TANZANIA INSTITUTIONAL DIAGNOSTIC

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September 2018

Institutions matter for growth and inclusive development. But despite increasing awareness of the importance of institutions on economic outcomes, there is little evidence on how positive institutional change can be achieved. The Economic Development and Institutions – EDI – research programme aims to fill this knowledge gap by working with some of the finest economic thinkers and social scientists across the globe.

The programme was launched in 2015 and will run for five years. It is made up of four parallel research activities: path-finding papers, institutional diagnostic, coordinated randomised control trials, and case studies. The programme is funded by the UK Department for International Development. For more information see http://edi.opml.co.uk.

Introduction

'Institutions matter'

'Institutions matter' became a motto among international organisations in the late 1990s, when it became clear that the so-called 'Washington Consensus' and its emphasis on markets was not generating the growth and development that was expected. The slogan could be interpreted in different ways. It sounded a note of disappointment for those liberalist reformers, sometimes jokingly called the 'marketeers', who promoted the generalised shift to market mechanisms and the pre-eminence of private actors in developing countries at the time of the development crisis of the 1980s. Giving more space to the market was perhaps a good idea from a theoretical point of view. Practically, however, it was another story. What the 'marketeers' had not realised was that a well-functioning market economy requires an institutional background, which most often was missing in the economies to be reformed, and that liberalising and privatising might in effect be counterproductive without concomitant institutional changes.

The 'institutions matter' slogan today stands for a fundamental truth about development, which seems now to be widely shared by the development community, including international organisations and the old marketeers, as well as academics. It now seems obvious that there is indeed complementarity between the market and the state. The economic efficiency to be expected from the former requires some intervention by the latter through adequate institutions or rules imposed on the various economic actors, including the state itself. Practically speaking, however, these rules are the produce of history or specific circumstances and are not necessarily well adapted to today's economic context or the specific circumstances of a country at a given point of its development process. This is precisely how 'institutions matter' – the debate bearing not so much on this basic fact, but on the way institutions should be reformed. This is where the old opposition between marketeers and state interventionists is back in the picture, with, to simplify, the former most often pleading for rules that facilitate business and increase economic efficiency and the latter more attentive to promoting social welfare and protecting public goods. This is also where political economy plays a major role, as all economic and political actors try to bend the rules in their own interest.

'Institutions matter' quite evidently to those academic economists who for a long time have emphasised the link between the process of economic development in a country, the nature of its institutions, i.e. the structure of political power and the norms and rules inherited from the past, and their joint evolution with economic development. As a matter of fact, institutional economics has a long history, from Karl Marx and Thorsten Veblen to the so-called New Institutional Economics associated in its development component, in particular, with Douglass North. The latter borrowed from the other components of that school of thought their extension of the neoclassical paradigm to a view where economic institutions would be a way to solve the inefficiencies arising from the existence of transaction costs, asymmetric information, and limited commitment capacity. Hence, the emphasis put in that literature on institutions that aim to protect property rights and enforce contracts as positive factors of development. At the same time, such a view of the role of institutions in development is criticised by the Institutional Political Economy approach, which relies more on a sociopolitical view of institutions as having consequences for the functioning of the

economy than it does on a view of institutions as addressing sources of economic inefficiency. It is also fair to say that both schools of thought rely very much on a historical view of institutions and development, drawing their examples from, and grounding their case on, development history or observed contemporaneous differences between so-called advanced countries and emerging or developing ones.

How institutions matter in development policy today

Faced with the disappointing performances of the 'Washington Consensus', international organisations and bilateral development agencies switched to what was called the 'post-Washington consensus', or what Stiglitz nicknamed the 'Washington Consensus plus'. This extended set of principles were seen as a way of compensating for the neglect of institutional considerations in the original consensus. Some recommendations about institutions were simply added to those about economic policy. Market reforms are not enough. They have to be accompanied by other reforms, including competition policy, the regulation of the financial sector, the improvement of government efficiency, and that of human capital formation. The accent was also put on good governance as a necessary adjuvant to development, especially in its capacity to protect property rights and guarantee contract enforcement. With time, governance then became a key criterion among donors for allocating aid across low-income countries.

