; Bangladesh, Mauritius and Indonesia almost quadrupled their GDP per capita[6,7]. Not quite Singapore (which grew at more than 6% per year) or China (with 9% per year growth in this period), but very impressive, nevertheless.

One could forgive those who subscribed to being sceptical about the prospects of Bangladesh, Mauritius or Indonesia in these periods given what they knew; in fact, in the subsequent years, there were enough grounds to remain concerned. In the years after its secession from Pakistan in 1971, Bangladesh experienced a dramatic famine, much political violence and instability, and poor economic decision making. Mauritius remained, for long after James Meade wrote, totally dependent on one commodity: sugar – within the decade after independence in 1968, sugar exports accounted for about 85% of total exports, with a seemingly stagnant economy controlled by a small colonial landed elite. In Indonesia, the army had engaged in a violent repression of suggested leftist sympathies leading to the killing of many hundreds of thousands of people, and deeply destabilising the rural economy, while in the 1970s becoming an economy seemingly largely dependent on oil.

Instability, conflict, and limited diversification of the economic base, often linked to a few commodities, are also the features characterising those economies that we tend to consider risky or difficult to do business in. At the same time, most if not all the countries appearing in Table 1 are countries that objectively speaking have a lot going for them: many have ample natural resources, and all have a young population and a small but growing educated and entrepreneurial middle class. The relative success of Indonesia or Bangladesh suggests that even with a recent history of conflict and instability, change is possible: even though they have had their problems in the last three decades or more, neither has descended back into their past deep rifts, but instead made steady economic and developmental progress. Limited diversification such as in Mauritius does not have to persist either – from an economy entirely dependent on sugar, it has evolved to a successful export-oriented economy based on processed agriculture, light manufacturing, tourism and financial services.

Even natural resource dependence does not need to trap countries for ever. Indonesia came out of conflict in the 1960s, and in the 1970s had an economy dominated by oil – by 1980, 26% of its GDP came from natural resources, virtually all oil[8]. Fast forward and these days Indonesia has greatly diversified its exports across basic and more advanced goods and services, including the reinvestment of early revenues into improving infrastructure, human capital and its investment environment[9].

Mascarene Islands, Africa - Harbour seen from Tombeau Bay, cargo terminal, Port Louis, Mauritius

Increasing differences

In contrast, across sub-Saharan Africa, economies are on average barely better off than 40 years ago (having grown by 0.2% per year per capita on average), and only slowly improving in the last 15 years (with growth of 1.2% per year). However, that is not universally the story across the continent; there are many countries that managed to do better. In the last 15 years before COVID-19, per capita growth rates in various countries accelerated – to between 3 and 4% per year per capita in countries like Côte d'Ivoire, Tanzania and Ghana, and even 7% per year in Ethiopia.

So what happened in countries like Mauritius, Bangladesh, and Indonesia that appeared to lay the foundation for longer-term growth; what happened to Ghana and Ethiopia to appear to lead to a growth acceleration, but that did not happen, at least seemingly for now, in other sub-Saharan African countries?

It is helpful first to start with qualifying a popular reason. It is often claimed that growth failure stems from not having the kind of institutions that are familiar to those investing in Western economies: a history of a fair rule of law, strong property rights, clear regulation, or limited corruption. Or a political system that mirrors that found in Britain, with democratic restraints on the economic power of politicians. Indeed, this appears to be the core thesis to explain success or failure of a well-known book on growth and development, "Why Nations Fail" (Acemoglu and Robinson, 2012)[10]. There is little doubt that these institutions have helped a great deal for European and North American economies to grow fast in the last century, and it may well be required for any country to achieve levels of economic development seen there. However, it is also true that some of the fastest growing economies in recent decades, such as China, India, Bangladesh, Indonesia or Ethiopia, did so without having these 'perfect' institutions in place. In fact, as seen from the archetypical perfection, they appear to have many features far away from this in terms of economic and other governance, with obscure regulation, corruption, or slow or failing courts to adjudicate disputes[11]. While no doubt coming at a cost for economic activity, this is also hopeful news for countries struggling to achieve the take-off of their economies: perfection is not quite necessary, and those currently with the power to make things happen do not need to be constrained by lack of perfections in the institutional development. The agency of the leaders and those around them matters: their actions can lead to success, even when institutions are still imperfect.

