INSTITUTIONS AND INSTITUTIONAL CHANGE AS EXPLANATION FOR DIFFERENCES IN ECONOMIC DEVELOPMENT – A STUDY OF THE FIRST THREE DECADES OF THE POST-COLONIAL EXPERIENCE OF ZAMBIA AND BOTSWANA

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Declaration

I, the undersigned, hereby declare that the work contained in this dissertation is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

Signature:………………………………

Date:………………………………………

Abstract

Numerous theories have been constructed to provide reasons for economic growth differences between countries. As data became more readily available, cross-country empirical studies identified a set of variables that contributed to economic growth, including variables such as the investment in human and physical capital. Although most of the identified variables provide some support to economic growth, they still do not fully explain all growth differences. Furthermore, the analysis of these variables does not disclose, for instance, why two countries receiving the same amount of aid would spend it differently. The New Institutional Economics (NIE) accepts the importance of the variables identified, but extends the analysis of growth differences between countries to the link between policy choices and economic growth.

In the NIE literature it is widely accepted that policies should support the minimisation of transaction costs and the protection of property rights. It asks the question of what lies behind different policy decisions and explores why different countries take different routes to growth and development (or alternatively to economic stagnation).

Policies originate as formal institutions, i.e. the "rules of the game". These formal institutions come into being due to various reasons and are mostly in support of groups in society that have the power to influence decision-making. Important also are the informal institutions, which encompass the culture, norms and codes of conduct that have been present for some time in the specific country. The effect of different existing informal institutions makes it impossible to duplicate formal institutions between countries and expect these formal institutions to lead to the same outcome.

How do countries establish institutions that support the minimisation of transaction costs and the protection of property rights? Case study research provides useful information, but studies of this type on African countries have so far been rare. The purpose of this dissertation is to contribute to case study research in NIE by focussing on two African countries. Among others it proposes to answer the following questions: where do institutions that are detrimental to growth come from, and why do countries find it difficult to change them?

Botswana and Zambia are the two countries chosen for this comparison because they are similar in various respects that can be related to growth differences. Both countries are situated in sub-Saharan Africa, are mineral dependent in their exports, landlocked, and were under British rule until the 1960s. There are marked growth differences between these two countries, which new classical growth theories do not fully explain. But when

empirical institutional data is analysed, new explanations for growth differences come to the fore.

If sovereign leaders were responsible for postcolonial policies, why did leaders in Zambia make decisions that increased transaction costs and infringed property rights? Differences in colonial experiences are explored, as well as the situation that prevailed in pre-colonial days. It is found that due to the informal institutions that were created by these two experiences and the lack of legitimacy of the post-colonial leadership, the Zambian government was able to turn away from two formal institutions that provide checks on government decisions: i.e. democracy and the rule of law. Without these oversight agencies, the post-colonial Zambian government was able to make decisions that had short-term benefits (especially in terms of ridding the country of any colonial influences), but were to the long-term detriment of the country.

Institutions in Botswana tell the opposite story. Informal institutions created before and during British rule supported the formal institutions left by the departing Britons. This created an atmosphere of stability and certainty in which the economy prospered.

Opsomming

'n Aantal teorieë is oor tyd ontwikkel om groeiverskille tussen lande te verklaar. Soos data meer beskikbaar geraak het, was dit moontlik om met behulp van 'n kruissnit van lande veranderlikes te identifiseer wat 'n bydrae tot ekonomiese groei lewer, insluitende veranderlikes soos investering in menslike en fisiese kapitaal. Alhoewel die meeste van hierdie geïdentifiseerde veranderlikes 'n bydrae lewer tot die verklaring van ekonomiese groei, verklaar dit steeds nie alle groeiverskille nie. Die ontleding van hierdie veranderlikes verklaar byvoorbeeld nie waarom twee lande wat dieselfde hoeveelheid finansiële hulp verkry, dit verskillend spandeer nie. Die Nuwe Institusionele Ekonomie (NIE) aanvaar die belangrikheid van die veranderlikes soos deur empiriese studies geïdentifiseer, maar brei die analise van groeiverskille uit na die verwantskap tussen beleidskeuses en ekonomiese groei.

In die NIE literatuur word dit algemeen aanvaar dat beleid die vermindering van transaksiekoste en die beskerming van eiendomsreg moet ondersteun. Dit ondersoek ook die oorsprong van verskillende beleidskeuses en waarom verskillende lande verskillende weë volg na ekonomiese groei en ontwikkeling (of alternatiewelik na stagnasie).

Beleid is 'n formele institusie, die sogenaamde "reëls van die spel". Formele institusies ontstaan weens verskillende redes- en meestal ter ondersteuning van die groepe in die gemeenskap wat die mag het om besluite te beïnvloed. Informele institusies, insluitend kultuur, norme en algemene gedrag wat reeds vir 'n geruime tyd in 'n land teenwoordig is, is ook belangrik. Aangesien informele institusies tussen lande verskil, is dit onmoontlik om formele institusies tussen lande te dupliseer en dieselfde uitkoms te verwag.

Hoe verkry lande institusies wat die vermindering van transaksiekoste en die beskerming van eiendomsreg ondersteun? Vergelykende gevallestudies kan hieroor inligting verskaf, maar hierdie studies was tot dusver skaars vir Afrikalande. Die doel van hierdie proefskrif is om 'n bydrae te lewer tot gevallestudie navorsing in NIE wat op Afrikalande fokus. Van die vrae wat ondersoek word is: waar kom institusies wat nadelig vir groei is vandaan, en waarom vind lande dit moeilik om hulle te verander?

Botswana en Zambia is vir die studie gekies weens die feit dat hulle ooreenstem op 'n aantal gebiede wat aan groeiverskille verwant is. Beide is geleë in sub-Sahara Afrika, mineraal-afhanklik in hul uitvoere, deur land ingesluit, en onder Britse bewind tot die 1960s. Daar is duidelike groeiverskille tussen die twee lande wat die nuwe klassieke groeiteorieë nie ten volle kan verklaar nie. Wanneer empiriese institusionele data op hierdie lande toegepas word, kom nuwe verduidelikings vir groeiverskille na vore.

Indien verkose regerings verantwoordelik was vir na-koloniale beleid, waarom het die leiers in Zambië besluite geneem wat transaksiekoste verhoog en eiendomsreg benadeel? Verskille in koloniale ervarings word ondersoek, sowel as die omstandighede in voor-koloniale tye. Dit blyk dat die informele institusies wat deur hierdie twee gebeure ontstaan het, en die gebrek aan legitimiteit van die na-koloniale leierskap, dit vir die Zambiese regering moontlik gemaak het om die twee formele institusies wat beperkings op besluitneming plaas, naamlik demokrasie en die gesag van die reg, te verontagsaam. Weens die afwesigheid van hierdie beperkings kon die na-koloniale Zambiese regering besluite neem wat korttermyn voordele inhou (veral om die land van enige koloniale invloede te bevry), maar tot die langtermyn nadeel van die land was.

Institusies in Botswana vertel die teenoorgestelde storie. Informele institusies wat voor en gedurende Britse bewind geskep is, het die formele institusies wat deur die Britte agtergelaat is, ondersteun. Dit het 'n atmosfeer van stabiliteit en sekerheid geskep waarbinne die ekonomie kon groei.

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For my mother,

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CHAPTER 1
INTRODUCTION

1.1 RESEARCH PROBLEM

The new economic growth theory implies convergence, with developing countries catching up with developed countries because knowledge is available to everybody and capital moves freely among countries (Meier 2001). But the twentieth century proved this theory to be wrong. High levels of economic growth do not come easily, or naturally, and divergence seems to be more prevalent than convergence. After a thousand years of Western civilization, despite the immense decline in information costs and despite the advantages of international free trade, there are still enormous disparities between economies.

On closer investigation, growth differences become even more puzzling. Some east-Asian countries succeeded in catching up with industrialised countries, while Africa has fallen behind even more. There are developing countries, like Argentina, that at one stage seemed to be catching up, but then collapsed again. Some developing countries experienced unprecedented rates of economic growth during the post-World War 2 period, but were unable to sustain it after the oil shock of 1973. And, of all the regions in the world, Sub-Saharan Africa (SSA) has experienced the slowest economic growth, with poverty looming large and deepening.

The reason why SSA performs so badly remains an important area of study for many economists. Numerous reasons have been proposed to explain the slow growth and several cross-country studies of growth (for example, Easterly and Levine 1997) have found that the conventional factors of growth (labour, physical and human capital accumulation, and so on) do not fully explain the African experience.

In recent years attempts to clarify growth differences internationally, and also for Africa, have favoured an explanation based on institutional differences. Currently, most development economists agree that differences in institutions are amongst the crucial determinants of growth differences.

Institutions, both formal and informal, create incentives for role-players in the economy. The net effect of these institutions taken together can either be growth enhancing or growth retarding. Each country has its own matrix of institutions, and for a country to reap the benefits of mineral riches or technological innovations, the growth-enhancing institutions have to be in the majority. And for institutions to be growth enhancing, they have to lower transaction costs and secure property rights.

Governments play an important role in securing a structure of incentives that would support growth-enhancing institutions. Not only do they influence the rules of the game through policy choices, but they are also third-party enforcers of formal institutions. Mancur Olson (1996: 32) claims that "those countries with the best policies and institutions achieve most of their potential, while other countries achieve only a tiny fraction of their potential income…".

An interesting question that is discussed in the literature is why countries find it so hard to adhere to growth enhancing institutions. Why do some countries succeed in their creation and maintenance, while others fail? Why do some governments fail to lower transaction costs and secure property rights? And why is it difficult for a government to change growth-retarding policies to those that would secure a higher growth path?

In her address to the International Society for New Institutional Economics (2003), Mary Shirley suggests more cross-country work, combined with more comparative case studies to provide answers to questions relating to institutions and institutional choices. Much research has been done cross-sectionally on this topic, but very few country studies have been done, especially of sub-Saharan countries, to establish exactly why some countries fail to achieve their potential.

A recent book, edited by Dani Rodrik (2003), contains a number of country studies from an institutional perspective. Only two countries from Africa were included in this study, i.e. Botswana and Mauritius, as the "African success stories". In the chapter on Botswana, Acemoglu and his co-authors (2003a: 113) suggest that more research needs to be done on African countries: "The puzzle is why Botswana ended up with such good institutions… there is relatively little research done on this topic, and a satisfactory answer requires a detailed analysis of Botswana's history and comparison with other African experiences". And this is the main purpose of the study: to determine why some governments succeed in creating growth enhancing institutions and others not.

The two countries chosen for this study are Botswana and Zambia. These countries offer fertile ground for an institutional comparative study given their many similarities, including the fact that both countries were under British rule up to independence in the middle of the 1960s, both are mineral dependent, landlocked, and at the time of independence had hostile neighbours.

At the time of independence, on a general level, their "initial conditions" were very similar, with Zambia slightly better endowed than Botswana. The Zambian economy was better placed for development, but the subsequent experience has been the opposite. Botswana has since become one of the best-managed economies in Africa and is often referred to as the "African miracle", while the Zambian economy has stagnated. Why did they develop differently, and can it be explained by differences in institutions?

One of the explanations for low growth that fits Botswana and Zambia well, is the influence of their respective colonial experiences. Acemoglu, Johnson and Robinson (2001) suggest that countries subjected to extractive colonisation[1] experience lower post-colonial growth than countries in which participatory institutions were established. This seems to be a plausible argument for growth differences in Zambia and Botswana, because Botswana was merely a protectorate of Britain and underdeveloped at independence, whereas Zambia was subject to extractive colonisation.

However, it cannot be ignored that although path dependency has a bearing on decision-making over time, it does not state that the path cannot be reversed. Colonial experience does not predestine post-colonial policies. This study links the colonial experience of the countries with post-colonial policies, but goes one step further in explaining the reasons why the post-colonial Zambian government was unable to reverse the low growth path created by the extractive nature of their colonial rule. The good practice in Botswana is found to be a very useful comparison.

Linked to their colonial experience is another difference that may explain their divergent growth experiences: the fact that rich diamond deposits in Botswana were only discovered after independence, whereas European companies had been mining copper in Zambia since the 1920s. With no foreign companies operating within Botswana at independence, the government was, for instance, not under the same pressure as the Zambian government to nationalise the mining industry.

The minerals as such also have explanatory power: with diamond prices being regulated by the Central Selling Organisation, they hardly fluctuate, while the price of copper has been unstable. The study, however, shows that although differences in the minerals have a lot of explanatory power, there is still room for explaining the different spending patterns of the two governments.

[1] Under extractive colonisation property rights of the indigenous population were not protected.

A comparison between Botswana and Zambia has not been done as yet. Individual studies on the two countries are numerous, of which a number is relevant to (and made use of) the present study. In the theoretical discussion the work of Acemoglu, Johnson and Robinson is followed very closely. In their study on Botswana (Acemoglu, et al. 2003a) they attribute the country's success to the adoption of good policies, which promoted rapid accumulation, investment and the socially efficient exploitation of resource rents. They link this with the pre-colonial tribal institutions and benign neglect during colonial rule. They also stress the importance of political leaders with rural interests, and particularly the sensible decisions made by Khama and Masire.

Kenneth Good (1992) considers the advantages of an open "elite" democracy. According to him competitive politics was to the advantage of the country, with no "debilitating cult-of-personality" being allowed to mar developments. Charles Harvey and Stephen Lewis (1990) conclude their book on Botswana by summarising the reasons for Botswana's success as: luck due to colonial neglect and the discovery of diamonds after independence; good management by the post-colonial government; and good skills in negotiating with South Africa and the mining companies.

These reasons are supported in the present study and yield a sound contrast with the experience of Zambia. Most of the work done on the Zambian economic stagnation focuses either on the declining income from the copper industry or on colonial rule. Arne Bigsten (2001), for instance, links the resource curse to policymaking. For good policymaking he suggests a democratic process and judicial control. He also suggests that an elite that builds up its economic interests outside government will come to a point where the benefits of having an efficient economy outweigh those of having one with extensive scope for rent-seeking. These findings of Bigsten are supported by the current study.

Unravelling the causes for their different performances is not only of theoretical interest but also of practical importance. A plausible account of growth enhancing institutions might guide institutional and policy decisions, not only in Zambia and Botswana, but also in other similar countries and may guide growth paths in the decades ahead.