A major difficulty with this 'new' approach to development policy is that there is no real theory behind this extended set of principles – to such an extent that Rodrik, commenting upon a volume reviewing the evolution of the economic thought of the World Bank over the 1990s, entitled his review with the question: 'Goodbye Washington Consensus, Hello Washington Confusion?'. In effect, the main difficulty of extending the former orthodox development paradigm to include institutions is that there is limited knowledge on the way institutions can be reformed. It is one thing to adopt rigorous fiscal and monetary policies, and to observe that badly governed countries tend to perform less well than others, but it is quite another thing to change institutions, i.e. to regulate private monopolies, to change the law on land rights, or to improve governance and fight corruption. The latter policies will most likely be opposed by part of the political or economic elite, so that their implementation – or lack of it – will depend on the structure of political and economic power. Identifying development obstacles in a country necessarily touches upon economic and institutional challenges, but addressing the latter requires dealing with the political economy of a country.

In their best-selling book *Why Nations Fail*, Acemogulu and Robinson (2012)[1] masterfully showed the role of institutions in several historical and contemporaneous developments, or development failure experiences. They stressed, in particular, the key role of inclusive institutions as compared with predatory ones, and most importantly the role of politics in changing institutions and triggering development or, on the contrary, bridling it. If there is absolutely no doubt that institutions matter for development, the real issue is to know how they matter, how they should be reformed, and how such reforms could be implemented.

[1] Acemoglu, D. and Robinson, J. (2012). *Why nations fail: The origins of power, prosperity, and poverty* (Pbk. ed.). New York: Crown Business.

Despite intensive efforts over the last two decades or so, researchers have not gone very far in resolving these questions.

Searching for evidence on the quality of institutions and development

Three approaches have been developed to identify the institutional factors hindering development or ways of remedying specific factors. All of them have their drawbacks, however.

The first approach is historical case studies. Scholars have done in-depth studies of the history of successful, and unsuccessful, development processes, to identify the factors responsible for success or failure. The glorious revolution in Britain, the redistribution of land in Korea after Japanese departure, the success of Maghribi traders in the 11th-century Mediterranean basin, or the violent fight for the appropriation of natural resource rents in several post-independence African states are examples of the establishment of institutions that led in some cases to vigorous development headed by developmental states of diverse natures, or to underdevelopment under essentially predatory states. These studies are all of utmost interest as they show the way in which institutions are being transformed, often under the pressure of economic circumstances, and sometimes lead to fast development while at other times prevent development from happening. The problem is that these experiences are rarely transferable in time or in space and are not necessarily very relevant for developing countries today.

The second approach is the contemporaneous era cross-country analysis. It relies on indicators that describe the strength of a particular set of institutions in a country, e.g. property rights, legal regimes, strength and nature of controls on the executive, extent of democracy, corruption etc., and that show whether there is a correlation with growth or other development indicators. These indicators are generally put together by asking experts in various areas to evaluate, on a comparative basis, countries on which they have specialised knowledge. Then correlations between these various indicators and various economic development indicators, primarily GDP growth rates in the first instance, are established. Results, which do not necessarily show the direction of causality, are sometimes significant. But the use that can be made of them is problematic. They essentially refer to an abstract 'average country' and may be of little use for a specific country. Most importantly, they say nothing about causality and still less about the policy instruments that could improve particular institutions. Within such a macro approach, corruption is generally found to be bad for development, but in what direction does the causality go? Is it the case in all countries and all circumstances? What about the cases where corruption 'greases the wheels' and reintroduces economic efficiency in the presence of too stringent administrative constraints? This is a nice first approach but it has a long way to go to be of direct relevance at the country level.

