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Conventional and unconventional approaches to strengthening business and investment in Africa: Rwanda, Tanzania, and Ethiopia compared

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Introduction

Conventional wisdom on the investment climate in Africa has it that the state should limit itself to providing an enabling environment for private capital. It should steer clear of 'picking winners' as some of the more ambitious East Asian states did during growth-oriented industrial strategies, and it should maintain an arm's length relationship with business, avoiding the close relations that often degenerate into growth-unfriendly clientelism, cronyism, and rent-seeking. This paper examines three cases from contemporary Africa, two of which, Rwanda and Ethiopia, have pursued policies at variance with the conventional wisdom, and one of which, Tanzania has taken a more orthodox approach. The paper argues that Rwanda and Ethiopia have outperformed Tanzania, and that the standard policy advice needs to be rethought.

The World Bank and the investment climate

Creating a better investment climate is a pillar of the World Bank's strategy for developing countries:

> A good investment climate provides opportunities and incentives for firms – from micro-enterprises to multi-nationals – to invest productively, create jobs, and expand. It thus plays a central role in growth and poverty reduction {World Bank, 2004 #375, 1}.

According to the Bank, governments play a key role shaping the investment climate and should focus on reducing costs, risks, and barriers to competition for business. When they do this, firms will invest, jobs will be provided, the economy will grow. However, governments typically face a number of challenges here, challenges that stem from the tension between creating an investment climate good for particular individuals and firms, and an investment climate good for everyone.

One challenge is the need to restrain rent-seeking, including state capture, patronage and clientelism. Another is ensuring that policy responses reflect a good institutional fit, by which the Bank is chiefly concerned with state capacity for market intervention.

According to the Bank, investment climate policies are an easy target for rent-seeking practices. Corruption and predation are the most glaring examples, and can create extremely damaging distortions in policy. But the investment climate can also be harmed by more subtle forms of state capture, or patron-clientelism.

Government may design policies with specific constituencies in mind, suppressing economic competition, devising market restrictions, tolerating cartels, granting special tax exemptions, and using middlemen to control private sector credit. Firms that are part of the favoured circle face a more attractive policy environment, but are likely to innovate less {World Bank, 2004 #375, 44}.

To combat these dangers the Bank proposes enhancing the transparency of government-firm relations, broadening policy dialogues, and strengthening accountability mechanisms. The first may involve making government regulatory policy transparent, procurement policies competitive, and preceding certain government decisions by public access and comment. The second involves including a broad spectrum of interests from large producers to small consumers in policy dialogue, and in particular encouraging business associations. The third can involve strengthening competitive legislatures, expanding legislative authority over budgetary matters, strengthening oversight, and promoting a free and independent media {World Bank, 2004 #375, 45}.

The Bank recognizes that more personalized mechanisms, for example the 'crony capitalism' of Suharto's Indonesia can allow investment to proceed with few of these formal checks and balances. But it worries that 'these arrangements can ossify to the detriment of the broader investment climate – and to the detriment of the more innovative entrepreneurs, smaller firms, and consumers' {World Bank, 2004 #375, 50}.

When it comes to the extent of state intervention in the economy, the Bank seems skeptical about the ability of many developing country governments to correct market failures. It cautions against selective interventions such as the temptation to 'pick winners' or to woo investors with special inducements, since 'there are many examples of selective interventions going spectacularly wrong – at best wasting public resources, but sometimes creating large distortions that harm the investment climate' {World Bank, 2004 #37, 13}. The Bank recommends that poor country governments focus on delivering 'the basics'. These include stability and security, verifying rights to land and other property, and facilitating contract enforcement. In the Bank's view, 'the better protected these [property] rights from governments and third parties, the stronger the link between effort and reward, and thus the greater the incentives to open new businesses, to invest more in existing ones, and to simply work harder' {World Bank, 2004 #375, 9}. Barriers to competition benefit some firms but deny opportunities and increase costs to other firms and to consumers. They also weaken incentives for protected firms to innovate and improve their productivity {World Bank, 2004 #375, 15}.