1.2 METHODOLOGY

To explain growth differences between countries an analytical framework is necessary to trace the historical evolution of their economies, and to provide a guide to policies that can improve their economic performance. Cross-country empirical research accounts for growth differences at a general level, but provides little information regarding specific countries and their particular experience. Case study research that draws on the theory of the New Institutional Economics (NIE), presents a requisite framework. The framework of the NIE bases the analysis of the causes and consequences of institutions and institutional change on theory, and less on culture as was the case previously[2].

The NIE defines institutions as encompassing rules that constrain and influence human behaviour. A key aspect of these humanly devised rules is that they structure human interaction by providing incentives that shape economic and political organisations. Among the institutions that are most important for economic performance are those involving the lowering of transaction costs and the definition and enforcement of property rights. If transaction costs are minimised and property rights protected, the cost of production and distribution is lower. This allows private agents more scope to benefit from specialisation, investment and trade, thus leading to economic growth.

Case study research has an important role in the broadening of our understanding of institutions and institutional change. Comparison, as such, is an important research tool. Swanson (quoted in Ragin 1987: 1) described it as follows: "Thinking without comparison is unthinkable. And, in the absence of comparison, so is all scientific thought and scientific research". Referring to the comparison of countries, Giovanni Sartori (1994: 16) feels that "knowing one country means knowing none".

The experience of Botswana and Zambia provides a suitable and appropriate basis for an analysis of the impact of institutions on economic development. Both these landlocked countries were colonies of the same colonial power, Great Britain. Both are mineral-rich, but have had distinctly different growth experiences and have relied on dissimilar institutional structures to support economic and political governance. Linking the differences in economic performance to institutions is the principal objective of this study and to do this, the experience during the period after independence (but including colonial experience to the extent that the impact of path dependency on decision making demands this) until about 1990 provides a suitable setting for a comparative analysis. In 1991 the Third Republic was launched in Zambia. The institutional and policy changes this brought about represented a structural break for Zambia, which makes 1990 a convenient cut-off for the study period which even so remains sufficiently long for meaningful analysis.

After 1990 economic growth slowed down in both countries, but with Botswana still averaging almost 5 percent for the 1990s and Zambia barely able to realise 1 percent.

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[2] In his account of growth differences in *The Wealth and Poverty of Nations – why are some so rich and some so poor*, David Landes (1998) relied much on cultural differences.

Since 2000 the two countries have moved closer to each other in terms of GDP per capita growth, with Botswana realising 4.0 percent in 2003, and Zambia 3.5 percent. Botswana's average annual inflation for the period 2000-2003 reached 7.7 percent while Zambia's average annual inflation decreased to 14.4 percent for the same period.

For the period 1990-2003 the countries had almost the same average annual population growth: 2.3 percent for Botswana and 2.2 percent for Zambia. Both societies have become more urbanised.

An alarming trend in both countries is the increase in infant mortality rates. This can be ascribed to an increase in the incidence of HIV Aids. For Botswana life expectancy at birth peaked at 60 years in 1985 and then declined to 38 years in 2002. For Zambia it also peaked in 1985 at an expected 50 years but declined to a low 37 years in 2002.

Exports as a percentage of GDP have remained more or less constant for Botswana during the 1990s, whereas Zambia has witnessed a decline. Botswana has become less dependant on imports, while the Zambian situation has changed very little. In 2002 Zambia received more foreign direct investment than Botswana – 197 million dollars relative to Botswana's 37 million dollars. However, external debt remains a problem for Zambia. In 2002 external debt was 127 percent of GNI, compared to 8 percent for Botswana.

Relevant literature on the political and economic history of the two countries was studied and published empirical data on economic activity collated to illustrate the differences in economic structures and performance. In Zambia copper is the dominant commodity and in Botswana it is diamonds. An intensive analysis of the copper industry and the impact of variations in the copper price were undertaken. But we were unable to undertake a similar exercise for diamonds (with present resources) and a comparison of the two dominant products was made impossible by the difficulty of finding wholesale diamond prices.

Extensive research benefits were derived from a two-week visit to Botswana, which allowed access to a wider range of sources and the opportunity to interview scholars and observers of Botswana's economic development. During this visit a number of Zambian scholars were also consulted. The theoretical sections of the study on the New Institutional Economics were strengthened by discussions at the Summer School of the European School for New Institutional Economics in Cargése, Corsica, in May 2004, where a summary paper on the study was presented. Similarly, the study also benefited from a presentation at the STIAS interdisciplinary summer school in Stellenbosch in September 2004.

1.3 STRUCTURE OF THE STUDY

Chapter 2 presents an economic comparison of Zambia and Botswana. The purpose of the chapter is to show how these economies developed, and especially how their paths of development differ. It provides an overview with the aid of tables and figures.

Chapter 3 discusses theoretical reasons for growth differences between Zambia and Botswana. The purpose of the chapter is to broadly outline the progress made in development thinking since the classical economists, and to establish whether the neo-classical Solow growth model, endogenous growth models, and other models that feature in growth literature, sufficiently explain the growth differences illustrated in Chapter 2. Special focus falls on growth differences that result from the ownership of the natural resources of the two mineral-rich countries. A clear explanation of growth differences between the two countries does not emerge from this discussion; hence, the focus shifts to the theory of the New Institutional Economics in chapter 4.

Chapter 4 introduces the NIE as the approach that can explain growth differences between Botswana and Zambia. The NIE is currently perceived as one of the most important explanations for growth differences in the development literature. Chapter 4 defines and discusses institutions and pays special attention to the importance of the lowering of transaction costs and the protection of property rights.

Another important section in this chapter is the discussion of the reasons why institutions that are detrimental to growth persist over time. One explanation is the colonial experience. But, although path dependency links decision-making over time, it does not make stagnation or prosperity inevitable. Post-colonial decision-making determined post-colonial growth experiences, although some of these decisions can be justified by the colonial experience. If colonisation is not deterministic, other reasons for bad post-colonial policies need to be identified. Theory shows these to be, amongst others, an inability of the polity to commit and the prevalence of social conflict.

Chapter 5 uses empirical measures to determine whether institutions provide evidence for growth differences between Zambia and Botswana. These measures act as empirical indications of institutional development in Zambia and Botswana and the role it played in their divergent economic performances.

The next stage of the investigation is to explain the causal differences in the experience of Botswana and Zambia that can explain institutional differences. Chapter 6 summarises their respective histories up to independence. Although the study focuses on the time after independence, history is important in understanding decision-making; therefore, important instances in their pre-colonial and colonial pasts are highlighted. The discussion of the pre-colonial and colonial situation in the two countries enables a deeper understanding of the post-colonial state and is consistent with the theory of path dependency.

The lowering of transaction costs and the protection of property rights in Zambia and Botswana are explained in Chapter 7. Examples from the two countries show how Zambia has increased transaction costs through decisions made to prevail over European influences. In a similar manner it infringed on property rights in various ways – directly through nationalisation, but also indirectly through taxation and regulation. Although the Botswana government was also active in the economy, it proceeded through consultation and cooperation. It created an atmosphere of confidence–which lowers transaction costs.

Chapter 8 discusses the political institutions in the respective countries. Because governments are important role players in economic development, there is a growing interest in the development literature in the determinants of policies and in the institutional choices that governments make. Although the two countries inherited the same constitution from Britain, they have followed different paths since then. Specific attention is given to the democratic process and the separation of powers between the legislature and the judicial authority.

Chapter 9 concludes the study.

CHAPTER 2
ECONOMIC COMPARISON OF BOTSWANA AND ZAMBIA: HIGHLIGHTING SIMILARITIES AND DIFFERENCES

2.1 INTRODUCTION

Although similar in many respects, Zambia and Botswana developed very differently since independence. This chapter sets the stage for a discussion of the reasons for these divergent growth paths, which are illustrated with tables and figures.

The data used are mostly from the World Bank, the IMF, and other international organisations. As far as possible the time period will range from independence to 1990. Botswana remained a member of the Rand Monetary Area (RMA) during the first number of years after independence, and is also a member of the Southern Africa Customs Union (SACU), as a result of which comparative data for Botswana is often impossible to find.

2.2 GENERAL BACKGROUND

As stated earlier Botswana and Zambia are two landlocked countries, situated in sub-Saharan Africa. Botswana shares boundaries with Namibia, South Africa and Zimbabwe, and Zambia with no less than seven other countries, i.e. Angola, The Democratic Republic of the Congo, Malawi, Mozambique, Namibia, Tanzania and Zimbabwe. These borders were drawn by the European colonial powers at the Berlin Conference, which was held from November 1884 to February 1885.

Although Botswana was never a colony, it was administered as a British protectorate from the Cape Colony since 1885. At that stage Britain had no intention to increase its costs in Africa, and with the rich diamond deposits still undiscovered, had no incentive to colonise Botswana.

With the copper resources already known in Zambia at the end of the nineteenth century, Zambia was of much greater economic importance to Britain. The British takeover of the country was formalised in 1889 when the British government granted permission to Rhodes's British South African Company to bring about a series of land-ceding treaties with African leaders north of the Zambezi. The country gained independence in 1964.

Although roughly similar in size - Botswana at 566730 sq km and Zambia at 743390 sq km - their population sizes differ considerably (see Table 1). In Botswana water shortages place a constraint on the size of the population.

Table 1: Total population (in millions)

	Botswana	Zambia
1964		3,7
1966	0.5	
1990	1.3	7.8

Source: World Development Indicators (World Bank 2002a)

Zambia is classified as a tropical country, situated 15° south, while Botswana is semi-arid and 22° south. Botswana faces desert and near desert conditions in the bulk of the country, while Zambia is more fertile. Although the soils are poor in Zambia, the climate makes possible the cultivation of a wide range of crops. In Botswana the shortage of water, sometimes severe, is a major impediment to the development of almost all areas of economic activity. Apart from some of the rivers that border on the country, the Okavango is the only source of permanent surface water for Botswana.

Both countries suffer from tropical diseases, although to a different extent. Malaria risk in Botswana occurs from November to May/June in the northern parts of the country, while for Zambia malaria risk is present throughout the year in the entire country.

Being neighbouring countries that are landlocked, ex-British colonies, and mineral dependent, one would expect to see more or less similar economic structures. The following section, however, shows how they have developed differently.

2.3 ECONOMIC STRUCTURE AND CHANGES OVER TIME

Experience from a wide range of countries shows that structural transformation (the transition from a low income, agrarian economy to an industrial urban economy with substantially higher per capita income) is important for economic growth. According to Syrquin (1988) the reallocation of resources from sectors with low productivity, such as agriculture, to sectors of higher productivity, such as, for instance, manufacturing, contributes to growth if it leads to fuller or better utilization of resources. This differs from the experience, not only in most African countries[3], but particularly so in Botswana and Zambia (see Table 2).

Table 2: Change in economic structure

	Botswana				Zambia			
	1960	1970	1980	1990	1960	1970	1980	1990
Agriculture (% of GDP)	40.6	28.5	11.0	4.6	15.6◊	11.6	15.1	20.6
Industry (% of GDP)	13.6	30.7	45.1	56.4	58.8◊	59.8	42.1	51.3
Manufacturing (% of GDP)	10.9◊	6.7	5.3	4.9	6.9◊	11.0	18.3	36.1
Services (% of GDP)	45.8	40.9	43.9	39.0	25.6◊	28.6	42.8	28.1
Imports of goods and services (% of GDP)	31.2	47.7	52.1	50.1	40.1	36.8	45.4	36.6

Source: World Development Indicators (World Bank 2002a)

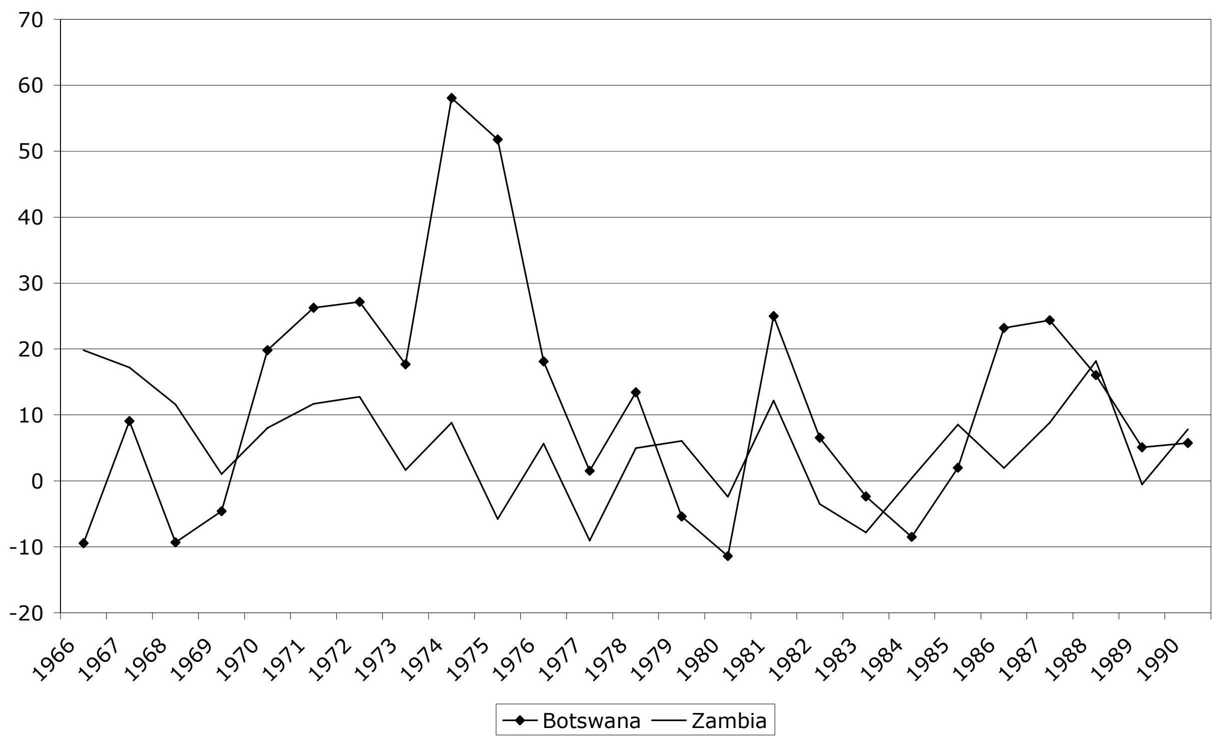
◊ 1965 data

At independence the Botswana economy was dominated by agriculture, especially beef. The change in the structure of economic activity started with two major events that took place during the last few years of the 1960s. Firstly, De Beers announced its rich diamond discovery at Orapa, and secondly, Bamangwato Concessions Ltd (an Anglo-American and Amax subsidiary) decided to develop the Selebi and Phikwe copper-nickel deposits. By the beginning of the 1970s industry (which includes mining) overtook the agricultural sector as the sector contributing most to GDP (see Table 2). Attempts to diversify the economy into manufacturing have not been that successful.

