State Legitimacy vs. Policy Externalisation? Examples from Sub-Saharan Africa

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Development Studies Seminar

Lisbon, 4 April 2019

DS DEVELOPMENT STUDIES

CEsA Centro de Estudos sobre África, Ásia e América Latina

CSG INVESTIGAÇÃO EM CIÊNCIAS SOCIAIS & GESTÃO

LISBON SCHOOL OF ECONOMICS & MANAGEMENT UNIVERSIDADE DE LISBOA

1. Argument

- **Having the capacity to carry out policies is a key feature of state legitimacy**
- **And, in an economic perspective, a key feature of policy credibility and effectiveness**.

- It is argued that the deficit in legitimacy affecting many Sub-Saharan African/SSA states is explained by a **sequence of causalities,** which can generate **vicious circles.**

The reliance of SSA economies **on primary commodities for their exports induces the 'externalisation' of the policies** of governments (to external agencies),

which, in turn, erodes their legitimacy vis-à-vis citizens and capacity to conduct specific policies that could reduce this reliance (e.g., industrial policies).

- These '**externalised' policies have relied on a stable conceptual framework** over 4 decades ('stabilisation'),

whatever countries' historical and economic characteristics (e.g., Asia, Greece after 2010, etc.) and creditors:

particularly in SSA since the start of the policy externalisation subsequent to the fall in commodity prices at the end of the 1970s, whatever the political changes.

- **This externalisation of policies takes two major forms:**

- i) A first modality stems from the dependence of SSA governments' **fiscal policies on international commodity and financial markets**.

It is structural: **as commodity-based structures generate the volatility of fiscal revenues**, and hence fiscal deficits and indebtedness.

Vicious circles also stem from the propensity of investors to invest in commodity sectors, thus reinforcing commodity-based structures.

- ii) A second modality also stems from this dependence on the volatility of international markets:

i.e. a **financing from external agencies conditional to policy reform** (‘*exchange of finance for policy reform*’):

aid (ODA) for low-income countries,

and **repeated borrowing** from international financial institutions/IFIs (‘hard’ commodities exporters).

IFIs justified conditional financing as locking-in policies, enhancing international credibility:

yet this is questioned by SSA low growth; Asian states reduced their dependence on aid and implemented industrial policies.

This modality makes governments **accountable to external entities** (Kaldor, 1963) and **breaks a key element of legitimacy**, **taxation.**

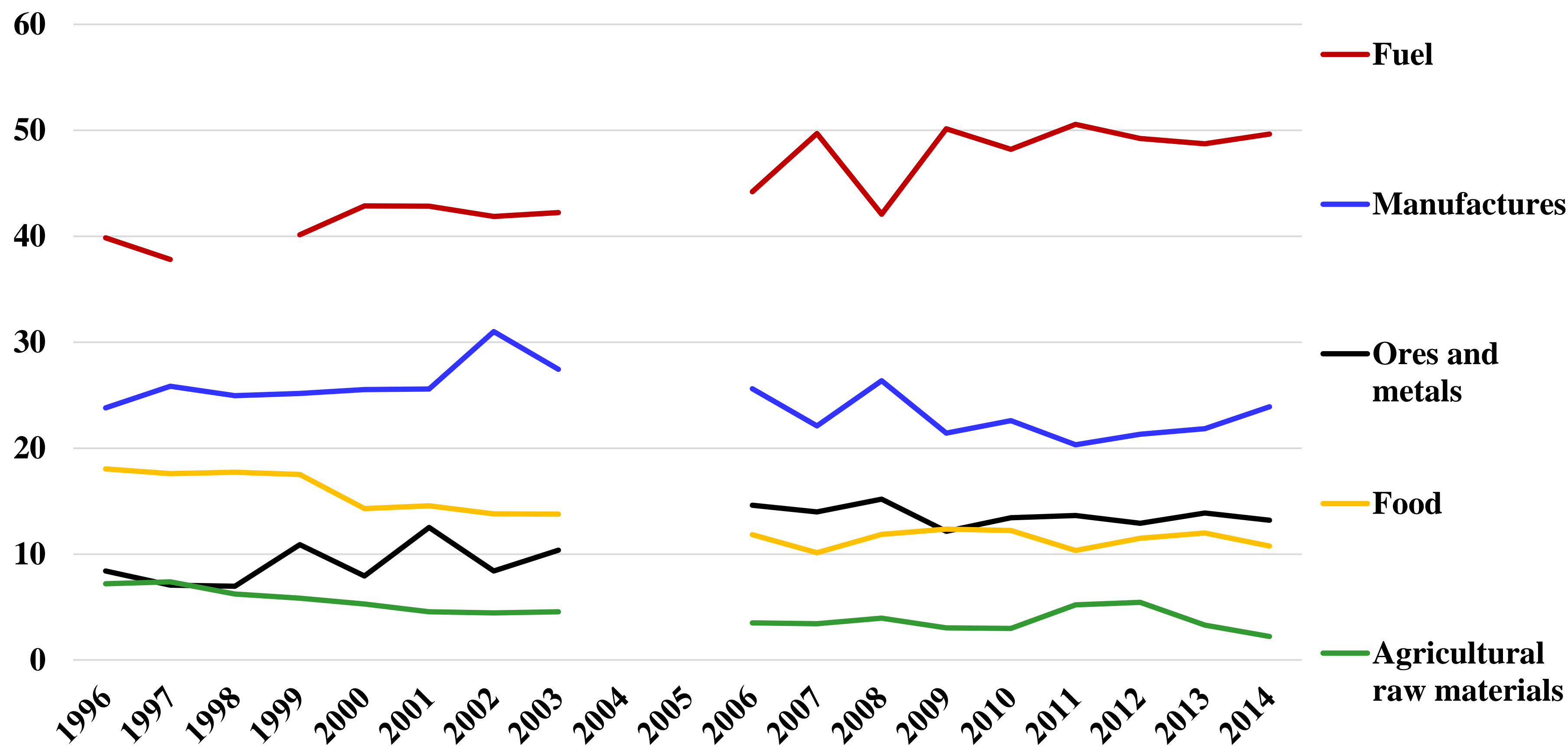
2. A first modality of externalisation: the dependence of SSA economies' fiscal policies on external causal processes

- **A commodity-dependent region: price volatility as a reinforcing factor of externalisation**

- **Most economies in SSA are characterised by their dependence on primary commodities,**
- **and a low level of exports of manufactures**.