This central role for agency is not without bounds. When 20 years ago, the World Bank's Growth Commission studied those successful economies that had grown in the preceding decades at 7% or more for 30 years, it found that no single recipe was used but success was rather country specific (World Bank, 2008)[12]. They stated that "we don't know" the recipe for growth, but "we know the ingredients". And these ingredients include sensible matters: macroeconomic policies for stability, sufficient respect for the price mechanism and market incentives, and investing in infrastructure and human capital. Successful countries appear to have done so, but in varying degrees and with much variation. Again, it brings to the fore the agency of those who have the power to influence the economic direction of their countries by acting sensibly for the economy. Singapore or China hardly is an option for most African countries, but nevertheless, much better outcomes could be achieved by many more countries than at present. As I heard Donald Kabaruka, former President of the African Development Bank, say at an event at the 2023 Spring Meetings of the World Bank: "growth by African countries is a choice"[13].

"Growth by African countries is a choice."

Donald Kabaruka
Former President of the African Development Bank

Historical analysis

It may surprise to hear an argument that not all countries and their governments choose growth and development. Most commentators tend to forget that even in Europe or North America this is a relatively recent phenomenon. It took two world wars in the 20th century, and a deep economic crisis in between to crystallise a broad political consensus there that governments had a key role in driving growth and development through policy making. Think of the expansion of public infrastructure investments, regulation and competition policies, stronger legal systems, the emergence of public health services, and active monetary and fiscal policies.

In fact, it helps to think a bit deeper about what states are, and how they have emerged, including through history. A classic but insightful view for our purposes is that the state is a solution to the presence of violence: a deal between powerful groups to limit violence as a better way to capture "rents" from controlling society than through violence. Mancur

Lloyd Olson Jr., the American economist and political scientist, famously suggested that a state emerges when "roving bandits" turn into "stationary bandits" (Olsen, 1971)[14]. This may seem a cynical view, but it points to two closely related features: a state as source of peace and stability, and the state achieving this through a political and economic deal on who controls the state and how resources are generated and distributed, including through the economy. This deal is typically between "the elite" broadly defined, including key people in politics, either in government or opposition, in the military, in the senior ranks of the civil service, religious or traditional leaders, trade union or civil society leaders, senior journalists, academics and other opinion makers. The "elite" here is defined as all those with power and influence, so not just the president or military chief but also those public or non-public figures that can drive or stop change, one way or another.

The "Elite Bargain"

Any more or less stable state has at its foundation such a deal between its elite, rarely enshrined in a formal deal, but more an implicit understanding of 'how things are done' and 'for what purpose' in politics and the economy. This is often called an "elite bargain". It is helpful to recognise that Western societies also have these at their basis. So it meant that 19th century Britain was a stable state involving an implicit and evolving deal between an emerging bourgeoisie, industrialists and historical landed classes delivering both an industrial and agricultural revolution, but what happened to ordinary workers wasn't such a concern in their implicit deal on power in politics and the economy. The "robber barons" of late 19th century (industrialists such as Andrew Carnegie, Cornelius Vanderbilt or John D. Rockefeller) were allowed to accumulate wealth through ruthless, unethical, and often what now would be called corrupt and illegal practices. And today, elections in the United States, and, therefore, how the state is controlled, involve huge spending by big corporations and wealthy individuals in a quest for influence in ways that would not be allowed in most of Europe. Each of these examples offered 'stable' elite bargains – and involve a deal, an implicit understanding on how the state is controlled and the economy is allowed to function.

The developing world also has elite bargains underlying the stability of states. In my book "Gambling on Development", I give plenty of examples (Dercon, 2022)[15]. For example, Mobutu's Zaire (now the Democratic Republic of the Congo), was a state where being connected to the leadership and through it with access or control over the state organisations, meant a license to steal; a kleptocracy. It delivered stability for some decades, but in the end a persistently further impoverishing economy, and an increasingly high cost of loyalty led to its failure. Indeed, in the Democratic Republic of Congo and other highly fragile economies in the world, basic state formation is often fundamentally incomplete: there is not even a well-defined elite bargain on how the state and the economy's resources are controlled.

"In Indonesia, President Suharto, but with the support of the main elite in the country and with an empowered set of technocrats, moved the economy gradually towards an export-oriented model, using the natural resource rents for infrastructure and with sensible macroeconomics."

Light Rail Transit, Jalan Rasuna Said, Jakarta, Indonesia

An elite bargain is also at the basis of the recent successful developing countries in economic terms, like Indonesia, Bangladesh, China, or Ethiopia. They were, however, more than just an economic and political deal to share rents, as part of generating peace and stability. The key to their success was that the underlying deal also involved a commitment to focus on growth and development: I call this a development bargain, an elite bargain with growth and development at its core.