Institutional weaknesses are also sometimes readily observable, as is sometimes the case in the delivery of public services in education or health. For instance, the absenteeism of teachers in public schools reveals a breach of contract between civil servants and their employers as well as a monitoring failure by supervisors. If there is no identification problem in that case, there is an issue in remedying this state of affairs. Numerous experimentations

rigorously evaluated by randomised control trial (RCT) techniques in various community settings have taken place over the last two decades or so. There is certainly something to be learned from a community faced with this kind of challenge in the literature, even though the transfer of effective policy measures from one social context to another is not necessarily automatic. Moreover, this kind of approach to resolving institutional weaknesses refers to relatively simple cases. Experimentation and the use of RCT techniques may be much less easy in other situations.

It is these limitations of the standard analysis of the relationship between institutional inweaknesses and development that motivated the Economic Development and Institutions (EDI) research programme, the aim of which is precisely to provide better methods and tools for dealing with all kinds of institutional obstacles to development and, in the first place, identifying them. Within the EDI research programme, the latter is more precisely the objective of the 'institutional diagnostic' research activity.

Institutional diagnostic as a new approach to institutions and development

The 'institutional diagnostic' research activity aims to develop tools that would permit the identification of major institutional obstacles to development in a specific country at a specific point of its development process, as well as possible lines of reform and the political economy issues associated with them. This is a country-centred approach that differs from the historical case studies mentioned above, in the sense that the focus is not on a particular event or episode in a country but on the overall functioning of its economy. It is not a straight application of the econometric approach because usual governance indicators used in cross-country analysis appear much too rough when dealing with a real economy.

Institutional diagnostics bears an obvious resemblance to the 'growth diagnostics' approach developed by Hausmann, Rodrik, and Velasco to identify the binding economic constraints to growth. The resemblance is only semantic, however. Practically, the growth diagnostics approach relies on a model of growth based on the accumulation of capital and its determinants among entrepreneurs, on the availability of infrastructure, on financial facilities, on the control of risk through appropriate insurance mechanisms, and on the development of human capital. Constraints in one of these dimensions should translate into a relative shadow price paid for that resource or that facility. No such implicit simple model is available in the case of institutions and there is no shadow price easily observable for the availability of a fair judiciary, an honest civil servant, or an effective regulatory agency. Another, more heuristic approach had to be developed.

It was decided in a first stage not to choose diagnostic tools *a priori* and to test their accuracy by applying them to various countries. On the contrary, the choice was made to proceed to in-depth studies of the relationship between the state of a large range of institutions and the nature of the development of a limited number of countries, and then to see whether these in-depth studies suggest common analytical tools to more systematically identify possible institutional obstacles to development. It was a requirement of the organisation funding EDI, the UK Department for International Development, to work on low-income and lower middle-income countries. The first country selected for such a deep-dive study was Tanzania.

The main general definition of institutions within the EDI project derives from that of North (1990)[2]: 'Institutions (are defined) as rules, procedures or other human devices that constrain individual behaviour, either explicitly or implicitly, with a view to making individual expectations about others' behaviour converge and allowing individual actions to become coordinated'. It is that definition that is used in the institutional diagnostic research activity, even though it is very much restricted to economic and political–economic relations and frequently involves rules emanating from the public authority.

Equipped with this definition, the procedure to establish the in-depth review of possible obstacles to development in a given country comprises two steps. The first one is 'mechanical'. It consists of asking various types of decision makers, top policymakers, and experts their views on institutional obstacles in their country. This can be done by questionnaire survey or simply by qualitative interviews. The literature has also to be consulted and a complete survey of the economic and development performances and constraints faced by the country has to be established to see whether the most obvious 'binding economic constraints' are caused by clearly identified institutional factors. From such a direct and unbiased approach, the goal is to select several thematic areas where critical institutional factors seem to be predominant. Some of these areas are obvious. For instance, various aspects of the functioning of the state have to be scrutinised, the same being true of the relationship between economic and political power or the nature of the political leadership. Others would be country dependent.