- **'Hard' commodities, fuels, and ores and metals** (vs. 'soft' commodities, agricultural products) represent since the 2000s **more than half of exports**.

Sub-Saharan Africa: exports by category as percentage of total merchandise exports, 1996-2014



Source: World Bank, World Development Indicators database, March 2019 (***no data after 2014***).

It could be argued that such an export structure is not unusual and hence has no major consequences for SSA economies and public policies.

Yet a comparison shows **the amplitude of the distortion in SSA**: it **is by far the region that is the most dependent on primary commodities,** with the share of manufactures in exports even declining.

Structure of merchandise exports, world, percentage of total exports

	Food		Agricultural raw materials		Fuels		Ores and metals		Manufactures	
	2000	**2017**	**2000**	**2017**	**2000**	**2017**	**2000**	**2017**	**2000**	**2017**
World	7.1	10.1	1.8	1.7	13.0	12.0	3.2	5.2	71.3	66.8
East Asia & Pacific	5.2	6.6	1.4	1.3	5.1	5.5	2.4	4.2	84.5	80.4
Europe & Central Asia	7.1	8.6	1.7	1.2	9.0	10.4	3.3	3.5	73.1	72.4
Latin America & Caribbean	19.6	26.1	3.0	2.4	15.8	7.1	9.0	13.2	51.3	50.2
Middle East & North Africa	1.9	3.0	0.4	0.2	80.2	56.3	1.6	2.3	13.8	20.5
North America	7.3	10.9	3.3	2.9	4.7	13.4	2.5	3.8	78.7	59.2
South Asia	12.5	13.2	1.4	1.2	2.9	10.4	2.3	3.8	79.1	71.4
Sub-Saharan Africa	**14.3**	**10.8**	**5.3**	**2.2**	**42.9**	**49.7**	**7.9**	**13.1**	**25.6**	**23.9**
Low income	..	..	..	..	..	..	..	..	..	..
Lower middle income	13.4	17.5	2.4	2.1	23.3	23.3	4.6	4.8	54.8	52.2
Upper middle income	7.5	8.9	1.9	1.4	18.3	13.8	4.0	4.2	66.0	69.5
High income	6.1	8.9	1.7	1.6	10.3	8.5	2.8	4.7	74.9	71.7

Source: World Bank World Development Indicators online, table 4.4, September 2016 and March 2019. http://wdi.worldbank.org/table/4.4#. Data for SSA are for 2014 instead of 2017.

- **This dependence on commodities has detrimental consequences:**

- i) **SSA economies' growth rates are driven by commodity prices**.
- These were high during the 2000s, resulting from China's growth.
- The decline from the 2010s onwards has induced a fall in SSA growth rates, investment and government spending (Slater, 2017).

- **These commodity prices are determined by international commodity markets and by evolutions specific to countries outside SSA, on which SSA domestic policies have no influence.**
- Oil prices are determined by US demand, and metal prices by China's demand (Roache, 2012).

- Moreover, **the fact that growth rates are driven by commodity prices is an incentive for governments to keep this export structure when prices are high,**

which generate **self-reinforcing processes** locking producers in their past export structure.

International investors in SSA significantly invest in commodity sectors (UNCTAD, 2017).

- These pro-cyclical processes are compounded by the openness of SSA to foreign investment required by IFIs.
- The latter have contributed to the '**externalisation' of governments' policies,**

and hence to the erosion of their legitimacy vis-à-vis citizens and of their capacity to conduct policies reducing reliance on commodities.

- **Such a distorted export structure is detrimental to SSA because commodity prices are subject to decline and volatility**
- (Jacks et al., 2009; Arezki et al., 2013).

- E.g**., 4 major shocks have hurt SSA oil producers since the 1980s**:
- **oil prices** declined by about 66% from November 1985 to July 1986,
- then by 55% from November 1996 to December 1998,
- then by 67% from July to December 2008,
- then by 43% between June and December 2014 (IMF, 2015)…

- **Dependence on commodities makes countries vulnerable to global instabilities**,
- **also because of the financialisation of the commodity sector** from the 2000s onwards,