The high growth in value added manufacturing for Botswana over the first half of the 1970s (see Figure 1) was only enough to initiate industrial development, but manufacturing was unable to deliver sustained growth afterwards. This is shown in Figure 2 where the absolute values have increased only slightly over the relevant period.

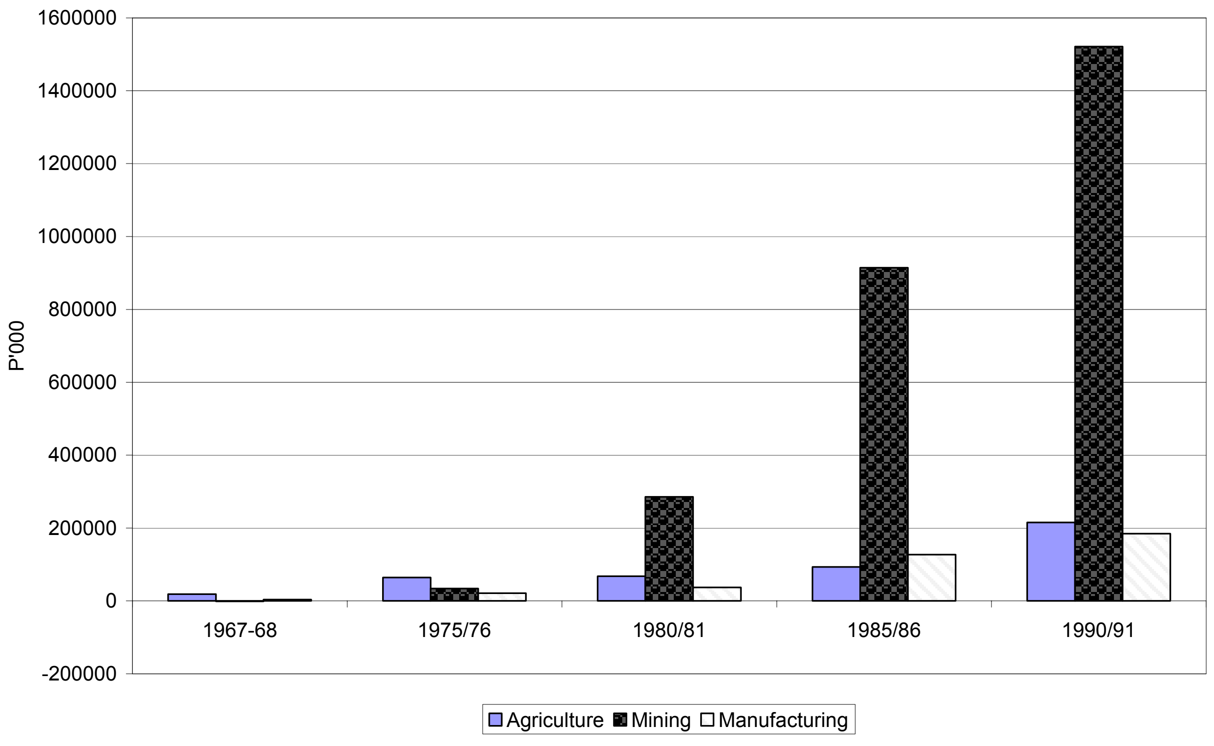
[3] According to Collier & Gunning (1999a) the reallocation of resources from agriculture to the industrial sector did not contribute to growth in Africa. The reallocation took place with the help of an urban-based government, who taxed agricultural exports heavily in order to finance the industrial sector. This bias against agricultural exports in favour of import-substituting industry was common both to socialist regimes (like Zambia) and more market-oriented ones.

Figure 1: Manufacturing - value added (percentage growth)



Source: World Development Indicators (World Bank 2002a)

Figure 2: Changes in Botswana's economic structure: in Pula value



Source: World Development Indicators (World Bank 2002a)

From Table 2 it seems that during 1960-90 Botswana had not achieved much in its attempt to diversify. The contribution of the manufacturing sector, apart from the meat processing industry, remained negligible. Possible reasons why this structural change did not happen are:

- The focus of the government in the first two decades after independence was not on the diversification of the economy. Due to neglect during British governance government identified more pressing matters at that stage, such as the lack of basic infrastructure. The first priority stipulated in the National Development Plans, therefore, was to invest the income from the mining operations in physical and social services. It was only by 1976 that most of these were taken care of. The next pressing issue addressed in the National Development Plans was employment creation. In was only in the 1980s that the focus shifted towards diversification away from the country's dependence on mining and cattle (Harvey and Lewis 1990).
- A more practical reason was the proximity of the mines to suppliers of mining materials, equipment and consumables in South Africa. With these suppliers already established, there was no clear necessity for firms to start producing these goods in Botswana (Solomon 2000).
- As a member of SACU Botswana could not impose any import protection measures to encourage the development of local supplies of consumable materials and equipment for the mining industry (Solomon 2000).
- Most of the income generated from the mining sector did not flow directly through into the economy. Apart from salaries, and dividends received by the Botswana government, the vast majority of shareholders lived outside Botswana (Solomon 2000).

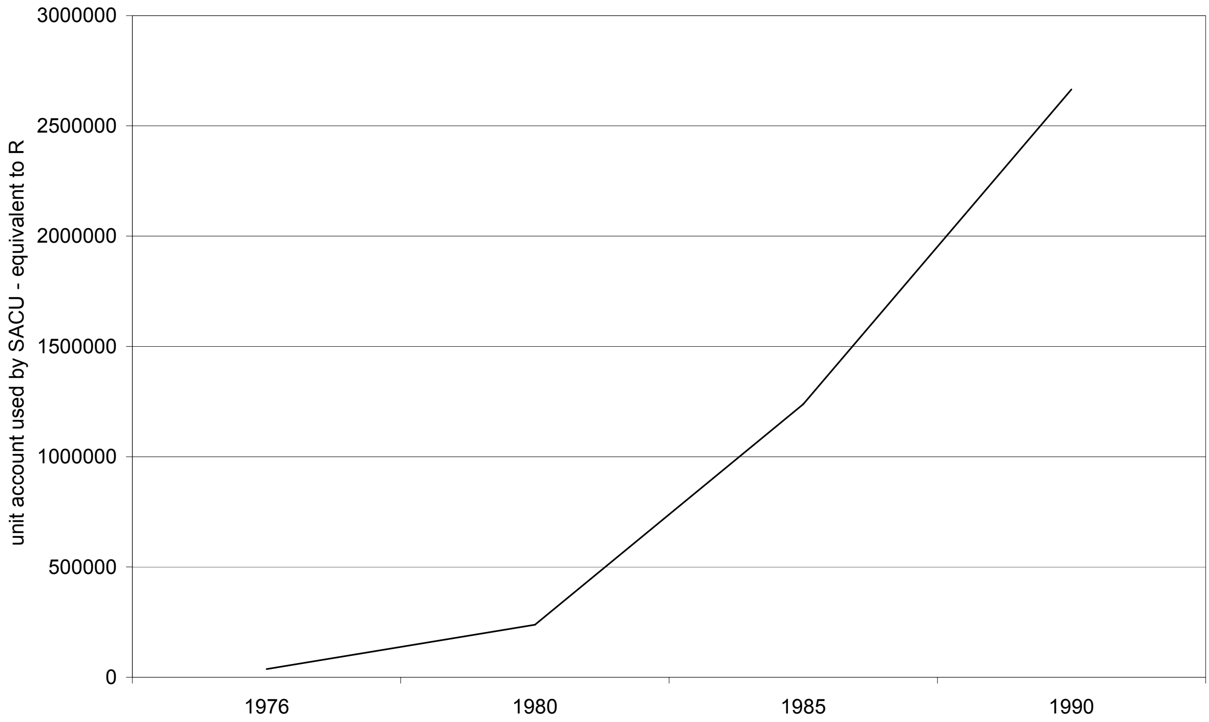
The increase in mining activities contributed to the increase in exports as a percentage of GDP. Exports increased almost 700 percent between 1969-70 and 1975 (Dahl 1981). Table 3 confirms the increasing importance of exports to the GDP of Botswana and Figure 3 shows how the value of diamond exports, in particular, has increased over time.

Table 3: Exports of goods and services (% of GDP)

	Botswana	Zambia
1965	28.53	49.25
1970	23.11	53.64
1975	41.10	36.60
1980	49.74	41.39
1985	61.97	36.44
1990	55.42	35.88

Source: World Development Indicators (World Bank 2002a)

Figure 3: Botswana diamond exports ('000 UA)



Source: Africa South of the Sahara (various years)

The increase in exports was also due to an increase in beef exports after successful negotiations with Britain gave Botswana easier access to the European market. Although the agricultural sector declined in relative terms because of the great expansion in the mining sector, beef exports grew in absolute terms. It was only at the beginning of the 1980s that diamonds had overtaken beef as the country's leading foreign exchange earner (see Table 4). In 1980 diamond exports accounted for almost 60 percent of total exports and rose rapidly thereafter to reach approximately 80 percent of total foreign exchange earnings by 1990.

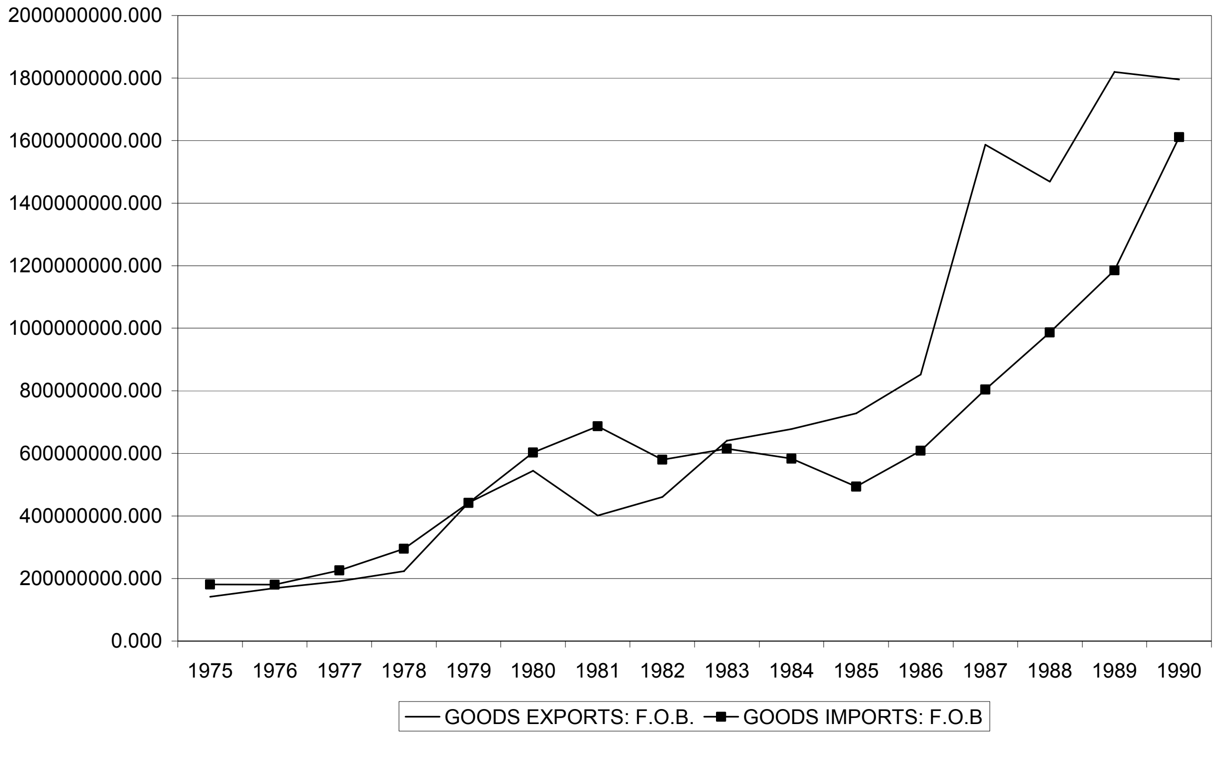
Table 4: Botswana Meat and Diamonds as percentage of total exports

	1966	1976	1980	1985	1990
Meat and meat products	6.7	28.1	7.2	7.0	3.9
Diamonds		24.5	60.7	75.8	80.2

Source: Africa South of the Sahara (various years)

Figure 4 shows how Botswana's inability to diversify has influenced its trade balance. As the country developed, its dependence on imports grew rapidly. Like many developing countries, Botswana would have suffered from a chronic trade deficit, had it not been for income from the country's strong mining sector (Picard 1985). Except for a negative balance between 1975-1978 and again at the beginning of the 1980s Botswana experienced positive balances throughout the indicated period.

Figure 4: Botswana: Goods exports and imports (millions US$)



Source: International Financial Statistics (IMF various years-a 61678AADZF... and 61678ABDZF...)

One area where diversification in the Botswana economy has taken place is at the labour front. At independence economic activity involved predominantly unskilled labour and land-intensive activities, with little capital employed (Leith 1997). Since then the economy has become a much more intensive user of skilled labour and capital.

The distribution of employment between the different sectors of the economy has also changed over time. From 1964-1980 a tremendous shift occurred, with labour moving from agriculture to industry. Data from the International Labour Organisation (ILO) (Various years) shows that in 1964, 90.8 percent of workers was employed in agriculture and only 1.8 percent in industry. Unfortunately the ILO did not publish comparable statistics for later years, but according to the World Development Indicators (World Bank 2002a) 5.1 percent of the workforce was employed in agriculture in 1980 and 33.1 percent in industry[4]. Comparable data for 1990 changed only marginally.

The structure and change of the Zambian economy differs slightly from that sketched for the Botswana economy. Table 2 shows that the percentage contribution of agriculture firstly declines and then increases again. And, according to these relative figures, the economy was more able to diversify into manufacturing than the Botswana economy. The manufacturing sector benefited from the import substitution strategy, but was unable to decrease the reliance on copper in the export market.