In Indonesia, President Suharto, but with the support of the main elite in the country and with an empowered set of technocrats, moved the economy gradually towards an export-oriented economic model, using the natural resource rents for infrastructure and with sensible macroeconomics as well as measures including for agriculture leading to a broadly inclusive economy. This "elite bargain" not just for stability but also for growth and development persisted even through the "Asian crisis" period after 1997, when the economy contracted substantially. It was renewed in a more open and democratic way, but with a continuing model supportive of growth and inclusion. Strikingly, rent distribution through corruption has remained rife, but typically in ways within limits not to derail the fundamental progress in growth.

To be clear, the Indonesian elite did not become growth or development focused through some enlightened ideas. The promise of future profits from growth may well have played a role, but it would still have been a gamble, as history tells us that growth and development may shift elites. More likely this consensus emerged to seek legitimacy for Suharto's military regime tainted by the violent crisis of the 1960s as well as its disposal of the traditional elite leader, Sukarno, who had led the country to independence, and whose supporters also needed to be paid off. Similar legitimacy-seeking behaviour can be found in other countries that took the gamble on development, such as China in 1979, Bangladesh in the 1980s or Ethiopia in 2005.

The reformist group led by Deng Xiaoping in China explicitly saw a commitment to seek growth and food security as a means of retaining power by the Communist Party after the disruption of the 1960s and 1970s following the cultural revolution, the death of Mao and the struggles within the party. The key change was that, rather than running an economy based on ideology above all, China's policy makers became pragmatic focused on growth, as in Deng's famous saying, "It does not matter whether the cat is black or white, as long as it catches mice." In Bangladesh, the conflict, famine and political instability appears to have led to a consensus to abandon the idea of state-led development, and given the relatively incompetent state, by the 1980s it encouraged rather than stifled private firms, such as the nascent garment industry, now the leading export sector and employing up to 4 million people, mainly young women. It supported the economy through sensible macroeconomic and other economic policies and combined this with sensible health and social safety nets to a large part of the population, all with a clear shared commitment to achieve progress in growth and development. In Ethiopia, after conflict, political turmoil and failed elections in 2005, the leadership essentially committed to seeking legitimacy through a strong focus on infrastructure-led growth and rural development at a large scale, leading to very fast growth and improvement of living conditions. It failed, however, to retain a stable political elite bargain between competing nationalities in the country, resulting in increasing instability and violent conflict in 2020-2022. That gamble for development did not quite succeed, as the basis for the elite bargain for peace and stability failed, even though it may well re-emerge.

What does this mean for the foreign investor?

As seen from investors' point of view, there may then well be different types of countries among those emerging and developing. First are countries with a stable elite bargain with a reasonably strong commitment to growth and development. Indonesia and much of Asia are in this group. There are plenty of them these days in Africa too, such as Ghana, Kenya, or Zambia. Nothing is perfect, but there is enough stability as well as commitment to growth for a stable and reasonably predictable private sector investment climate. Second is a set of countries where the elite bargain has broken down – as for example, in Sudan, making any investment tricky. Third is a more difficult group to judge: countries with much potential but with a history of fragility, often with valuable natural resources to invest in, and less clarity as to what the state of the elite bargain is, and whether it is committed to growth.

The latter comes with significant investment opportunities but also with considerable risks. Deals are possible in such settings even if none of these countries have the kind of rule of law, or governance of the public sector familiar to Western countries. However, they require nevertheless an approach to contracting that also extensively relies on building informal relationships and partnerships, outside formal processes, as contracts tend to be difficult to enforce. None of this is impossible: those in power also tend to have an interest in stability in their economies, and investment deals can also contribute to this.

None of this would be alien to investors: this is a high stakes game, and investors take a bet on high returns cognisant of the high risks in some settings. The nature of risk management is maybe less familiar. It requires not just an understanding of the project risks and of the evolution of markets, and more, but also demands a good understanding of the existing context, including of those who have power and influence beyond the formal power structures of governments, and of the nature, inclusiveness and stability of the current elite bargain. It will require investing in the informal networks and connections to help with knowledge and strategies that help to overcome the lack of reliable and fast formal enforcement mechanisms.

There is support available to manage risks further. One way is through international organisations such as the Multilateral Investment Guarantee Agency ("MIGA"), part of the World Bank Group and offering political and other non-commercial risk insurance to commercial investors. Working with and seeking co-investment from development finance institutions is also possible, such as the World Bank's International Finance Institution or those of various Western governments, such as the UK's British International Investment.

> "Foreign direct investment ("FDI") and other private investment can also be catalysts for change."