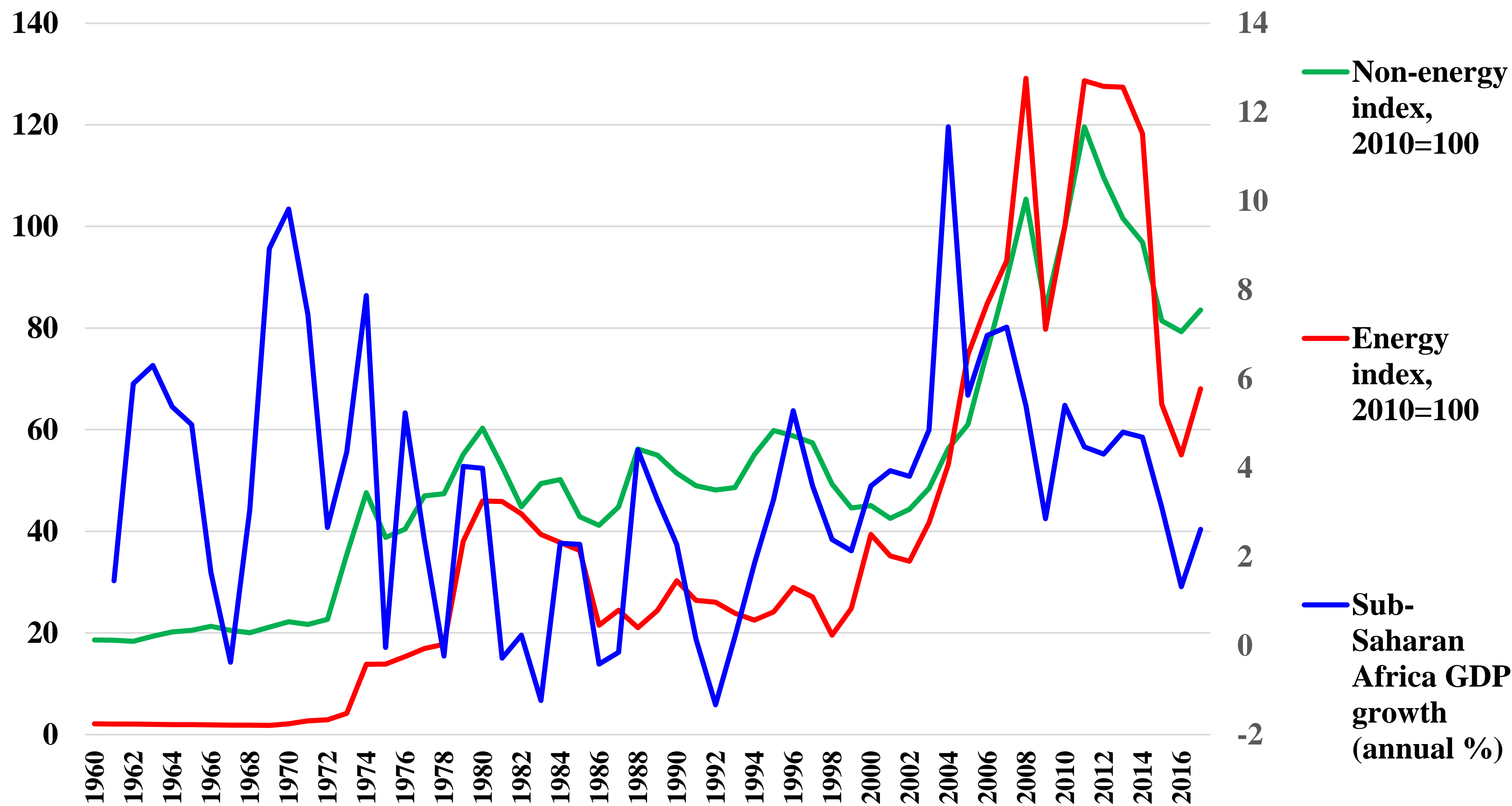
i.e. **the integration of commodity markets and financial markets.**

- It has increased co-movements and volatility spillovers between stock markets and commodity prices (Nissanke, 2011; Adams and Glück, 2015).

- Given the importance of commodities in export structures and hence in fiscal balances, **since the 19th century price volatility has had a negative impact on growth and terms of trade** (Blattman et al., 2007),

and hence has impeded the prospects for structural change of SSA economies (Rodrik, 2011).

SSA economies' growth rate (right scale) and commodity prices (real 2010 US$, left scale), 1960-2017



Source: World Bank Commodity Price Data, http://www.worldbank.org/en/research/commodity-markets; World Bank World Development Indicators, October 2018.

- ii) the **prices of some commodities are characterised by a decline:**
- Be they agricultural commodities (e.g., cotton, a major export of West African countries, Baffes, 2011),
- or hard commodities such as metals (e.g., copper, a major export for Zambia),
- **oil being an exception**.

- Commodity prices are characterised by **high volatility**,
- hence by **constant shocks** on SSA economies,
- **which *per se* have a negative impact on their long-term growth trajectories**.

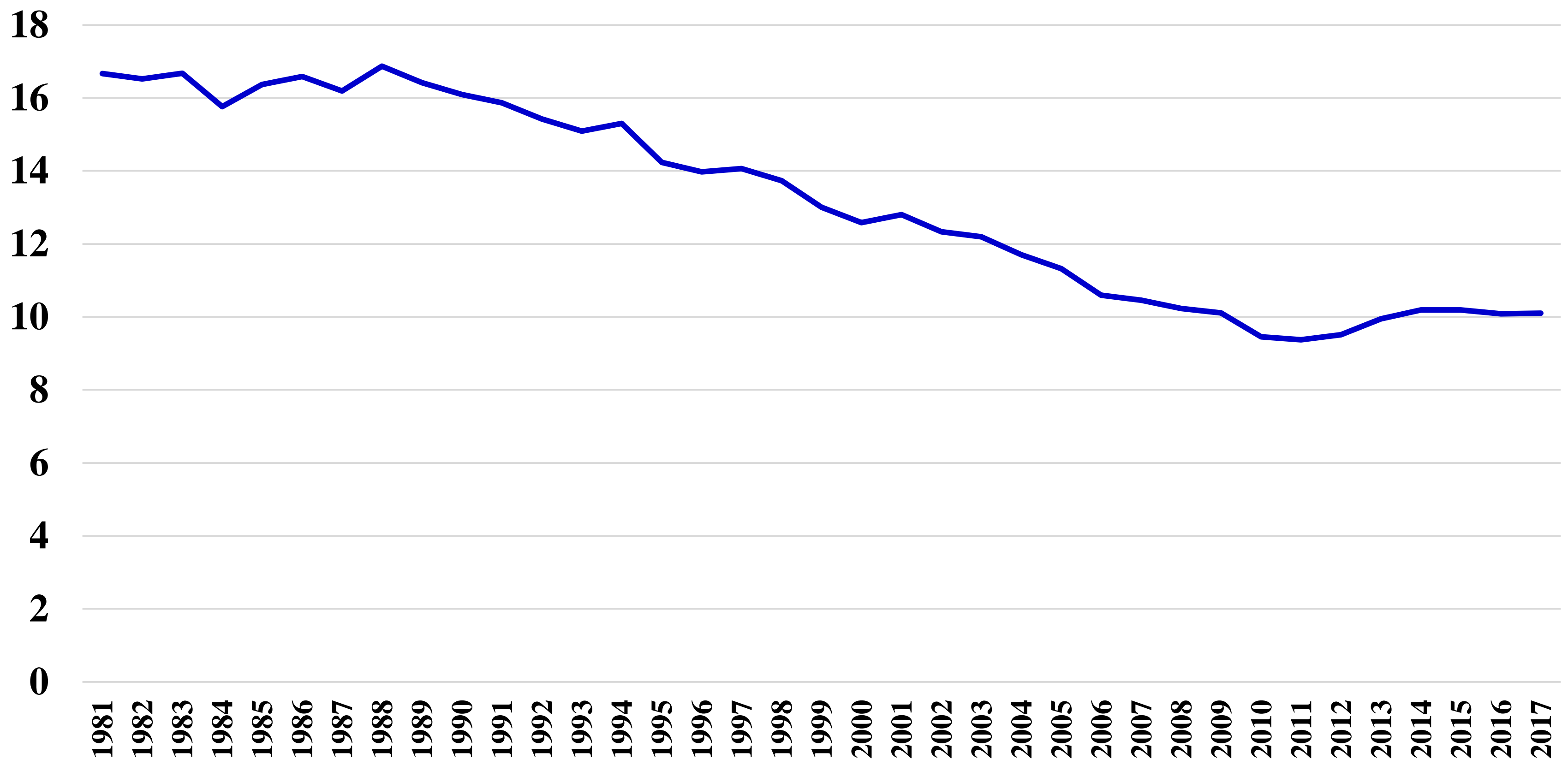
- iii) **other detrimental consequences include a low level of industrialisation.**
- **Commodity price fluctuations induce deindustrialisation** via, e.g., 'Dutch disease' (e.g., appreciation of the exchange rate).
- **This is even worsening**, with a **decline of industry and manufacturing and an increase in services in SSA output**.