Zambian exports are concentrated in a single product, i.e. copper (see Table 5). Copper contributed 91 percent of total exports in 1964, and since then the ratio has changed very little.

Table 5: Copper exports as % of total export value: Zambia

1964	91
1970	96
1974	93
1980	85
1984	86
1993•	86

Source: International Trade Statistics Yearbook (United Nations various years)

•*Data could not be found for 1990; therefore the end date is shown as 1993.*

Copper has dominated the economy since big-scale mining operations started in 1924. It was discovered at a time when the world demand for copper increased with the expansion of electrical and automobile industries. This increased demand immediately stimulated Zambian copper exports. At independence in 1964, the industrial sector (which includes mining) was already the biggest contributor to GDP, as can be seen in Table 2.

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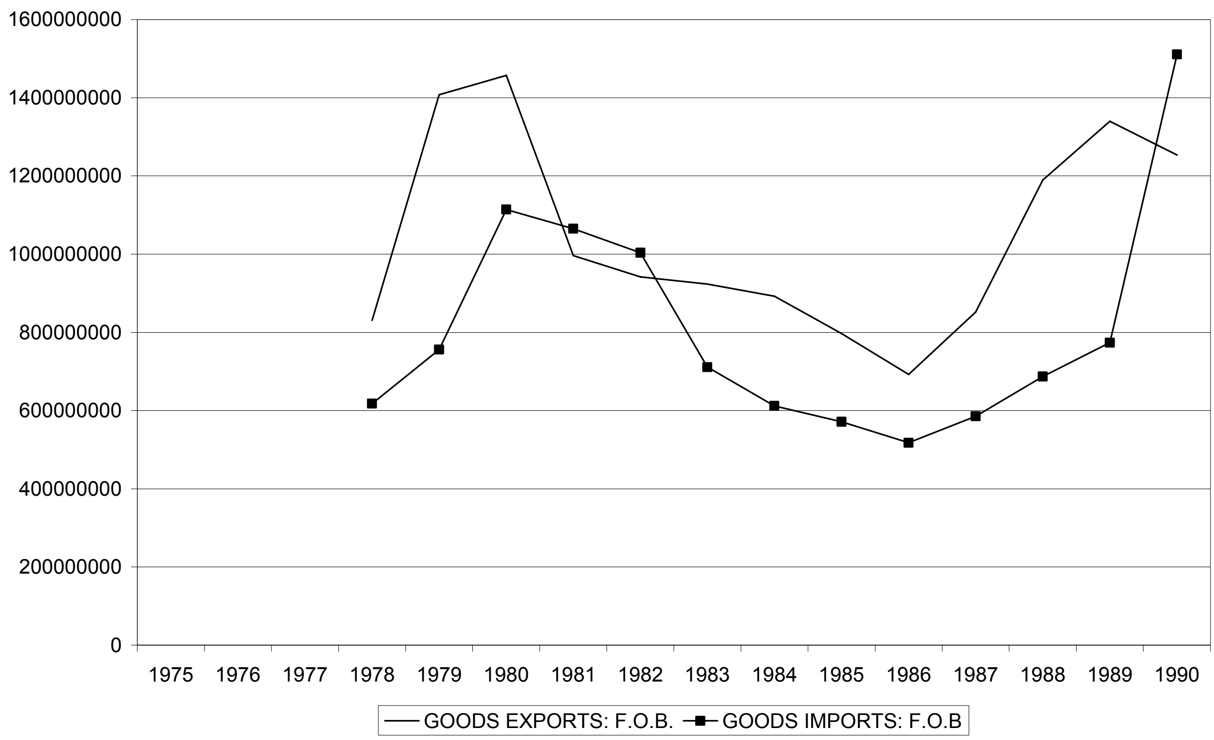
[4] These figures indicate formal employment, which probably under-measures informal employment in, especially, the agricultural sector. With agriculture producing 11 percent of GDP in 1980, it can hardly be the case that only 5.1 percent of the population was economically active in the agricultural sector at that time. A figure that includes formal and informal employment will therefore be higher than the 5.1 percent indicated by the World Bank figures.

Table 3 shows how exports up to the mid-1970s contributed much more to the Zambian economy than to the Botswana economy. This changed towards the 1990s when the situation was almost the opposite to that in 1965.

Figure 5 shows Zambia's high dependence on imports during the first number of years in the 1980s. Zambia was, however, able to realise positive trade balances for the period indicated, except 1981-1982 and 1990.

Figure 5: Zambia: Goods exports and imports (millions US$)



Source: International Financial Statistics (IMF various years-a 75478AADZF... and 75478ABDZF...)

The decline in the value of exports of copper from Zambia over time can be seen in Figure 6, but from Figure 7 it seems as if Zambian copper exports were also influenced by the change in the world demand for copper (over time the latter seems to have moved sideways)[5].

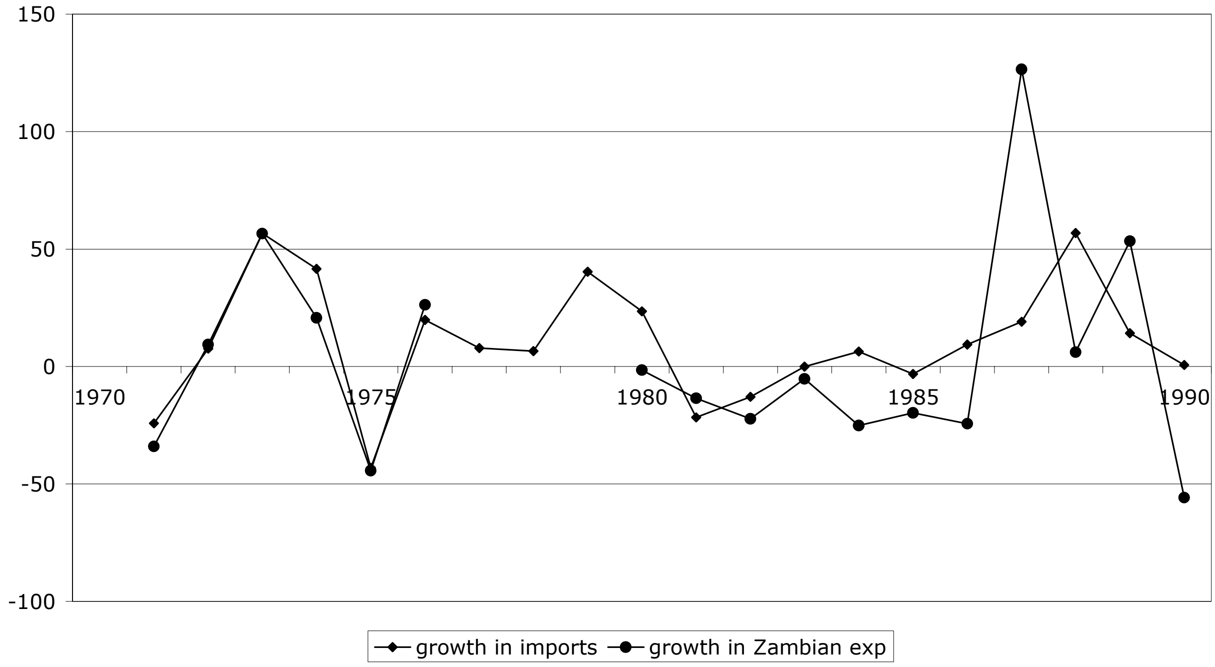
[5] A positive correlation of 0.52 is realised between growth in Zambian exports of copper and growth in world imports of copper.

Figure 6: Zambian copper exports (nominal)

Source: International Trade Statistics Yearbook (United Nations various years)

Data could not be found for whole period

Figure 7: Growth in world copper imports and Zambian exports of copper



Source: International Trade Statistics Yearbook (United Nations various years)

Zambia's First National Development Plan (FNDP, 1966-70) called for the diversification of the economy and consequently for a reduction in the export of unprocessed copper. Most of the set targets were met (Mwanza, Mwamba and Kakuwa 1992). The Second National Development Plan (SNDP, 1972-76) was not that successful. The launching thereof coincided with the emergence of a worldwide economic recession — a recession due to rising inflation that in turn was mainly caused by the 1973 oil crisis. The major objectives of the SNDP included the expansion of agricultural production, transformation of subsistence into commercial agriculture, reduction of regional inequalities, and development of tourism (Mwanza, et al. 1992). Most of these objectives were not achieved, and the country's agricultural potential was left undeveloped.

One reason for the neglect of the agricultural sector (see Table 6 for growth figures) was the overwhelming presence of the mining sector. The copper industry undermined agricultural production, not only with policies that forced males to find paid employment on the mines, but also due to the fact that employment on the mines promised a more consistent income than agriculture. The absence of so many men, working for wages away from home, was detrimental to the development of agriculture.

Table 6: Average annual percentage change in agricultural value added per hectare

	Botswana	Zambia
1965-70	8.7	1.6
1970-75	16.7	2.9
1975-80	-1.1	0.1
1980-85	-5.5	2.5
1985-90	11.0	2.3

Source: World Development Indicators (World Bank 2002a)

Another reason for the lack of agricultural development according to Gulhati (1989) and Gann (1986), was the result of the specific policy framework. Although government declared its intention to support agriculture, the country's economic policy after independence gave primacy to import substituting industrialisation. Zambia's development strategy was to use its copper earnings to create a manufacturing sector that would produce import substitutes in a highly protected environment. This resulted in agriculture receiving only 6.6 percent of total fixed investment during the FNDP and 5.2 percent in the SNDP. During 1975-80 only 3 percent of total government expenditure went to agriculture.

According to Gann (1986: 187) the funds spent on agriculture were largely wasted because of "excessive reliance on complex machinery, inadequate technical training, inefficient marketing and the gross mismanagement of credit facilities". Furthermore, the government fixed the producer prices of most major crops, and their level remained well below prices in neighbouring countries. According to Gulhati (1989) a reason for the fixed prices was to assure a regular supply of goods at low prices to the Copperbelt and urban areas. The farmers also had to pay high prices for locally manufactured consumer goods that were protected against imports. Farming was, therefore, not profitable and farmers had little incentive to increase their operations. The result was that food imports doubled in value in the first ten years after independence. In 1964-66 Zambia produced 97 percent of the staple grains it consumed, but by the end of the 1970s the proportion dropped to 79 percent (Gann 1986) and dependence on imports had increased (see Figure 5).

As previously mentioned, Zambia was more able to diversify its economy into manufacturing than Botswana. Its industrial policy started off with the Zambian White Paper of 1964, which placed considerable emphasis on foreign private investment in support of import-substituting production. This intention changed a number of years later when President Kaunda abandoned the reliance on overseas investors. This he had done through a series of nationalisations at the beginning of the 1970s that left the public sector producing more than 50 percent of the output (Gulhati 1989). Government also regulated private firms via an elaborate battery of licenses, controls, taxes and subsidies[6].

The industrial sector absorbed a large share of investment and imports, while most of its output was sold in the home market, which was, therefore, a large net consumer of foreign exchange. The inability of Zambian manufacturers to penetrate foreign markets is the result partly of structural impediments, like being landlocked, but also by several organisational features and management practices peculiar to these firms. Gulhati (1989: 22) describes it as follows:

- new projects were selected without proper technical or economic screening
- the insistence on rapid Zambianisation led to the appointment of people to key positions who did not have the proper qualifications and experience

[6] This point will be elaborated on in Chapter 7.

- managers were not allowed to remain in their posts for a reasonable time; instead, they were shifted around from position to position
- overstaffing became obvious during 1975-80 when jobs increased twice as fast as the volume of production in the public sector while private firms shed workers more rapidly than their output fell

The ILO did not publish labour statistics for Zambia similar to that quoted for Botswana, but according to the World Development Indicators, 76.1% of all labour employed in 1980 was employed in agriculture and 8.1 % in industry. Although industry (including mining) was the biggest contributor to GDP, it clearly was not labour intensive.

It can be concluded that in 1990 both these economies were still dependent on their mining activities for generating income. Zambia had tried to diversify its economy much earlier than Botswana, and according to the relative contributions, it was more successful. However, this does not negate the fact that both these economies significantly depend on the export earnings of the mining products.

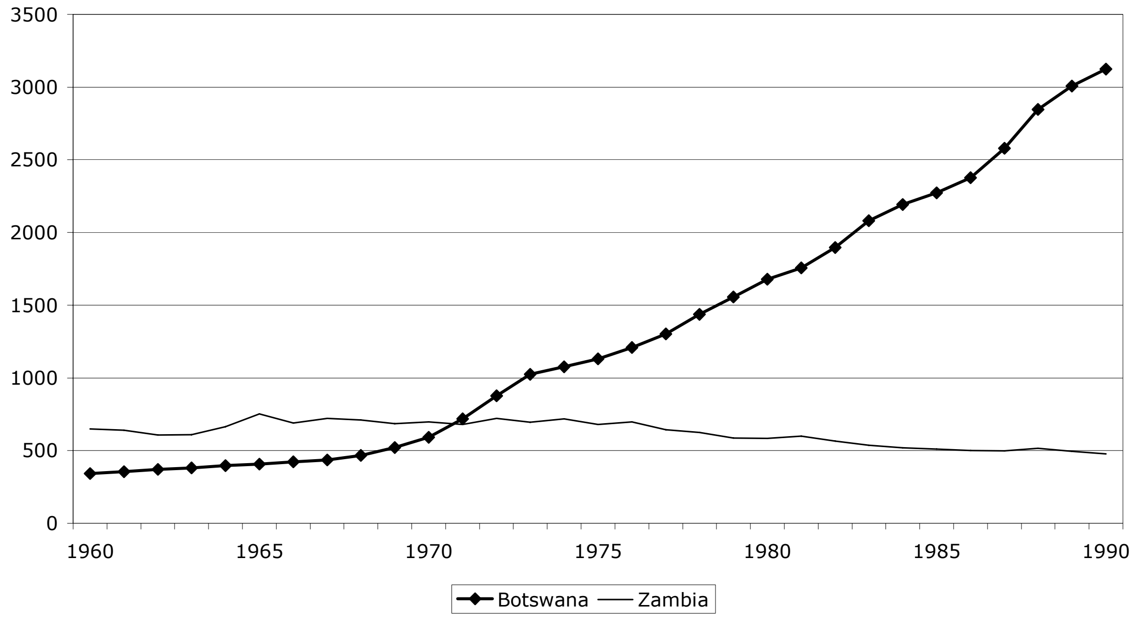
The following section reviews the fluctuations in the economic growth between these countries.