The second step consists precisely of a thorough analysis of these critical areas in order to understand what it is that does not function on the institutional side, why, how things could be fixed, and what would be at stake in such reforms. Are the observed institutional weaknesses due to a lack of skills of civil servants, the fact that they shirk or are corrupt, that the law or administrative rules are too complicated and possibly inconsistent, that the administration is badly organised? Why is it that reforms that seem adequate to remedy these weaknesses have not been undertaken? Who would be the gainers and the losers of such reforms and therefore who would promote and who oppose them?

Based on these detailed analyses of key thematic areas, the challenge will then be to synthesise what has been learned into some basic institutional weaknesses common to various areas, their negative consequences for development and, most importantly, their causes, proximate or more distant, and the potential for remedies and reforms. This will be the essence of the diagnostic to be delivered at the end of each case study, together with a list of all the potential reforms that will have been suggested in the course of the thematic studies and the synthesis exercise as a possible remedy to a variety of institutional weaknesses.

This will be a diagnostic, not a reform agenda. Because there are gainers and losers to most reforms, political economy factors as well as political and economic circumstances will determine whether they can be undertaken or not. From the point of view of the diagnosis, the important contribution is to put squarely on the table the nature of the weaknesses, possible reforms, and what is at stake in them. In other words, it is to make sure that all

[2] North, D. (1990), *Institutions, Institutional Change and Economic Performance*, Cambridge: Cambridge University Press.

decisive actors are aware of all that reforms would entail, collective gains, but also, occasionally, losses for various categories of agents.

The Tanzania study

Why was Tanzania chosen as the first in-depth case study of the relationship between the quality of institutions and development? First, because it is a peaceful country with a stable political regime and very limited ethnic rivalry in a sub-Saharan African context. In that way, it was easier to relate development issues to the functioning of institutions rather than latent conflicts of a purely political nature. Second, this is an economy that, as many others in the region, has gone through major institutional reforms at the time of the transition from the socialist experience attempted under the founder of the nation, Mwalimu J. Nyerere, to a full market economy under the auspices of International Financial Institutions in the 1980s and early 1990s. It was thus interesting to check whether there were still some remnants of that difficult transition in today's economic institutional framework and their implications. Third, it had been a fairly fast-growing economy for the past 10 to 15 years and had possibly settled into a steady state of solid growth, which many observers thought could still be accelerated further. On that ground, it was likely that institutions were stabilising themselves, making them easier to observe and analyse. Finally, Tanzania is a country that has been studied by various eminent scholars in economics and political science, so it was possible to rely on solid expertise in many areas.

With the help of various researchers who have agreed to devote some of their time to the questions raised in this introduction, it was possible to complete the methodological steps sketched above. The following table of contents of the Tanzania study lists the various chapters and their authors and discussants.

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PART 2. Thematic studies

3. Politics and business (Samuel Wangwe, with discussant Hazel Gray)
4. The civil service and economic development in Tanzania (Rwekaza Mukandala, with discussant Jan Willem Gunning)
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6. Land rights and the law in Tanzania: Institutional issues and challenges (Sist Mramba, with discussant Klaus Deininger)
7. Power sector reform and regulation in Tanzania (Catrina Godhino and Anton Eberhard, with discussant Antonio Estache)

PART 3. Synthesis

8. An institutional diagnostic of Tanzania: synthesis (François Bourguignon and Samuel Wangwe)

Acknowledgements

Before getting into the crux of the matter, we need to acknowledge the precious help the editors and authors of this study received from many friends and colleagues. In the first place, we would like to thank Katie McIntosh, who was the representative of Oxford Policy Management (OPM) in Dar es Salaam at the time this study was started and followed it on behalf of OPM from the beginning to the very end, not only making sure that drafts were handed over in time, organising meetings, workshops, and seminars, but also reading the various chapters and making judicious comments on them. This study would not have been completed without Katie's professionalism, devotion, and friendliness. Thanks again, Katie.