- Industry represented in 1990 34% of SSA GDP; in 2000, 36%; in 2017, 23%.
- Manufacturing represented in 1990 17% of the GDP of SSA; in 2000, 11% of GDP; in 2017, 10%.
- Services increased from 44% of GDP in 2000 to 53.2% in 2017

(WB-WDI March 2019, table 4.2).

- Yet, **industrialisation is the key way of enhancing the value-added produced by SSA economies**
- (Hausmann and Rodrik, 2006; Aryeetey and Moyo, 2012).

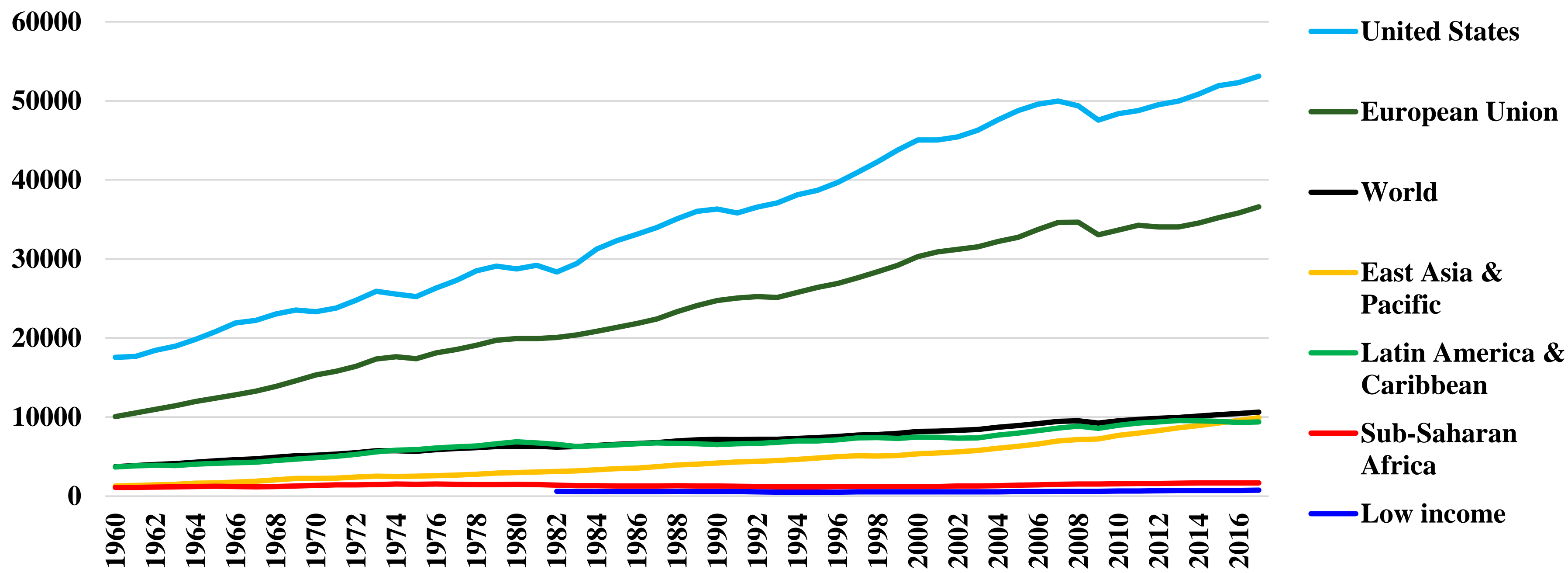
Indeed the evolution of SSA performance regarding manufactures leads to pessimism.



Source: World Bank, World Development Indicators database, March 2019.

The low value-added of the exports of SSA economies, with their vulnerability to terms of trade shocks, has had as a consequence that the **growth trajectories of SSA economies have diverged from those of the rest of the world**.