In recent years the Bank's approach has been criticized by what we might call 'counter-orthodox' development theorists. Moore and Schmitz criticize its over-dependence on the twin objectives of legal formalism and state minimalism. While they concur with the conventional view that investors needs some assurance that they will be able to reap and retain profits, legal protection of property rights is not necessarily the best or only way of doing this. Experience shows that it is difficult to bring about rapid reform of weak legal institutions, meaning that the standardized investment climate package may be trying to do too much too quickly {Moore, 2008 #92, 9}. Moreover, standard investment climate advice, 'embodies an excessive distrust of governments insofar as they have any direct role in undertaking or shaping economic activity' {Moore, 2008 #92, 9}. But governments often play a vital role in coordinating investment, coming to the aid of business in times of trouble, and using their authority in a supportive way {Moore, 2008 #92, 9}. Standard advice views government intervention as a dead hand, and government rent-seeking and predation as a constant threat to free markets, but this does not square with the evidence. According to Moore and Schmitz, 'We need more research to enable us to understand, in particular, the circumstances in which different *hand-in-hand* relations between politicians and business, that do not meet the highest standards of fairness, transparency or legality a) help promote investment and b) do so with limited risk that they will deteriorate into 'crony capitalism' {Moore, 2008 #92, 11}.[1]

In the following pages I will present three contemporary African case studies. The first two provide evidence that selective interventions, an unlevel playing field, and less than perfectly transparent relations between politics and business can sometimes work to the advantage of development. The third shows a less interventionist approach.

Ethiopia: the 'revolutionary democratic' approach to growth and poverty reduction[2]

Ethiopia has adopted some liberal reforms in recent years, but it also has a distinctive approach to development. Partly inspired by the ruling party's socialist roots, and partly by some of the counter-orthodox theory mentioned above, the regime is conscious of the problems of market failure in developing countries, and mindful of the 'rent-seeking' excesses of uncompetitive private capital. Thus in addition to pursuing a fairly conventional privatisation programme, it has also sponsored the activities of various party-linked *holding* or *'endowment'* companies, private conglomerate-style companies, linked to the ruling party, that have both economic and other social and charitable goals as their aim.

Take for instance EFFORT, the Endowment Fund for the Rehabilitation of Tigray. Within months of EPRDF coming to power in mid-1991, a series of share companies began to be established by individual shareholders who were prominent members of the Tigray People's Liberation Front, using resources

[1] See also work by Mushtaq Khan, Dani Rodrik, and Ha Joon Chang, who variously point to the possibility of productive patron-client relations between politicians and businessmen in the early stages of economic development, the importance of industrial policy to kick-starting growth, and the fruitfulness of a whole range of government interventions.

[2] For further details see, Sarah Vaughan and Mesfin Gebremichael, 'Economic Development and Private Enterprise in Ethiopia', Africa Power and Politics, forthcoming 2011.

amassed by the TPLF/EPRDF during its war against General Mengistu. In mid-1995, these companies were transferred to EFFORT, the aim of which was to act as an instrument to promote the industrialization of Tigray, open up new sectors into which private sector businesses could follow, and contribute to the development of human resources, as well as to generate income for the families of war victims, and other charitable causes.

EFFORT is formally governed by a Council of 55-75 members, made up of representatives of the regional government, local governments, and other associations. Overall strategic management, however, is controlled by a Board of between nine and 12 members, all senior TPLF members and leaders. For example, the current Board Chairman is head of the political office of the TPLF in Tigray and EFFORT's current CEO is a former Regional vice-President; both are long-standing members of the TPLF socio-economic committee and current TPLF politburo members. But when it comes to EFFORT's individual companies, many are managed by professionals with significant private sector experience and good business training.