Foreign direct investment ("FDI") and other private investment can also be catalysts for change, when done carefully. They can help those in powerful positions, keen for change to take place, prove to their populations, to future investors, and others in privileged positions that taking the gambles required for stable elite bargains committed to growth and development can pay off. In Indonesia, from the 1970s, Japanese FDI, and the firms that linked with them, showed local elites that there were other ways than rent-seeking and privilege to get rich. In Vietnam, from the 1990s, FDI brought capability but also helped a government that sought legitimacy through sensible development policies to have the required resources to invest in health or education. The FDI-led economic success put Vietnam on a road towards a remarkable transformation. In Bangladesh, it was not FDI, but international buyers of garments and textiles that helped local capital to build a successful garment export sector, the key engine of Bangladesh's growth success. Most strikingly, the success from exporting also locked an elite into sensible economic policies, as the benefits from a growing economy were also visible to them, and it created strong incentives for sensible economic policies, such as a competitive exchange rate, helping to perpetuate the gains. It also fuelled impressive female emancipation, with growing labour force participation and empowerment through employment in the garment sector, leading to girls scoring better in health and education than boys.

It is no doubt a challenge when the country has natural resources that appear to remove the need to growth for an elite to capture considerable rents. However, even countries with natural resources such as Indonesia have shown that they can provide the basis for progress in growth and development, even if at first it may not have looked liked this. Predictions of failure have been proven to be wrong: going back in time, Bangladesh or Indonesia have shown that countries currently fragile and without a stable elite bargain, as well as those focusing only on rent capture, can change.

Overall, it requires the investor not simply to be well-aware of what it is stepping into. More is then expected. It requires a deeper understanding of the context one works in, and to genuinely consider the likely impact of investments on the broader economy, society, and politics.

Natural resources can provide the basis to develop a broadly inclusive economy. For that, though, there is a need for the type of "elite bargain" between those with power and influence in the country that provides the foundation for a stable state with growth and development at its core. Country leaders can signal a willingness to focus on growth and development by inviting quality foreign direct investors that set high standards for themselves. Governments should bargain hard, but fairly and squarely in the interest of the country. They should strive for legitimacy, transparency and accountability in contracting, and work with trusted international partners, reducing the risks involved for all. The prize for all is higher returns for investors and countries alike.

Footnotes

1. The Africa Report, 2021. "Mo Ibrahim: Africa Is the Future of Global Growth", June.
2. Fund for Peace. 2023. Fragile States Index. Annual. Washington, DC: The Fund for Peace.
3. World bank. 2021. Doing Business Indicators. Annual. Washington DC: World Bank.
4. Meade, James E. 1961. Planning and the Price Mechanism: The Liberal-Socialist Solution. George Allen and Unwin Ltd.
5. Myrdal, Gunnar. 1956, Asian Drama: An Inquiry into the Poverty of Nations. Pantheon Book; and.
   Myrdal, Gunnar. 1967. "The Indonesian Dilemma: A Case Study in Political Instability and Economic Development." Economic Development and Cultural Change 15(3):281-312".
6. Throughout this contribution, I will use data up to and including 2019, as COVID-19 disrupted economies in various ways, but not necessarily in line with their fundamentals. I also report Gross Domestic Product (GDP) corrected for population size (per capita) including when reporting growth of GDP, to avoid misleading inference on changes of wealth and income of nations, simply based on total population size and growth.
7. Data from World Bank World Development Indicators, 1980-2020.
8. Data from World Development Indicators, World Bank.
9. Data in constant prices of 2015, from World Development Indicators, World Bank.
10. Acemoglu, Daron and James A. Robinson. 2012. Why Nations Fail: The Origins of Power, Prosperity and Poverty. Crown Publishers: New York.
11. Corruption indicators are an imperfect reflection of economic cost and consequences. The Transparency International Corruption Perception Index for 2022 ranks, out of 180 countries, Indonesia at position 110, below Ethiopia at 94. But Bangladesh, a fast-growing economy, ranks at 147 roughly the same as Nigeria, a stagnant economy (at 166). Deeper down the list, among the 20 countries with the highest perceived corruption, we find Sudan at 162, DR Congo at 166, Chad at 167, and South Sudan 178.
12. World Bank. 2008. The growth report: Strategies for sustained growth and inclusive development. Washington DC: The World Bank.
13. Donald Kabaruka is the former President of the African Development Bank and he spoke at an event on extreme poverty and fragility organised by the UK's FCDO, 12 October 2023.
14. Mancur Olsen 1971 The Logic of Collective Action
15. Dercon, Stefan. 2022. Gambling on Development: why some countries win and others lose. London: Hurst Publishers. This book is the basis for the rest of the analysis in this article.

Additional references

The Africa Report, 2023. "Guinea: Benny Steinmetz loses appeal in Swiss corruption case". 5 April.

World Bank. 2022. Correcting Course. Poverty and Shared Prosperity Report 2022. Washington DC: World Bank.