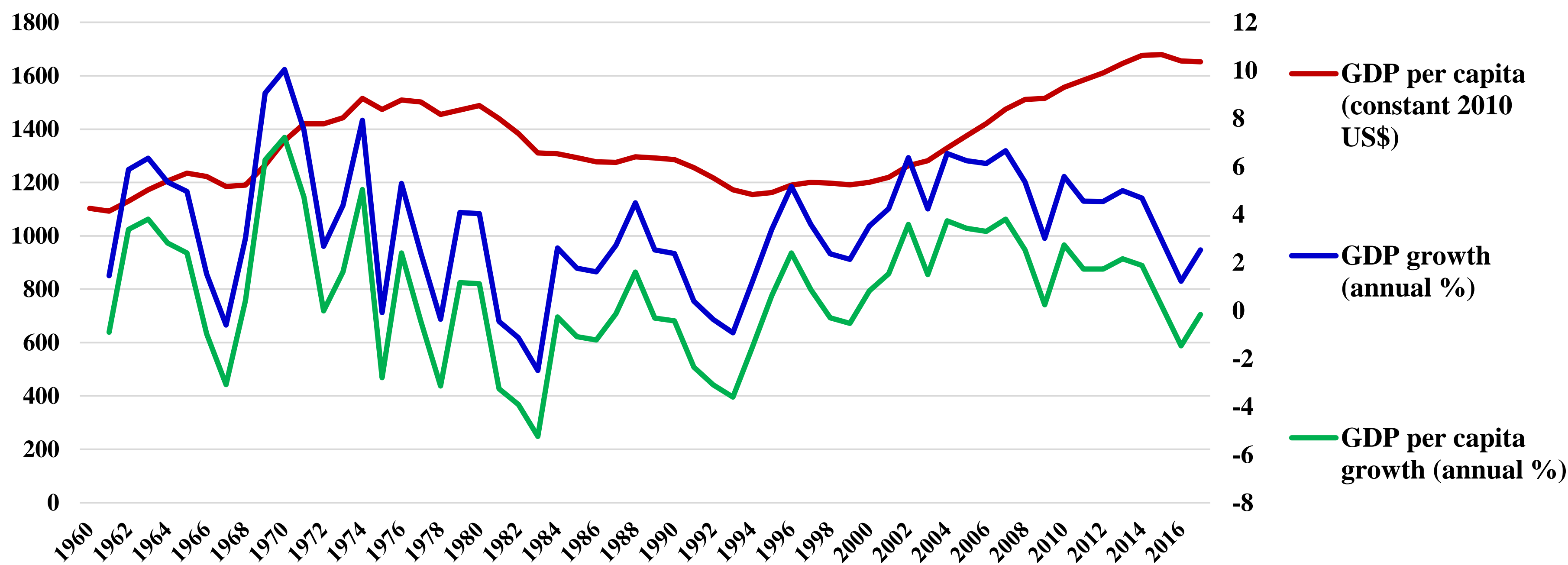
Poor income performance in SSA is driven by the facts that **most low-income countries are in SSA,** and **symmetrically 27 of the 48 SSA economies are low-income countries** (GNI below 995 US$ in 2017).



Source: World Bank, World Development Indicators database, March 2019.

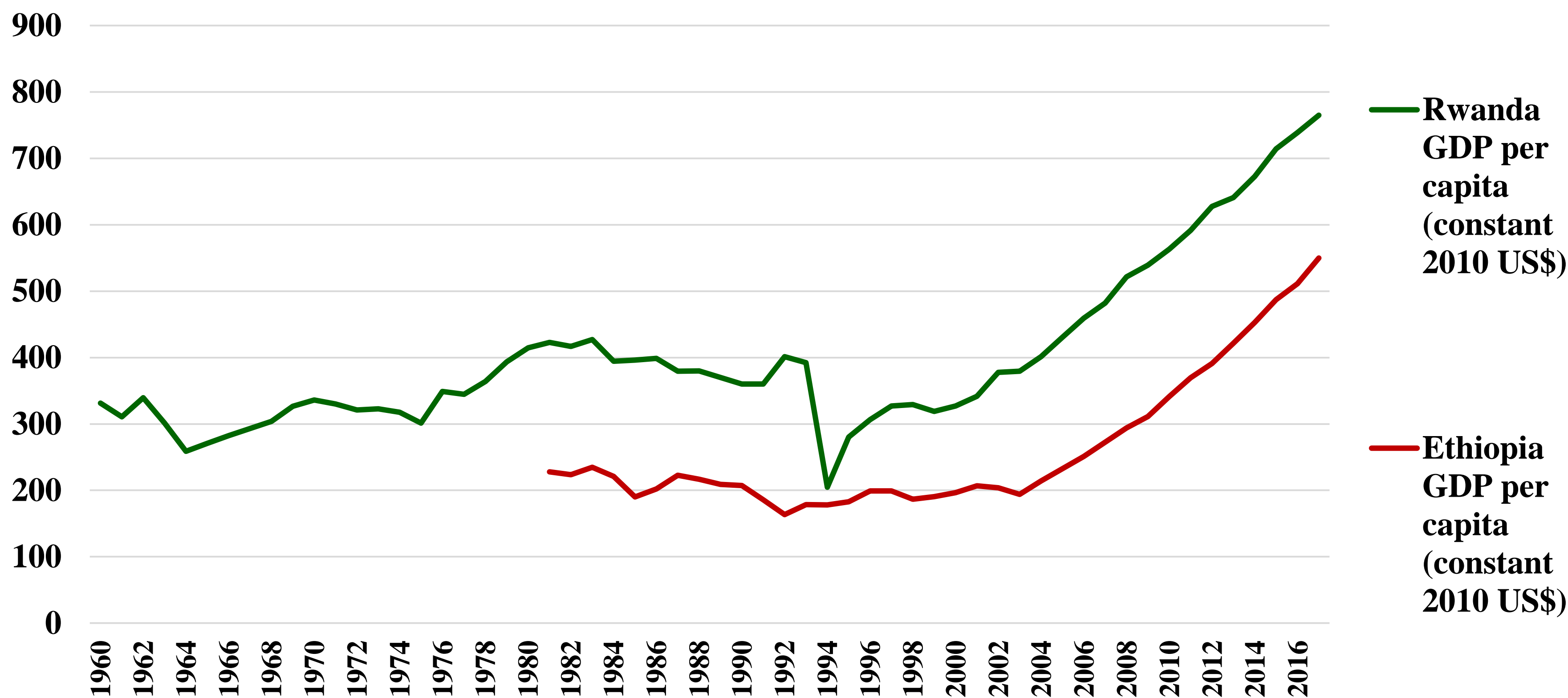
When one focuses on SSA growth alone (not including better performing regions that ‘flatten’ SSA performances), one observes **long periods of negative growth, especially the decades of the 1980s and 1990s** (‘the lost decades in spite of policy reform’, Easterly, 2001), which coincided with **the successive IFIs stabilisation and adjustment programs**.

SSA, GDP per capita (constant 2010 US $) (left axis), GDP growth and GDP per capita growth rates (right axis), 1960-2017



Source: World Bank World Development Indicators database, March 2019.

Some SSA states have witnessed **a remarkable growth that is not based on primary commodities,** thus coined SSA ‘developmental states’: e.g., **Rwanda, Ethiopia** (Booth and Golooba-Mutebi, 2012; Clapham, 2017).



Source: World Bank World Development Indicators database, March 2019.