2.4 ECONOMIC GROWTH

The divergent economic growth paths the two economies have experienced since independence are revealed in Figure 8. At independence in 1964, Zambia's per capita income was almost double that of Botswana's, namely US$664 compared to US$396. But for the 30 year period indicated, Botswana experienced an average GDP per capita growth of 7.6 percent, in contrast to Zambia's -1.0 percent. Botswana has even outperformed the rest of the developing world. According to Sachs and Warner (1997b), African growth (measured as the annual average change in GDP per capita) averaged 0.8 percent per year over the 25-year period 1965-90[7], whilst the seven fastest growing developing countries outside Africa experienced an average of 5.8 percent and the rest of the developing world an average of 1.8 percent over the same period.

[7] Sachs and Warner (1997) highlights the bad performance of SSA by calculating 1965 GDP per capita in SSA as 60 percent of the average of the rest of the developing world. By 1990 this figure had fallen to 35 percent.

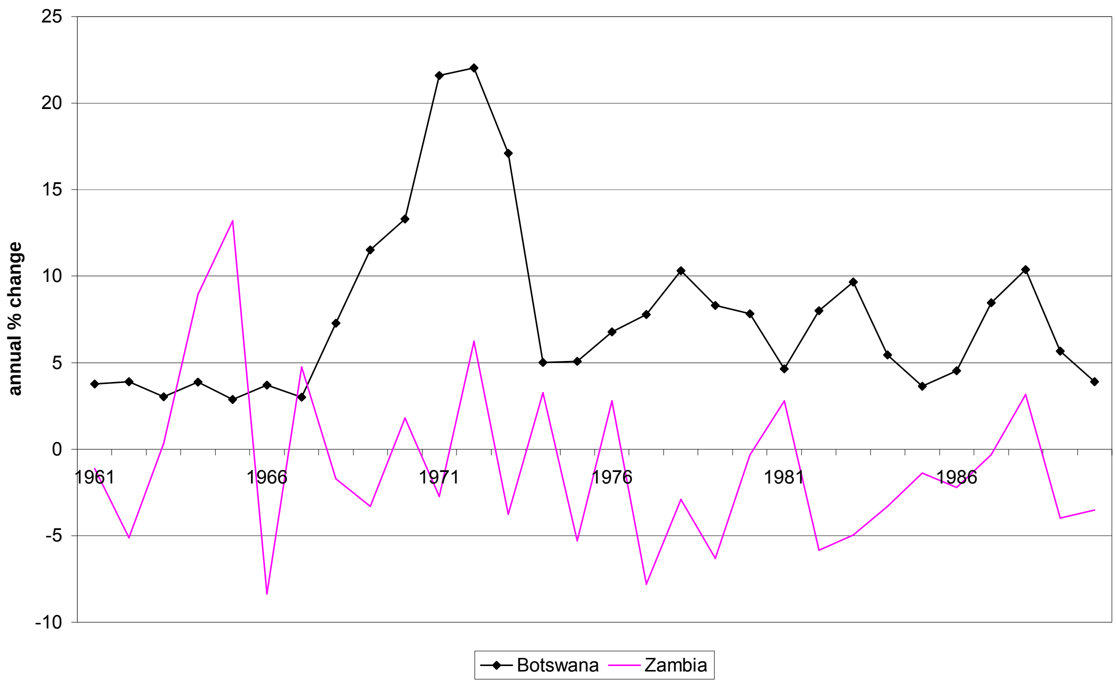
Figure 8: GDP per capita (constant 1995 US$)



Source: World Development Indicators (World Bank 2002a)

The divergent growth of the two countries is also evident from the following two graphs. The surge in Botswana's per capita GDP growth in the years following the discovery of diamond deposits, and the remaining high positive per capita growth for the rest of the period are shown in Figure 9. Also evident from the figure is the downward trend in the Zambian per capita growth, with negative growth occurring for most parts of the period.

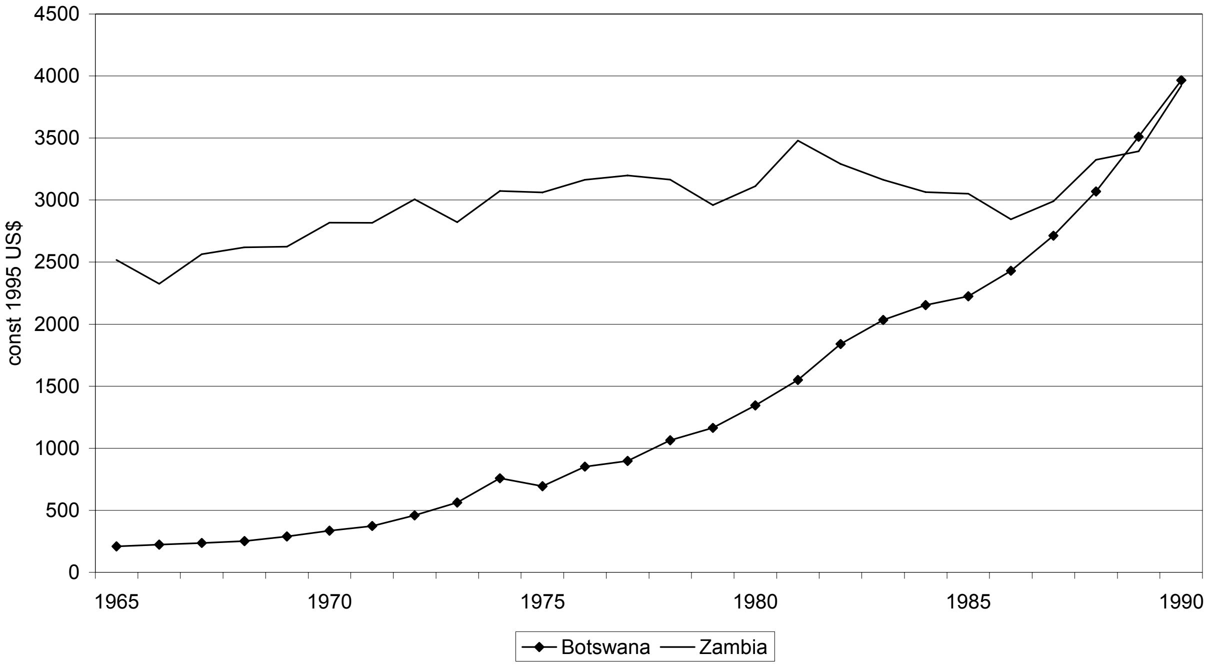
Figure 9: GDP per capita growth



Source: World Development Indicators (World Bank 2002a)

What makes Botswana's performance even more outstanding is the fact that the country was classified as one of the poorest countries in the world at independence in September 1966. But with persistent increases in GNP (see Figure 10) Botswana maintained an extremely good performance. If taken into account that Zambia's population is almost 10 times larger, the GNP clearly provides a picture of divergent growth. From 1965 to 1985, Botswana experienced the most rapid rate of growth of GNP per capita of any country in the world (Harvey and Lewis 1990).

Figure 10: GNP at market prices ('000 000)

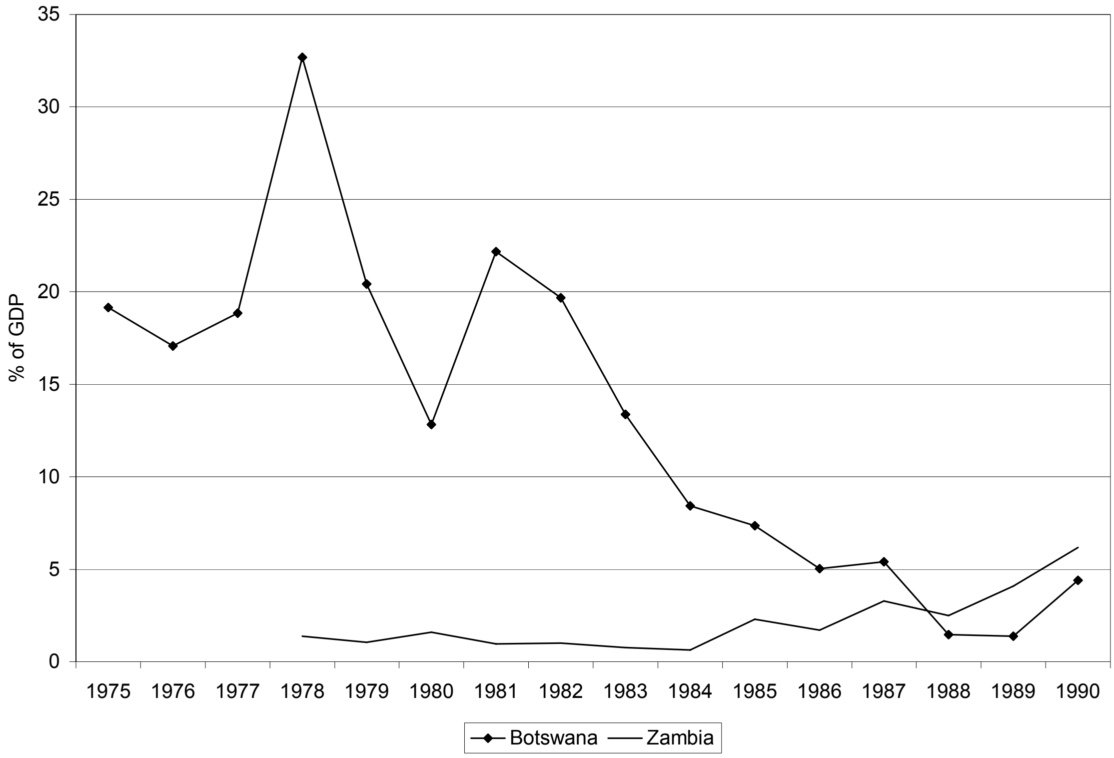


Source: African Development Indicators (World Bank 2000)

The growth in the Botswana economy was facilitated by the inflow of capital from abroad. Foreign investors developed the mines and the government paid for the infrastructural development largely out of foreign borrowings (Harvey and Lewis 1990). Figure 11 shows the high contribution of gross foreign direct investment to GDP that Botswana experienced from the mid-1970s (unfortunately comparable data for earlier periods is not available). The downward trend that can be observed in Figure 11 is still a source of concern in the Botswana economy. The trend coincides with the inability to diversify the economy's industrial base and the fact that investment in the infrastructure necessary for the operation of the mining industry, was complete.

With the nationalisations that took place in Zambia from the early 1970s, Zambia was not seen as a safe haven for foreign investors. The persistently low levels of the contribution of foreign investment to GDP are shown in Figure 11.

Figure 11: Gross Foreign Direct Investment



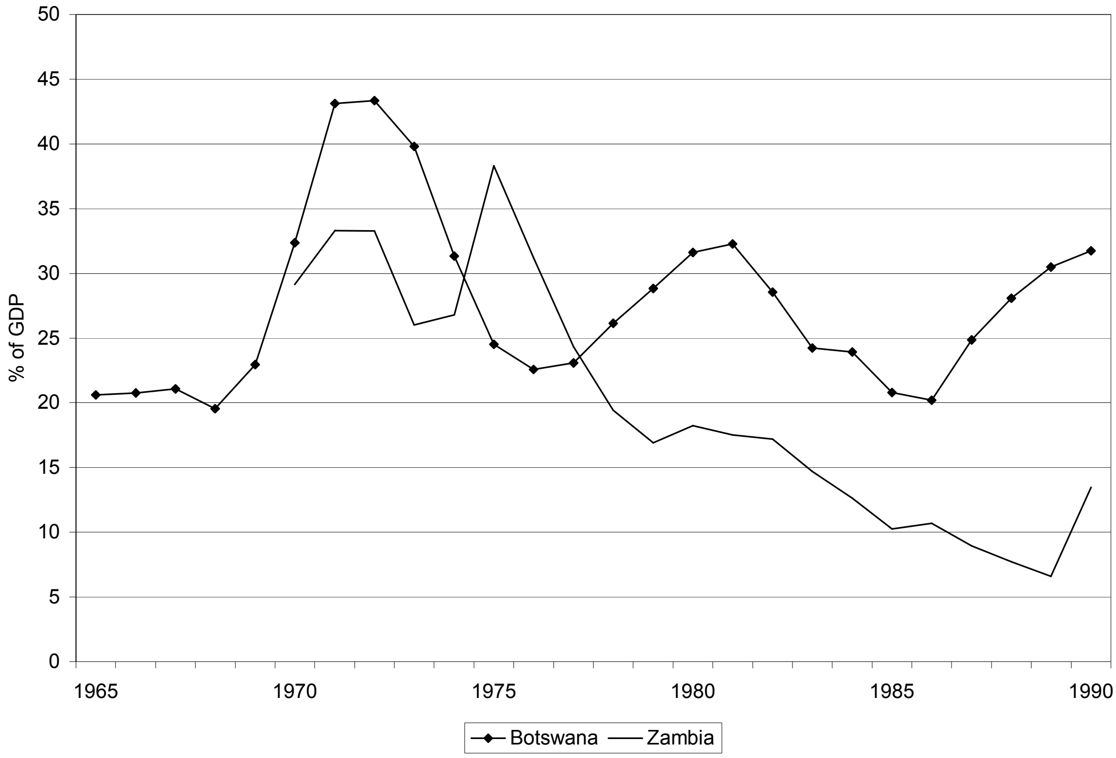
Source: World Development Indicators (World Bank 2002a)

Foreign direct investments (FDI) were used to different extents in the two countries. With the movement of the central government from Mafeking (in South Africa) to Botswana, a new capital was built at Gaborone. Capital investments were made in infrastructure, which includes modern housing, tarred roads to virtually all parts of the country, electricity generation and distribution, dams, a telephone system, as well as schools and health clinics (World Bank 1999). The growth in the contribution of gross fixed capital formation to GDP is evident from Figure 12 and was made possible first by FDI and later by the high diamond revenues[8] (Gaolathe 1997).