Today, EFFORT owns 18 enterprises covering areas such as cement manufacture, trading, textiles and garmenting, transport & logistics, industrial engineering, construction and pharmaceuticals. There is a high degree of vertical and horizontal integration of its companies, which offer a multitude of opportunities to exploit business synergies. Almost all its companies are profitable, and EFFORT is the largest regional taxpayer and non-state employer. Together with the scale of investment in new manufacturing plant and capacity in the region, these facts bear out the view that EFFORT has "created something tangibly new" in Tigray. In our research a number of interlocutors, including those critical of EFFORT, affirmed that: "Tigray without EFFORT would have been a disaster".

Experiments with venture capital and industrial learning in Africa are not new, of course. In the 1960s and 1970s many newly independent states embarked on ambitious import-substitution industrialization programmes, and in almost all cases these were a failure. Infant industries never grew up and could only survive by draining resources from other sectors, a trend reflected in macro-imbalances and disappointing growth. In Ethiopia, however, the activities of state-owned and endowment companies have been consistent with impressive economic performance. The country has shown increasingly strong growth since 1991, with a particular escalation in the period since 2003, and continuing high annual growth rates throughout the period of the global downturn from 2008. The IMF records Ethiopia's real average annual growth over the last decade as 8.4% (2001-2010), comparable with rates achieved by BRIC countries.

Rwanda: leading the market through party-based capital[3]

[3] This section is lifted from David Booth and Fred Golooba-Mutebi (2011) 'Developmental Patrimonialism? The case of Rwanda. APPP Working Paper 16'. London, Africa Power and Politics Programme

Like Ethiopia, Rwanda over the past 15 years has introduced some orthodox neo-liberal reforms, as well as using economic rents in a more unorthodox, and innovative way. Since 2000, rent extraction has been centralised within the operations of a holding company (Tristar Holdings) fully owned by the ruling RPF. Policy has been driven by a vision of economic and social development which is seen as a route to overcoming the ethnic divisions of the past. Rents are deployed in ways that correspond to this long-horizon vision, including ways that are objectively developmental.

At the beginning, Tristar companies were concerned exclusively with responding to the acute material shortages which characterised the immediate post-war situation, using RPF reserves to import goods. Soon, they moved into addressing politically crucial needs, including providing housing for returnees and private security services. Investments in basic import substitution followed (e.g. bottled water and basic dairy products). While in several of these activities Tristar may have benefited from an absence of competitors, there is no indication that they were massively profitable, and many suggestions that they were fairly badly run. During the Congo wars, Rwanda Metals was highly profitable, and it was probably in this period that the dominant role of Tristar moved from shoring up the government with the help of the RPF´s war chest to doing business on behalf of the party. Because of the international outcry about exploitation of Congolese natural resources, Rwanda Metals was eventually sold off soon after the effective end of the war in 2002 to a Botswana-based firm.

In its more interesting later phases, Tristar-financed companies combined the meeting of urgent socio-political needs with specific economic objectives, including demonstration effects aimed at other private operators. In due course, the activities of several of these firms stimulated other investment by private or public bodies in new or defunct sectors of the economy. As detailed in a companion Working Paper on the Tristar story, the investments included road construction, housing estates, building materials, fruit processing, mobile telephony and printing as well as furniture imports and security services. In all cases, the Tristar subsidiary was at first a pioneer in activities in which there was little interest from the domestic or (more relevantly perhaps diaspora) private sector. While no doubt these firms enjoyed some unhindered access to government and other large contracts – as well as preferred client treatment within the group – in most cases, this is the privilege that would have been enjoyed by any first-comer.

It is not clear that most of the firms were highly or even moderately profitable. Although they operated like private companies, they were run by party cadres with little or no business experience, and were probably not very efficient. The introduction of the accounting and reporting systems that would allow us to judge the matter only came later, which in itself tends to confirm the point. What is clear is that the operations were to a greater or lesser extent risky and involved heavy initial learning costs. The major contribution of Tristar and its biggest advantage over would-be competitors was its financial power (a combination of its own resources and its credibility as a borrower) and its willingness to use it to fund investments with high expected social benefits or economic externalities or high learning costs for a first-comer. In other words, the experience conforms closely to the argument of Mustaq Khan about the critical role that can be played by centrally controlled rents and other 'primitive accumulation' in financing the high learning costs that otherwise block the development of capitalism.