- Yet even if for the well-performing SSA countries incomes have more than doubled over 3 decades, **levels of incomes remain very low**:

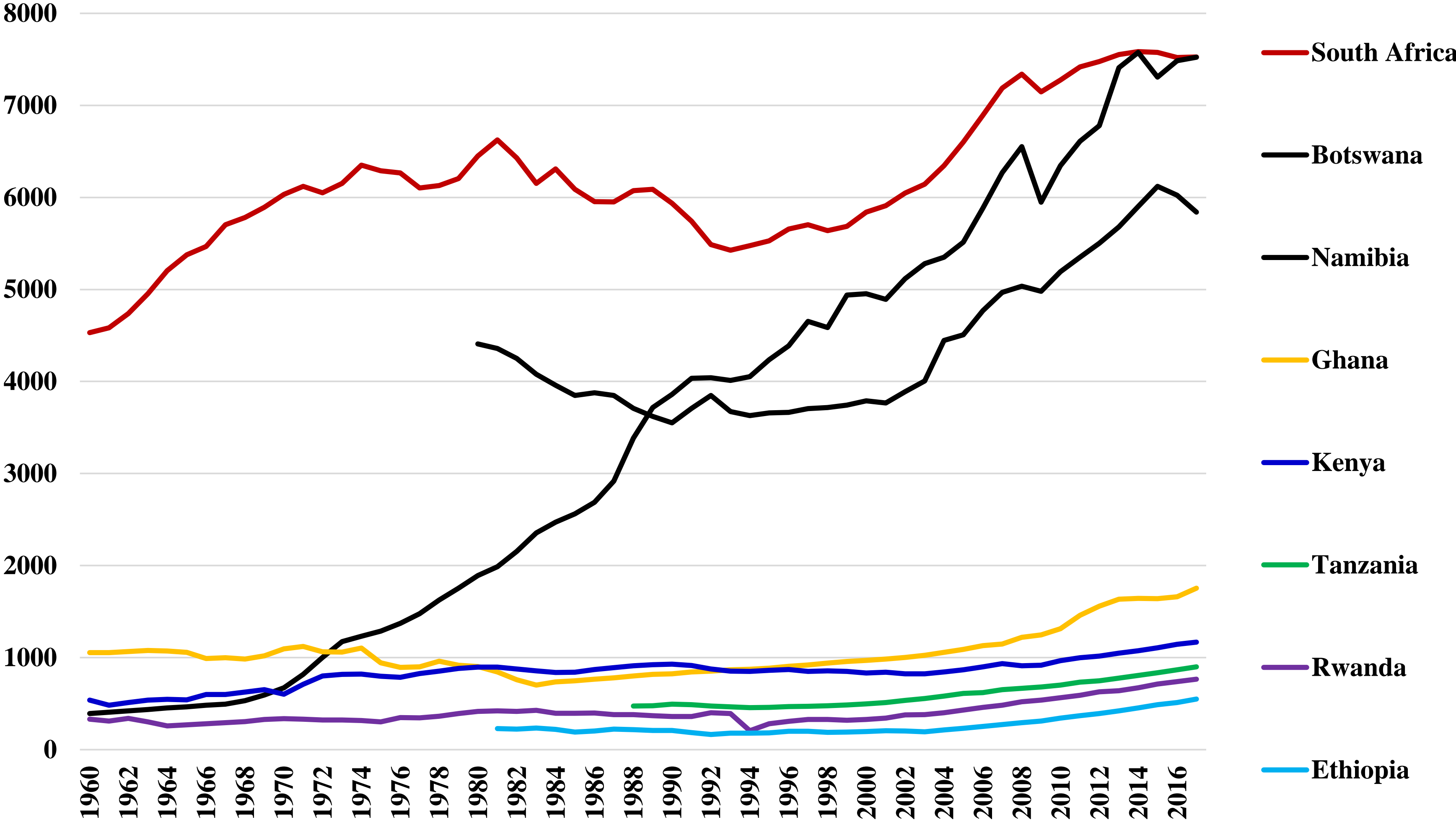
the comparison with richer countries 'flattens' individual countries' growth paths

(and foreign aid may have contributed to performances: e.g., it financed 13.7% of Rwanda's GNI in 2017, WB-WDI, March 2019, table 6.11).

- **Most SSA countries diverge vis-à-vis Botswana, Namibia, South Africa**.
- Ghana, Kenya, Tanzania, 'good pupils', remain low/lower-middle-income economies.

- The growth SSA governments have delivered has remained constrained by the **export structures inherited at independence, whatever the policies.**
- **Such growth trajectories are a factor of erosion of legitimacy and policy credibility**.

SSA, selected countries, GDP per capita (constant 2010 US$), 1960-2017



Source: World Bank World Development Indicators database, March 2019.

Hence the vicious circles of structural fiscal deficits and indebtedness

- SSA commodity-based economies **depend on commodities for their fiscal revenues since colonial times**

(the 'small colonial open economy', which imports manufactured goods from the colonizing country, and exports primary commodities to it, Hopkins, 1973).

- In such economies, **taxation has been based on that of international trade** (Frankema, 2014; Frankema and van Waijenburg, 2014).

Taxation of trade is an **'easy-to-collect' mode of taxation**,

vs. a '**hard-to-collect**' one, such as VAT, income taxes or corporate taxes, which require some minimal level of state (administrative) capacity (Aizenman and Jinjarak, 2009).

- Moreover, **the commodity-based structure has been aggravated by geographical and demographic characteristics** (poor infrastructure, low densities)

This resulted in constraints on the building of a **developmental taxation** (Herbst, 2000),

and therefore **in constraints on state redistributive capacity,**

and therefore **in constraints on the effectiveness and credibility of states' policies and consequently on their political legitimacy** (Sindzingre, 2007).

- **Oil-based economies are particularly dependent on the export of oil for their fiscal revenues**

because they are **less-diversified than economies based on 'soft' commodities** (e.g., cocoa, coffee, such as Ghana, Côte d'Ivoire).

E.g., in 2017, Angola oil represented 95% of exports, in Nigeria 95.8% (WB-WDI March 2019, table 4.4).

Depending on prices levels, oil has accounted in Angola for 60%-75% of fiscal revenues (IMF, 2018, art. IV; WB, 2016); 50% in Nigeria in 2017 (IMF, 2018).