The picture sketched for Zambia is not that positive. From the mid-1970s Zambia experienced a sharp decline in the contribution of gross fixed capital formation to GDP. This was probably due to a lack of income from copper exports, and as mentioned earlier, international investors were cautious to invest in a country known to have nationalised its mining industry. The growth in FDI in the last number of years of the 1980s coincided with the growth in fixed capital formation.

[8] The trend coincides with growth in per capita GDP.

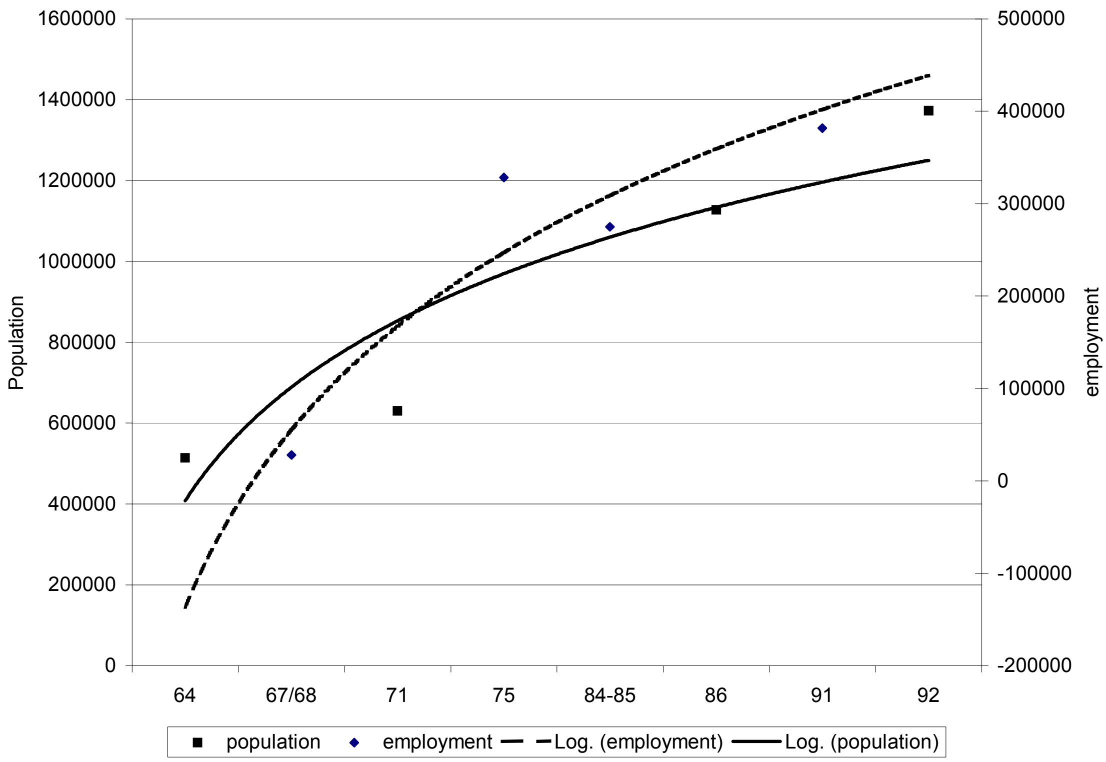
Figure 12: Gross Fixed Capital Formation



Source: World Development Indicators (World Bank 2002a)

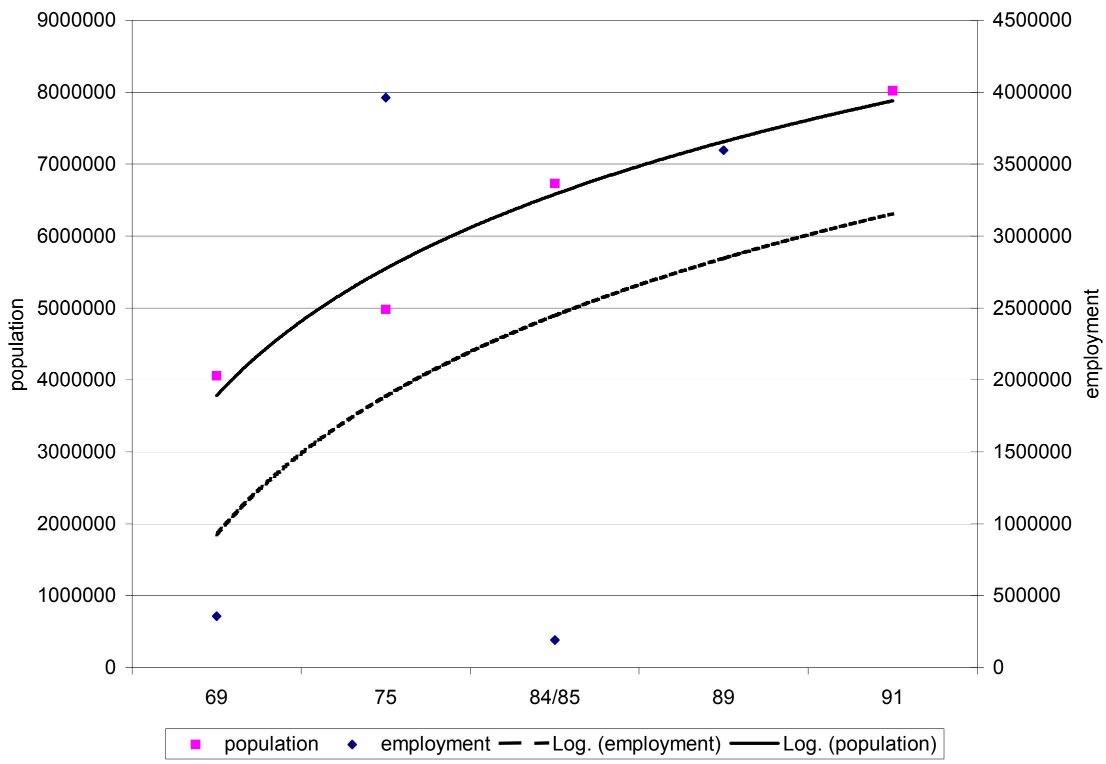
The figures presented for economic growth and capital formation in the two countries culminate in the following two graphs that show the employment situation in the two countries. For Botswana employment grew more rapidly than the population, whereas the opposite happened in Zambia, where a stagnating economy was unable to supply job opportunities to a growing population.

Figure 13: Botswana: Population and Employment



Source: Africa South of the Sahara (various years)

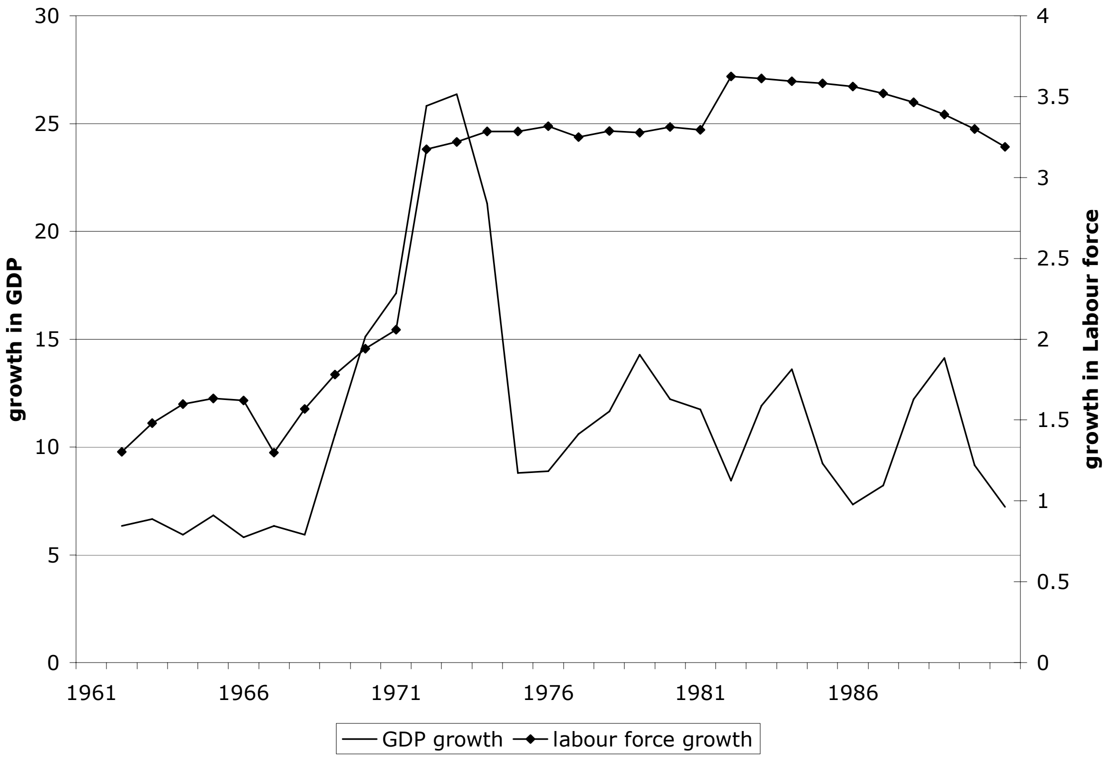
Figure 14: Zambia: Population and Employment



Source: Africa South of the Sahara (various years)

With positive per capita growth and increasing employment opportunities, Botswana displays the characteristics of a growing economy that invested its income in employment creating opportunities. Figure 15 displays high levels of labour force growth in the Botswana economy. The sharp increase in the beginning of the 1970s probably displays labour leaving subsistence agriculture to enter the formal labour market in order to share in the growth of the formal economy.

Figure 15: Botswana: production and labour force



Source: World Development Indicators (World Bank 2002a)

Figure 16 shows the situation in Zambia. The decline in the growth of the labour force in the first half of the 1970s, and again in the beginning of the 1980s, is probably due to a redefinition of the labour market.

Figure 16: Zambia: production and labour force

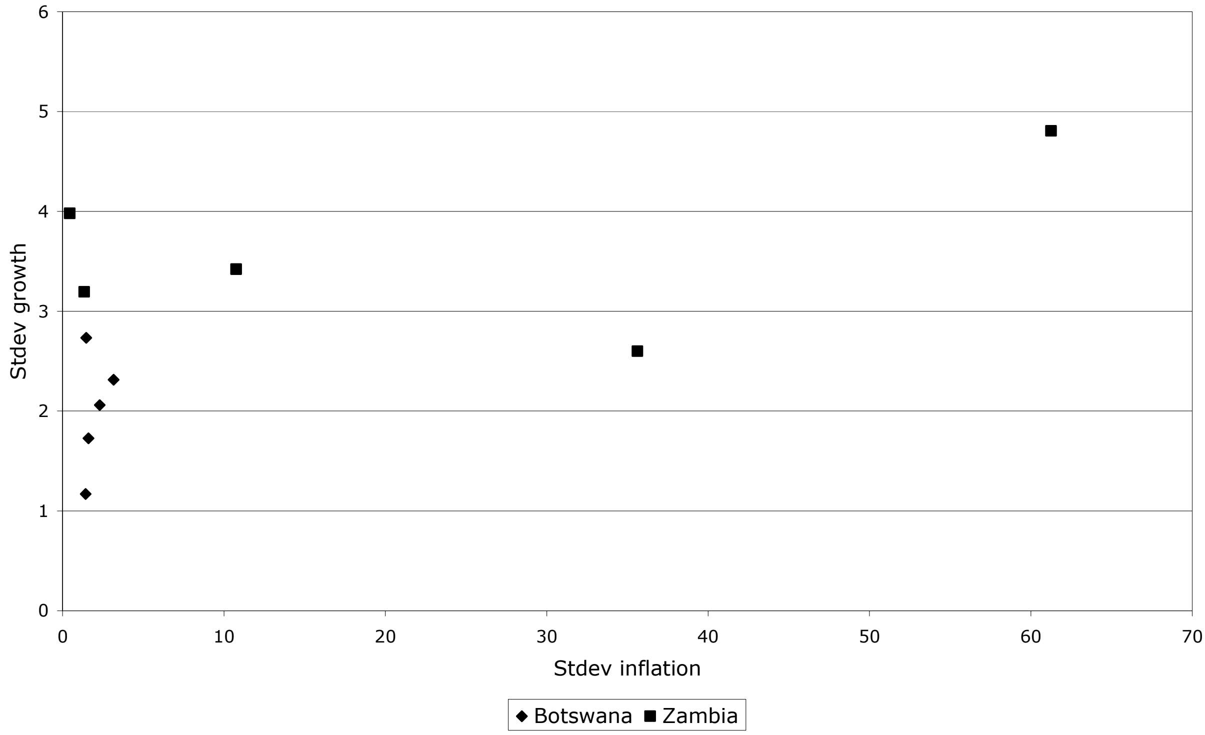
Source: World Development Indicators (World Bank 2002a)

The following section will cast light on stabilisation indicators for the two economies.

2.5 STABILITY INDICATORS

The instability in the Zambian economy, compared to the stability in Botswana, is illustrated in Figure 17, which presents a comparison between the standard deviations in growth and inflation for the two countries. With Botswana's data points grouped closer to the origin, Botswana has experienced less instability as measured by inflation and economic growth rates.