These generalisations apply quite clearly to the most important early Tristar investment, the one which brought the South African cellphone network MTN to Rwanda and later Uganda. Tristar fully funded the establishment of the MTN network in Rwanda, at a time when neither MTN nor any of the other global operators found the size of the country's subscriber base potentially interesting. The results of this venture were spectacularly successful, following which the MTN parent expanded its equity share and went on to establish a network in Uganda. In other words, Tristar contributed to a demonstration effect and learning experience in which one of the beneficiaries was an international firm. It thereby ensured not only that Rwanda entered the world of mobile telephony earlier than it would otherwise have done, but also that the network that was established was at least partly owned by domestic capital.

In other sectors, the emphasis has been more on using financial clout to enable local players to undertake the risks and learning associated with getting established in competition with international suppliers. This is particularly applicable to building and road construction, where some international firms, including increasingly Chinese companies, have not only experience but financial capacity which allows them to be free of risk-averse Africa-based banks. As our own studies in Uganda confirm (Booth and Golooba-Mutebi, 2009), operational competitiveness with international and particularly Chinese firms in these sectors is close to impossible to achieve for local firms in the sub-region in the absence of a mechanism for financing start-up costs and learning-by-doing.

In this respect and others, the operational management of the Tristar/CVL group has gone through at least three fairly distinct phases. The details are reserved for the companion paper. However, the broad picture is that in the earliest phases management styles within the group resembled those of the parastatal sector, but that progressively the companies have come to be managed according to the norms of the private sector. Increasingly, the model is early-stage venture capitalism and the orientation is towards creating firms that are attractive partners for international direct investors, not just large players in domestic terms.

In spite of the World Bank's scepticism about Tristar-style institutional relationships, Rwanda's economic performance has matched or exceeded that of its East African rivals, in spite of its being landlocked, having a much smaller domestic market and being resource poor.

Tanzania: liberal reforms without poverty reduction or development[4]

[4] For further details see Brian Cooksey and Tim Kelsall, 'The Political Economy of the Investment Climate in Tanzania', RR 1, Africa Power and Politics, 2011

Tanzania's approach to stimulating investment has not been completely orthodox, but it has been more orthodox than the approach in Rwanda and Ethiopia. Certainly in the field of business, there has been no sustained attempt on the part of the government to correct market imperfections, pick winners, or develop clustered investments with a high degree of vertical and horizontal integration. Similarly, there has been little attempt to combine profit with non-profit objectives in the incentives provided to private business. Tanzania has relied much more exclusively on a standard policy package of sound macro-economic management, property rights protection, incentives to investment through generalized tax breaks, strengthening the commercial legal framework, and increasing transparency through lifting restrictions on press and civil society. At first glance this strategy appears to have been fairly successful, since it has stimulated an investment boom, with Tanzania one of the top recipients of FDI in Africa. However, closer examination shows that this boom is concentrated in two sectors: mining and tourism, and that linkages to the rest of the economy are slender. While Ethiopia and Rwanda are making significant inroads into poverty reduction, poverty in Tanzania has hardly declined. Moreover, promising sectors with potentially greater pro-poor impact are stagnating. This can be illustrated by a consideration of the horticulture sector.

Large parts of Tanzania are well-suited to commercial horticulture and in the late 1980s its horticulture sector began to take off. The initial stimulus was a change in ideological direction on the part of the socialist government, which allowed some estate land in the Arusha and Moshi to be returned to its previous owners, many of whom then sold the land on. The original investors were horticulturalists in Kenya who were attracted to Tanzania by its comparative political stability. A new wave of investment was triggered by some concessional loan finance made available by the Tanzania Investment Bank. The value of horticultural exports from Tanzania increased from USD 5.2 million in 1997 to USD 26.7 million in 1999. In 2008, exports were worth an estimated USD 146 million but by the time of our research, and even controlling for the effects of the global recession, the industry appeared to be at a standstill. The reason seemed to be the lack of a vision for the sector on the part of government, meaning that it has suffered at best from neglect and at worst from nonsensical policies and predation.