Another special debt has to be addressed to the then Governor Benno Ndulu and Honourable Judge Joseph Warioba, former Prime Minister and Vice President, whose guardianship and advisory role on this work ensured it was of high quality, informed by a diverse set of viewpoints, and situated in the reality of the Tanzanian context.

The members of the Scientific Committee of EDI's institutional diagnostic research activity, Benno Ndulu, Louis Kasekende, Lemma Senbet, and Romain Houssa, as well as co-Research Director Jean-Philippe Plateau, must also be acknowledged for the crucial role they played in critically challenging the process and conclusions of the study, pushing authors to produce meaningful high-quality research. We must also acknowledge the EDI team members who contributed valuable insights and a management function to the process, including Mark Henstridge, Yasmina Yusuf, Benjamin Klooss, Vinayak Uppal, Stevan Lee, Umar Salaam, Tatiana Goetghebuer, and Ombeline de Bock. We would specifically like to acknowledge Kaley Milao for her coordination support to the team of authors and organisation of key events, including the Arusha workshop in January 2018.

REPOA, and specifically Cornel Jahari and Abel Kinyondo, must also receive a very special acknowledgement for partnering with the EDI programme on the implementation and analysis of the Country Institutional Survey, which is featured in Chapter 2.

There remain a few individuals who we must single out for their contributions to the thinking and analysis underlying the Tanzania Institutional Diagnostic. We would like to acknowledge Godson Nyange for his support in facilitating key meetings and providing valuable advice and reflection throughout the study. Josaphat Kweka and Donath Olomi must be acknowledged for providing valuable reflections on the design and analysis of the survey, as well as Tausi Kida and Moses Kusiluka for their contributions to the Arusha workshop discussions in January 2018.

We are extremely grateful to all those who met with us along the Tanzania Institutional Diagnostics journey to provide their reflections and challenge us to consider a variety of issues. We would like to express a special thank you to former Presidents Benjamin Mkapa and Jakaya Kikwete for their insightful reflections on Tanzania's development, particularly during their years in the presidency. We are grateful to past and present government officials who made time to speak with us, including Philip Mpango, Servacius Likwelile, Omari Issa, Neema Nduguru, Alphayo Kidata, Lordship Othman Chande, Mussa Juma Assad, Valentino Longino Mlowola, Adolf Mkenda, Wilfred Mbowe, Felix Ngamlagosi, Godfrey Chibulunie, Msafiri Mtepa, Mathias Kabunduguru, Maduka Kessy, Matern Lumbanga, Stephen Wasira, and Pius Msekwa. We acknowledge Zitto Kabwe and Ibrahim Lipumba for their comments.

We thank members of the private sector who contributed to a diversity of viewpoints, including Leodegar Chilla Tenga, Ali Mufuruki, Mohammed Dewji, Shabir Abji, John Wanyancha, and Patrick Rutabanzibwa.

We are grateful to a large group of researchers, academics, and others whose critical challenge function must be acknowledged. This includes Donald Mmari, Kasim Kulindwa, Vincent Leyaro, Jehovaness Aikaeli, Joseph Semboja, Dennis Rweyemamu, Issa Shivji, Ringo Tenga, Alphonce Tiba, Remidius Ruhinduka, Brian Cooksey, Aidan Eyakuze, Kees de Graaf, Risha Chande, Alex Makulillo, Richard Sambaiga, Bruce Heilman, William John, Bashiru Ally, Wilfred Kahumua, Stephen Kiraura, and Onejumo Selijio.

Finally, we must acknowledge the representatives from international organisations and donors in Tanzania who provided useful insights along the way, including Bella Bird, Yutaka Yoshino, Denis Biseko, Vel Gnanendran, Thomas Allan, Jean-Paul Fanning, Nick Lea, John Wearing, Francis Samba, Thomas Baunsgaard, and Virginie Ruyt.

This project was funded with UK aid from the UK government.