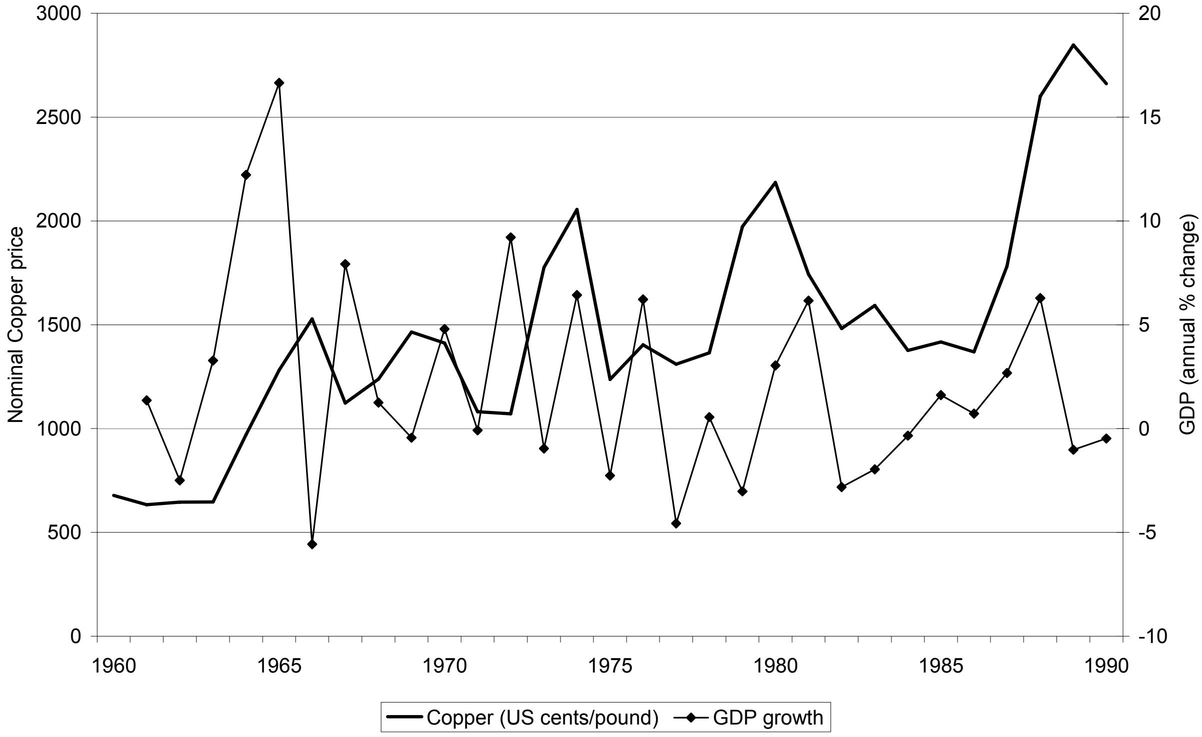
Figure 17: A comparison of the standard deviation in growth and inflation for Zambia and Botswana (1975-2000[9] @ 5 year intervals)



The instability in the Zambian economy has often been thought to be related to the price of copper (see for instance Mwanza, et al. 1992). Figure 18 shows, however, a negative relationship exists between economic growth in Zambia and the nominal price of copper. Intuitively one would have expected it to be different and this leaves room for interpretation. This is done in section 3.5.1 where the possible transmission mechanisms between the price of copper and economic growth are discussed.

[9] Due to the unavailability of data before 1975, the period is extended to 2000 in order to provide a more substantial comparison.

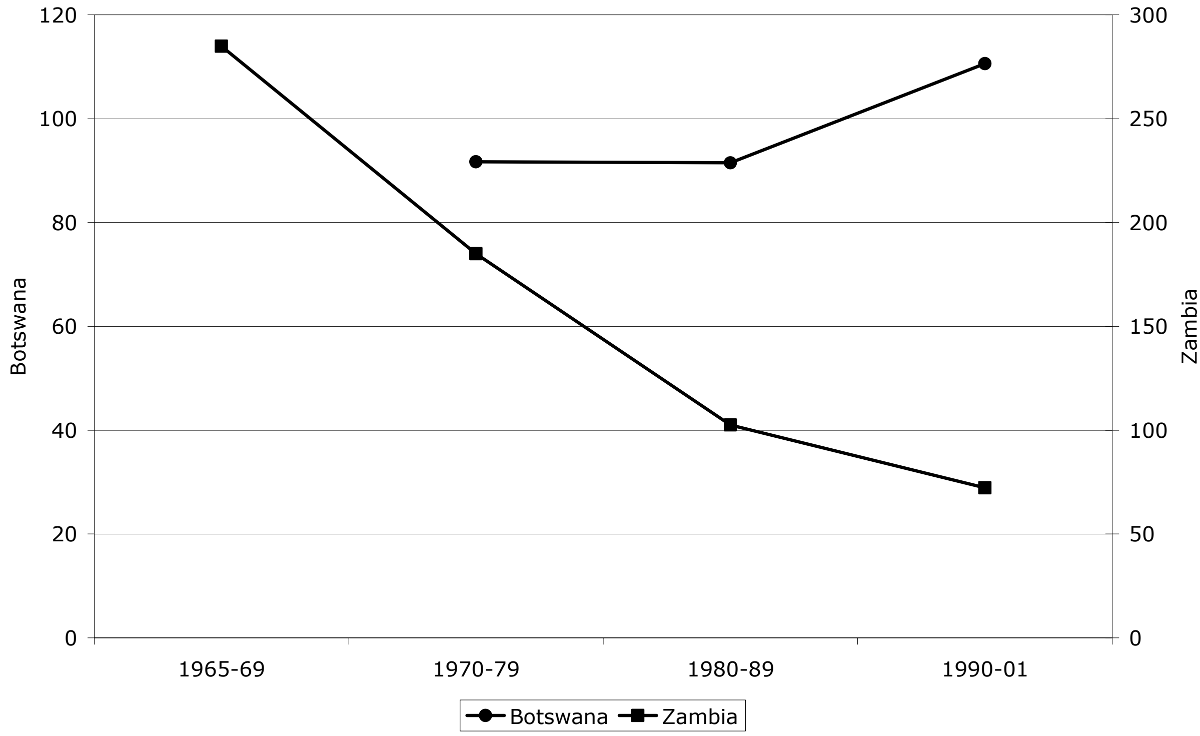
Figure 18: Zambian economic growth and International price of copper



Source: World Development Indicators (World Bank 2002a) and International Financial Statistics (IMF various years-a 11276C.ZZF...)

Figure 19 shows the movement in the terms of trade for the two countries. Both countries experienced unstable terms of trade, although in different respects. Zambia had to deal with a falling terms of trade, while Botswana had to deal with the opposite.

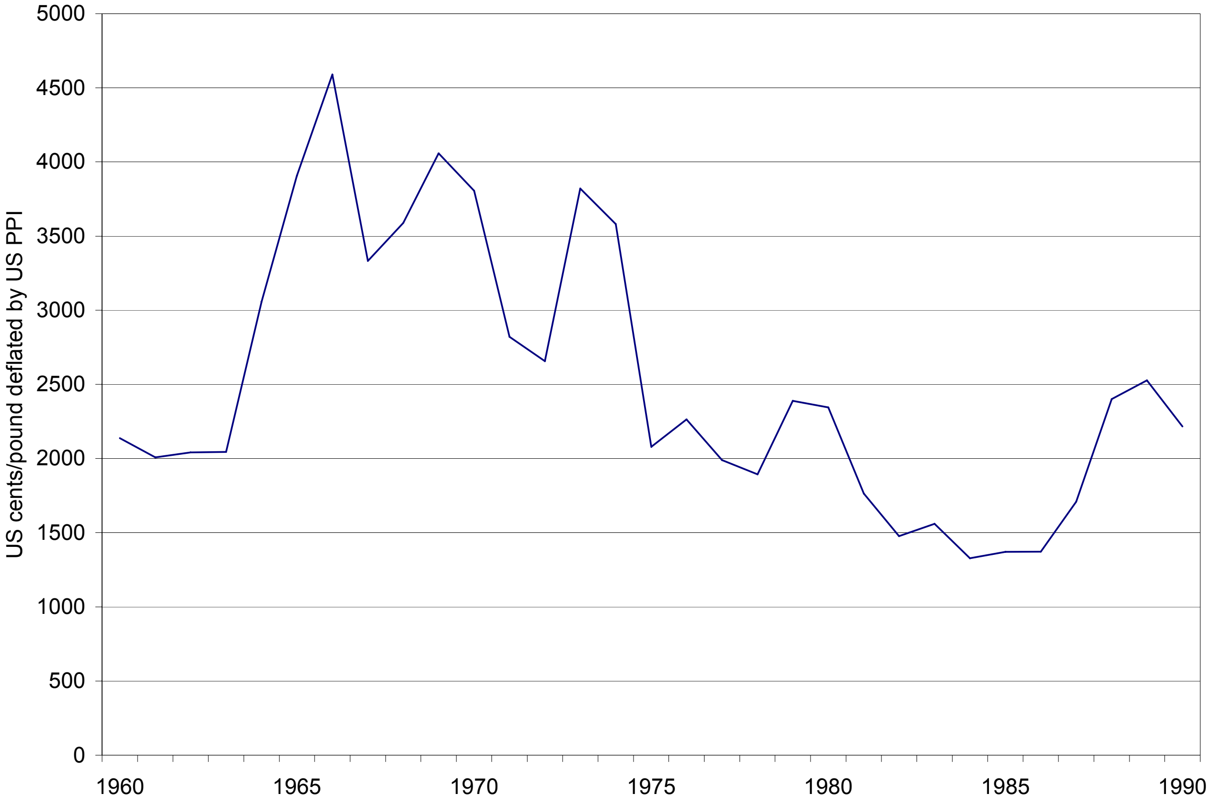
Figure 19: Terms of Trade (1995 = 100)



Source: Global Coalition for Africa (2002/2003)

With copper playing such a substantial role in exports in Zambia, the movement in the real copper price can probably explain the declining terms of trade (see Figure 20). Again, this issue is explored in section 3.5.1.

Figure 20: Real Copper Price



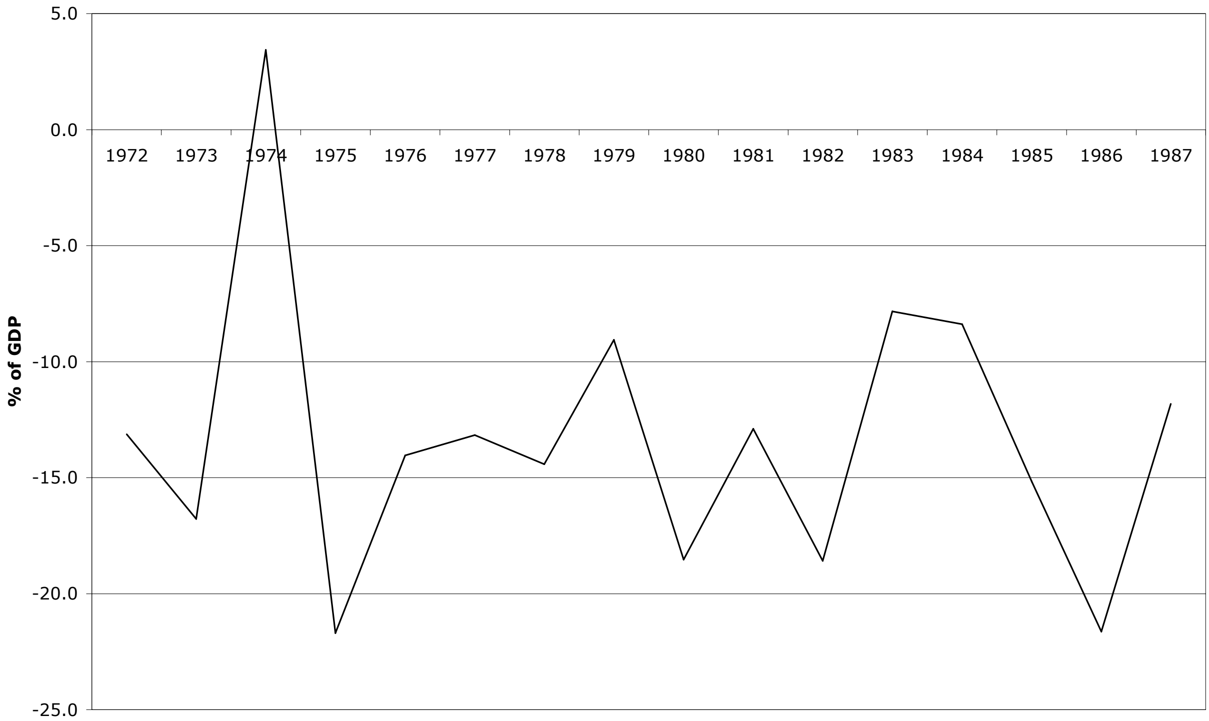
Source: (IMF various years-a: IFS series 11276C.DZF...)

Figure 21 indicates that Zambia experienced high levels of budget deficits throughout its post-colonial period, whereas Botswana was able to realise surpluses since the beginning of the 1980s (Figure 22). To finance their budget deficit, the Zambian government resorted to a number of methods: e.g. printing money, borrowing domestically, and borrowing externally. Each of these methods had serious consequences for the economy:

- Normally one would expect that the printing of money results in growth of the money supply and thereby pushes up real interest and inflation rates in the money market. High interest rates would be to the disadvantage of the economy because business people find it expensive to borrow money to extend their operations. This was, however, not the case in Zambia where interest rates were kept artificially low.
- But the crowding out of private sector investment happened through another route. Government borrowings averaged 10 percent of GDP in 1975-79, compared to 3 percent in 1970-74 (Gulhati 1989). An unfavourable consequence of such lending is that in order to accommodate government needs, the Bank of Zambia had to restrict credit to the private sector. In the words of Gulhati (1989: 10): "Monetary policy became hostage to the budget deficit".

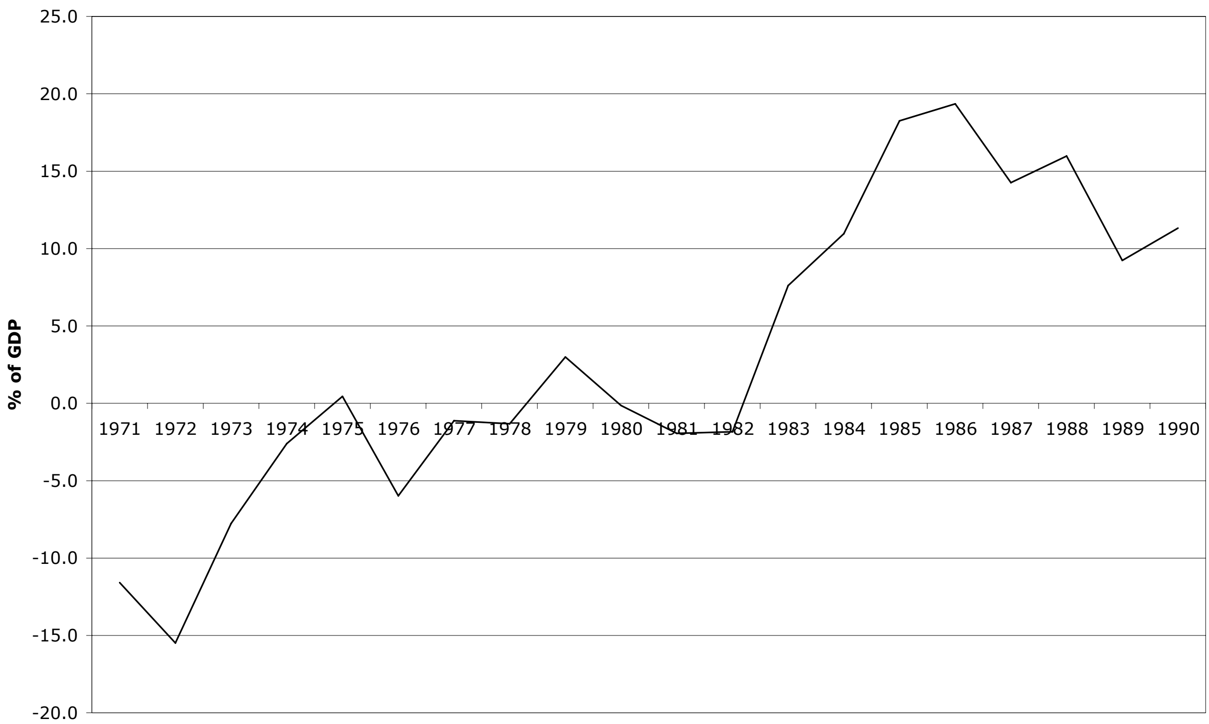
- The last option leads to external debt (and money creation), which is shown in the debt figures in Table 7. Zambia borrowed from foreign commercial banks, supplier's credit agencies and the IMF. Total external debt in 1995 was estimated at US$ 6,366 million, that is, three times the GDP and five times total export earnings.