SSA low- and lower-middle-income economies: dependence of fiscal revenues on the export of commodities, 2006-2010 average

Country	Type of primary commodity	Primary commodities exports (% of total exports, 2006-10 average)	Fiscal revenue from primary commodities (% of total revenue, 2006-10 average)
Congo, Dem. Rep.	Minerals and Oil	94	30
Liberia	Gold/Diamond/Iron Ore	--	16
Niger	Uranium	--	--
Guinea	Mining Products	93	23
Mali	Gold	75	13
Chad	Oil	89	67
Mauritania	Iron Ore	24	22
Zambia	Copper	72	4
Nigeria	Oil	97	76
Cameroon	Oil	47	27
Sudan	Oil	97	55
Côte d'Ivoire	Oil/Gas	--	--
Congo, Rep. of	Oil	90	82
Angola	Oil	95	78
Gabon	Oil	83	60
Equatorial Guinea	Oil	99	91

Source: adapted from Venables (2016).

- In this context, **the revenues from exports that exhibit very volatile prices are also volatile, which generate constant**, **‘structural’ fiscal deficits**.

- Hence in a vicious circle most SSA governments have had to **rely on external finance in order to fill their fiscal deficits.**

After independence, this external finance has been constituted by loans from private and public creditors:

yet such debt could be repaid only with resources determined by the fluctuations of commodity prices in international markets.

This has generated the accumulation of unsustainable debt 20 years later in the 1980s.

It cumulated with the debt that SSA economies had to resort to after independence because of state-building (infrastructure).

- SSA commodity-dependent economies thus became **'trapped' in cumulative causation processes,** where commodity price volatility, fiscal deficits and debt reinforced themselves – the '**international poverty-debt trap** (UNCTAD, 2002).

- For SSA (excluding high-income), debt stocks thus increased from 11.5% of GNI in 1970, to 78% in 1994 .
- The IFIs responded with lending conditioned on stabilisation programmes .

- In the context of the debt crisis of the 1980s, of SSA's 'lost decades' of the 1980s-1990s and the drying up of private credit to SSA after the 1980s due to fiscal deficits – caused by the volatility (fall) of commodity prices –, **the IFIs became key creditors of SSA countries.**
- For low-income countries (majority in SSA), the IFIs launched debt relief initiatives (HIPC, 1996, MDRI, 2006).

- Yet the end of the public debt crisis has not put in place a durable solution to **the vicious circles created by fiscal instability, then fiscal vulnerability and dependence on external events (international markets, IFIs):**

i.e. the **externalisation of SSA domestic fiscal policies**

and therefore the loss of control on them by SSA governments,

and therefore **the erosion of the credibility of their policies and of their legitimacy** vis-à-vis citizens.

- The commodity boom of the 2000s driven by China, combined with debt reduction, have allowed SSA economies to borrow again on international markets from the 2010s onwards via **sovereign bonds**.

Bonds have the advantage, compared to IFI conditional lending, of offering no conditions.

Yet **they entail risks,** i.e. shifting to **another modality of dependence on external events and entities**, the ‘sentiments’ of international markets, more prone to reversals than the IFIs (foreign exchange risks, IMF, 2016): e.g. currency exchange risk, interest rate risk…

3. A second modality of policy externalisation: the exchange of external agencies’ financing for policy reform

- **A consequence of fiscal vulnerability: dependence on foreign aid and multilateral institutions’ lending**

- This policy externalisation exhibits a second modality, which also stems from SSA dependence on international markets and their volatility:

i.e. a financing of development, **which comes from agencies that are external to SSA rather than from domestic resources** (savings, revenues).

- **Yet this financing by external agencies is conditional to policy reform (‘exchange of finance for policy reform**’, Nelson, 1990; Haggard and Webb, 1993)
- Be it concessional or non concessional lending.

- **SSA low-income countries are highly dependent on aid**.
- For SSA, net ODA represented in 2017 3.1% of its GNI, 14.1% of gross capital formation and 9.9% of its imports of goods, services and primary income (figures being driven by low-income countries),

Yet with disparities: e.g.., in 2017, in Liberia ODA represented 20.8% of GNI, 92.4% of gross capital formation and 41.8% of imports of goods and services, but 0.9% of GNI in Nigeria, 0.6% in Botswana, 0.8% in Gabon…

- **Non low-income SSA countries** are often producers of 'hard' commodities – oil, metals.
- **At the time of high commodity prices and high growth in the 2000s, they thought they would no longer need conditional lending**.
- **Yet when commodity prices fell again after the 2008 financial crisis**, growth witnessed sharp drops.
- **They therefore had to resort to the IMF, which as before conditioned its financing of fiscal deficits**.

- Be they low- or middle-income countries, **commodity dependence made it so that at each downward fluctuation of commodity prices, governments must call on the IFIs for financial support**

which is always conditional to externally devised policies,

resulting in a ‘prolonged’ use of IMF financing (IMF, 2002) (e.g., Angola after 2018).

- This contrasts with the states that grew at the end of the 20th century, the **Asian ‘developmental states’,**
- which put an end to the foreign aid received in the context of the Cold War in the 1950s:

- in Taiwan, the awareness that **US aid would be terminated was an incentive for the government to improve its legitimacy vis-à-vis its citizens and implement performance-oriented policies,** notably industrial policies (Brautigam, 1994; 2000).

Financial support conditioned on a specific and stable conceptual framework

- **This financing by external entities has been conditional to the implementation by recipient governments of policies devised by these external entities**.

- These policies derived from a **specific conceptual framework** that has become hegemonic within these agencies from the 1980s onwards (Toye, 1987)

and relies on specific assumptions, e.g., that minimal state intervention and liberalisation are the best routes towards growth (Adelman, 2000; 2001).

- **These agencies might have defended different conceptual frameworks**, e.g. a Keynesian one (increase in domestic demand), or a post-Keynesian one (instabilities intrinsic in financial liberalisation).

- Indeed the **‘truth’ of this conceptual framework** is questioned even by ‘mainstream’ economists (Rodrik, 1998; Przeworski and Vreeland, 2000; Williamson, 2008; Wyplosz, 2013; O’Rourke, 2014).