Examples of neglect include the reluctance of the government to consistently enforce property rights in the Arusha-Moshi area. Many farmers acquired their land in controversial circumstances and suffered from squatters living either on their land or villagers on its fringes who coveted the land. Some had been unable to develop their estates to full potential because of land invasions and security threats, and the courts and district authorities provided only intermittent support. Water rights were also an issue on some farms. Another example relates to unfavourable conditions at Kilimanjaro International Airport, where freight charges have been expensive and unreliable, partly on account of a monopoly held by Swissport. For a time horticulturalists mobilized a dedicated air freight carrier with the help of TAHA, a donor-supported business association. However, the experiment was shortlived and in its absence, most Tanzanian flower farmers are sending their produce the much longer route to Nairobi.

Examples of predation include unfavourable tax assessments from the Tanzania Revenue Authority, delays at customs, and unpredictable policies with regard to duties and exemptions. In addition, there were questions at the time of research over whether the TIB would roll over some flower farm loans in the face of recession-induced difficulties.

As mentioned above, the sector's interests were represented by a business association, which had had some success in mitigating some of the harmful policies of government, but our evidence suggested that these small victories had come at considerable cost and that a government keen to develop horticulture would be doing much more. Ethiopia provides a good contrast, where the horticulture industry, with government support, is expanding much more rapidly than Tanzania's.

Conclusions

Rwanda and Ethiopia are both pursuing active industrial policies using institutional arrangements that deviate from the 'best practice' advice of Africa's main donors. Relations between government, party and business are close (arguably clientelistic), party-linked businesses receive special favours (though perhaps not as many as is commonly believed), and there is a lack of transparency to these relations. Business politics relations in Tanzania are for the most part more 'correct' and the country has much less in the way of an industrial strategy or vision for the country's development – but its economic performance, especially when it comes to poverty reduction, is less impressive.

This is not to say, however, that Tanzania could easily adopt the policy and practice of Rwanda and Ethiopia. In other research we have argued that economic performance is impressive in the latter and disappointing in the former because the latter have in place a structure of centralized, long-term rent-management. This allows the leadership to set economic goals for the society and implement them, steering resources to the desired areas and ensuring that those resources are used with considerable discipline and efficiency. It is probable that in due course these clientelistic arrangements will outlive their usefulness and that new arrangements will have to be found, but as transitional measures they appear to be performing commendably.

Interestingly, Tanzania has also seen some large investments as a result of close relations between business and politics, especially in the gold sector, where foreign mining companies were given special inducements to invest in mysterious circumstances.[5] Because these inducements were not under the control of a leadership with a long-term vision for society, however, their main effect has been to drain a larger than normal amount of the rents from gold production away from the country.

A number of lessons can be drawn from this comparison:

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[5] For further details see Brian Cooksey and Tim Kelsall, 'The Political Economy of the Investment Climate in Tanzania', RR 1, Africa Power and Politics, 2011

- Where the political leadership is committed to a long-term development vision and can control the major rents in the economy, interventions in the market may produce favourable economic results.
- If the above conditions hold, the fact that relations between politicians and businessmen are close, clientelistic, and not perfectly transparent is not necessarily fatal to rapid development, at least in its early stages.
- Where the top leadership lacks control over the economy's main rents, or has no credible long-term vision for them, market interventions and special inducements for business are likely to work to the detriment of society overall.
- A society that lacks this type of control is also unlikely to be able to implement standard investment climate advice convincingly.
- Until a credible strategy can be found for this type of regime, standard investment climate advice may be the lesser of two evils.