- **At the empirical level, the outcomes of its application to SSA economies from the 1980s onwards have been mixed** (the ‘lost decades’).

- **This conceptual framework has been exceptionally stable across space and time**, applied by the IFIs and all donors.

- **The policies conditioning disbursements were applied to all SSA countries in the 1980s, Latin America, Asia,**
- **then continued almost unchanged from the 1980s onwards**

(e.g. Greece from 2010 onwards, by the IMF, EU and bilateral lenders, Sindzingre, 2015).

- Against the many critiques of the rigidity of this conceptual framework, the **IFIs claimed they had improved conditionality** (*ex post*, ‘ownership’…).

- The IMF displayed pragmatism, vis-à-vis taxation, excessive liberalisation, inequality, exhibiting even some ‘statism’ (Ban and Gallagher, 2015)

Indeed the mandate of the IMF includes the surveillance of monetary and financial stability and thus revenue collection.

- Equally, flexibility has stemmed from geopolitical considerations (Thacker, 1999; Dreher, 2008).

- Yet the **conceptual framework underlying IMF conditionalities has displayed** a **remarkable stability over 3 decades (1985-2014),**

whatever the countries, developing or developed (Kentikelenis et al., 2016).

The impacts of externalisation on policy credibility and political legitimacy: the possibility of vicious circles

- **This second modality (externalisation of policies, conditional lending) may have a negative impact on two key dimensions of economic performance:**

i.e. the **credibility** (effectiveness) of SSA governments' domestic public policies,

and the latter's **political legitimacy**,

thus generating **vicious circles** (low economic performance, low policy credibility, low government legitimacy).

- **The 2 concepts – credibility, legitimacy - refer to different theoretical frameworks and causalities**.
- **In contrast with the concept of legitimacy** (Weber: a faith or trust of individuals in a political ruler or order), the concept **of credibility refers to that of policies:**

i.e. **for a government the ability to credibly commit** (Kydland and Prescott, 1977).

- **In contrast with legitimacy**, **credibility is an internal feature** (a policy content) **also provided by entities external to policy promises and decisions**

(supra-national arrangements, independent institutions - central banks, judiciary).

- **A problem in credibility is that there is no meta-level above government that has the coercive capacity to enforce government policies and promises** (Acemoglu, 2003):
- particularly in SSA, where political regimes may *de facto* weaken *de jure* independent institutions.

- **Conditional financing** has thus been justified by the IFIs as a device that can **'lock-in' the policies of SSA governments and hence enhance their credibility** vis-à-vis international investors (IFIs as 'global public goods', Rodrik, 1995) and their citizens.

- Yet the low growth of SSA economies before the increase in the 2000s (more driven by commodity prices than domestic policies) has questioned this.

- Moreover, **conditionality is a device that is inherently asymmetric** (a 'donor', a 'recipient') and implies coercion (Sindzingre, 2016):
- if governments were willing to implement these policies, there would be no conditionality

(despite IFIs claims that conditionalities are 'internalised' with time, Coate and Morris, 2006).

- Low growth, policies ‘devised in Washington’, the stability of conditionalities over decades **eroded the credibility of policies for citizens**, but also the **legitimacy of governments:**

even if governments have displayed ‘agency’ vis-à-vis policy externalisation: ‘double-edged diplomacy’ (Putnam, 1998), ‘scapegoat’ (Vreeland, 1999), policy reversals (Kahler, 1992), ‘non-reform’, ‘permanent crisis’ (Van de Walle, 2001), ‘Samaritan dilemma’ (Gibson et al., 2005; Svensson, 2005)…

- In commodity-dependent SSA economies, this **externalisation has stabilised self-reinforcing vicious circles**.
- Dependence on commodities induces **volatile government revenues and hence uncertainties on investment** (Ebeke and Ehrhart, 2012);
- and **in low-income countries the tax ratio is very low** (‘Wagner law’).
- For the IMF, below 12.75% of GDP, **tax ratios cannot contribute to growth** (Gaspar et al., 2016)
- In 2016, the revenue/GDP ratio was 5.0% in Nigeria; 9.8% in Sierra Leone; 10.4% in Ethiopia; 16.7% in Angola; 17.0% in Tanzania, 18.1% in Zambia; but 24.0% in Mozambique; 30.6% in Namibia; 33.5% in Botswana (WDI, 2019)

- **Low tax ratios reduce redistribution and investment, hence the credibility of governments' promises**;

the financing gap is filled by external entities, but with conditions.

Conditional financing and foreign aid **make governments accountable more to external entities than to citizens: this breaks a key element of political legitimacy, taxation.**

This induces citizens into not paying taxes and relying on non-state redistributive circuits (patronage):

in vicious circles, it further weakens the state's redistribution and hence legitimacy.

- **The participation of citizens in the channel of legitimacy built by taxation is weakened in 'hard' commodities countries**:

where revenue relies on devices involving governments and multinationals (production sharing, royalties), **not citizens**.

- **This social contract - a government taxing citizens with the latter's consent-, is a foundation of legitimacy** (Kaldor, 1963, Levi, 1988; Tilly, 1990; Englebert, 2000) .

Yet in commodity-based countries, the **events crucial for wealth are external** (international markets),

agencies that devise policies are external,

and rather than taxation on domestic wealth, **state's resources come from external origins** (taxes on trade, foreign aid).

- **Externalisation generates causalities detrimental to governments**' **legitimacy**, which **'split' states**.

Governments are accountable to external entities that finance them (Moss et al., 2006);

Governments are also in the inferior position of having no control on the price volatility of their exports and of being ‘recipients’ of financial flows, with no other choice than to accept conditions.

Citizens are aware that the government cannot implement a side of the social contract, ie ‘fair’ taxes,

and that their government redistributes a wealth on the value of which it is powerless, or which comes from the outside.

Such ‘splitting’ of the relationship governments/citizens and inferiorisation undermine legitimacy.

- *In fine*, policy externalisation highlights theoretical issues.
- **Policy credibility can be built by external entities (lock-in),**
- but **legitimacy is an internal process (‘trust’).**
- **The externalisation of sources of wealth and accountability, the asymmetry of conditionality**, **inherently erodes governments’ legitimacy**.