Figure 21: Zambia overall budget balance



Source: World Development Indicators (World Bank 2002a)

Figure 22: Botswana overall budget balance



Source: World Development Indicators (World Bank 2002a)

Table 7: Central government debt (% of GDP) – various years

	Botswana	Zambia
1977	28.8	85.7
1981	14.1	94.6
1985	18.2	192.6
1987	15.8	127.6

Source: World Development Indicators (World Bank 2002a)

The large deficit is probably the reason for the high levels of inflation experienced by the Zambian economy (Figure 23). This assumption is not out of the ordinary, because such a relationship has been established empirically for countries in general. The relationship between fiscal deficits and inflation has been studied widely, with econometric studies supporting the view that the relationship between the two variables is positive. Fischer and Easterly (in Agénor and Montiel 1999: 161) put it as follows: "Milton Friedman's famous statement that inflation is always and everywhere a monetary phenomenon is correct. However, governments do not print money at a rapid rate out of a clear sky. They generally print money to cover their budget deficit. Rapid money growth is conceivable without an underlying fiscal imbalance, but it is unlikely. Thus rapid inflation is almost always a fiscal phenomenon". It is therefore reasonable to assume that the same is true for

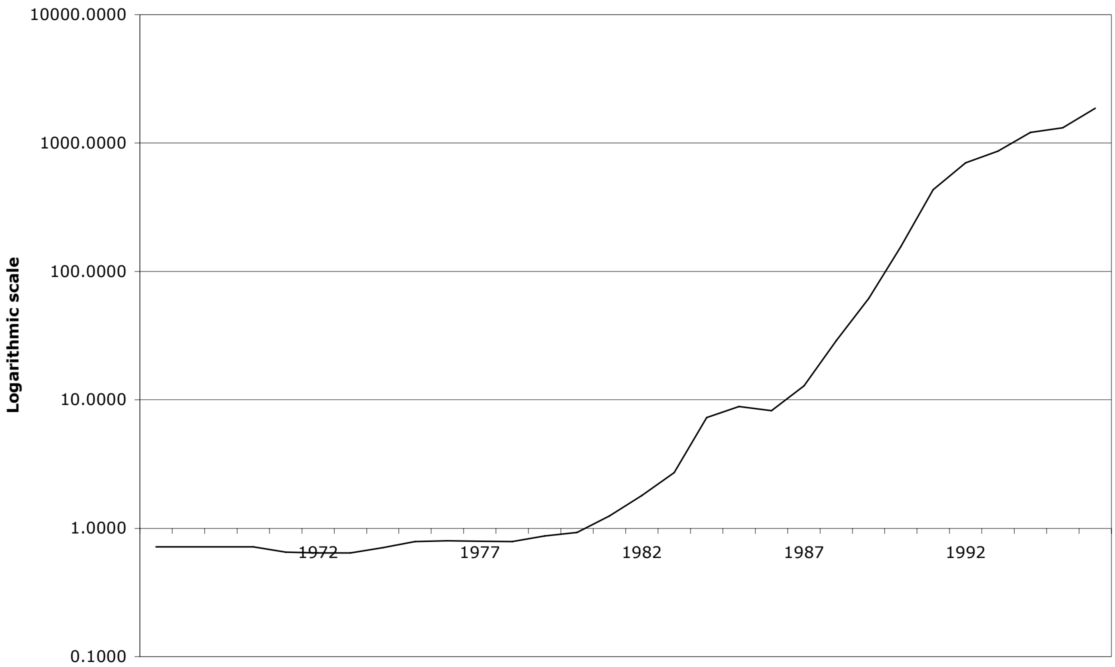
Zambia.

Figure 23: Inflation

Source: International Financial Statistics Yearbook (IMF various years-b)

Towards the end of the 1970s Zambia faced stagflation and a rising burden of public debt. The IMF, as part of a Structural Adjustment Programme, required a devaluation of the Kwacha in the early 1980s of no less than 40 percent, but the government decided to devalue the currency by only 20 percent in 1983. During that same year the Kwacha, which had been linked to the Special Drawing Rights (SDR) was floated and pegged to a basket of currencies of Zambia's major trading partners (Mwanza, et al. 1992). The exponential path of the devaluation of the currency is evident in Figure 24.

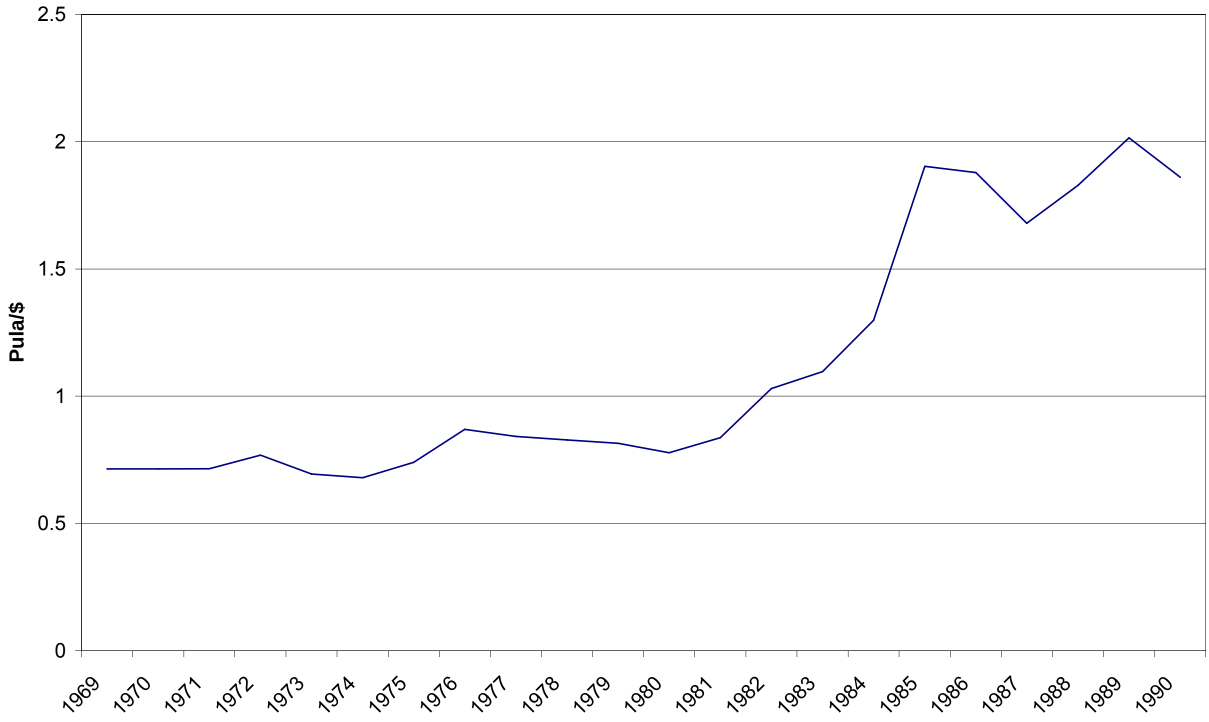
Figure 24: Zambian Kwacha/US$



Source: International Financial Statistics Yearbook (IMF various years-b)

The Botswana Pula, which was linked to the Rand for most of the period, has experienced a depreciation against the dollar, especially in the first half of the 1980s (see Figure 25).

Figure 25: Botswana pula / US$



Source: International Financial Statistics Yearbook (IMF various years-b)

2.6 SOCIO-ECONOMIC INDICATORS

The age distribution of the populations of the two countries has not changed much over time. In 1960, 47 percent of the population in Botswana was younger than 14 years. In 1990 the comparable figure was 46 percent. In Zambia 45 percent of the population was younger than 14 years in 1960 and 46 percent in 1990. Both countries, therefore, have young populations.

Although Zambia has a much larger population than Botswana, both countries have low levels of population density. However, due to the fact that Zambia was a more developed country at independence, the population was more urbanised at that stage than was the case for Botswana (see Table 8). Urbanisation in both countries continued until the 1990s. In 1990 both had the same percentage of rural populations.

Table 8: Rural population (% of total population)

	Botswana	Zambia
1960	98.2	82.8
1970	91.6	69.8
1980	84.9	60.2
1990	58.5	58.0

Source: World Development Indicators (World Bank 2002a)

At independence Zambia was the third most urbanised country in mainland sub-Saharan Africa, with 78 percent of the urban population located in the 10 largest urban areas, all situated along the railway line extending south from the Copperbelt, through Lusaka, to the Victoria Falls. In Botswana the population distribution is skewed towards an eastern strip. This area is the best-endowed and most developed region of the country, where 80 percent of the total population live. The Botswana population is concentrated along the railway line (Picard 1985: 4).

Another important difference between the two countries is the ethnic composition of their populations. There are 73 different ethnic groups among Zambia's indigenous population, and over 80 languages have been identified (Williams 2001). In contrast, the Batswana consists of only eight ethnic groups.

According to the World Bank (1996) living standards have declined in Zambia since the mid-1970s, with nearly 70 percent of Zambians living in households where basic needs are not being met and where chronic malnutrition affects 45 percent of all children. Malnutrition is pervasive in both rural and urban areas. Furthermore, Zambia is one of the few countries to have experienced an increase in infant mortality (World Bank 1996). Table 9 shows the relatively high figures of infant mortality for Zambia.

Table 9: Infant mortality rate - deaths per 1000 live births

	Botswana	Zambia
1960	170	213
1970	139	181
1980	94	149
1990	62	191

Source: World Development Indicators (World Bank 2002a)

The emphasis placed on primary health care facilities in Botswana resulted in a dramatic decline in infant mortality in the 1970s and 1980s. The strategy since the mid-1970s emphasised the widespread provision of primary health care, rather than providing hospitals and doctors for a few. The effectiveness of this strategy is illustrated in a much lower infant mortality rate for Botswana than for Zambia.

For both countries life expectancy has declined from the mid-1980s to 1990, (see Table 10) due to a high incidence of AIDS. But both countries were in 1990 still in a better position than they were in 1960.

Table 10: Life expectancy at birth, total (years)

	Botswana	Zambia
1960	47	42
1965	49	44
1970	52	46
1975	55	49
1980	58	50
1985	60	50
1990	57	49

Source: World Development Indicators (World Bank 2002a)

Both countries have done well in lowering illiteracy rates (see Table 11).

Table 11: Illiteracy rate, adult total (% of people ages 15 and above)

	Botswana	Zambia
1970	53.9	52.3
1980	42.5	41.4
1990	31.9	31.9

Source: World Development Indicators (World Bank 2002a)

Table 12 points out that school enrolment has been a problem in both Botswana and Zambia. At primary school level Zambia started out much better than Botswana, but in 1990 the figure dropped to below 100 percent again. At secondary level, Botswana has also outperformed Zambia.

Table 12: School enrolment (% of gross◇)

	1970	1975	1980	1985	1990
primary school					
Botswana	63	71	91	105	113
Zambia	90	97	90	105	99
secondary school					
Botswana	7	15	19	29	43
Zambia	13	15	16	19	24

Source: World Development Indicators (World Bank 2002a)

◇: total enrolment, regardless of age, to the population of the age group that officially corresponds to the level of education shown

One of the problems in the Botswana economy is a skew distribution of income. The success of attempts to reduce income inequality has been modest. Income inequality in Botswana is high by international standards. Botswana comes second only to Namibia as the country with the highest Gini coefficient in the world, with the poorest 20 percent earning 2.2 percent of national income and the highest 20 percent 70.3 percent (see Table 13 for a comparison with South Africa and Zambia). According to Picard (1985), little of the economic revenue generated from the mining industry has gone to the average citizen, with the effect that rural income has risen very little.

Table 13: Gini coefficients

Botswana (1993)	63.0
Namibia (1993)	70.7
Zambia (1998)	52.6
South Africa (1995)	59.3

Source: World Bank (2005)

The same trend can be identified in Zambia. While two-thirds of the population live on the land in Zambia, the agricultural sector was neglected in favour of the mining industry. This has had a skewing effect on income distribution, where those with formal employment in the mining industry and government agencies received a much higher income than those people living off the land.

2.7 CONCLUSION

In this chapter the two countries were compared on different grounds. From the overview an interesting picture unfolds. At the time of independence in the mid-1960s, the

Zambian economy was performing much better than the Botswana economy in terms of economic growth and investment in infrastructure. Since independence the picture has changed markedly, with Botswana achieving economic growth levels that are high not just for Africa, but also the world. The Zambian economy, on the other hand, has stagnated.

At independence, Botswana largely depended on agriculture to provide the country with income. This changed with the discovery of rich mineral deposits. In Zambia the mineral wealth was already known and being exploited at independence, and due to a number of reasons the agricultural sector was neglected. Both countries failed to diversify their exports and depended on mining for the generation of GDP and export income.

Copper and diamonds performed very differently in the international markets and this difference may be the reason for the divergence in economic growth between these countries. Rich diamond deposits were discovered in Botswana shortly after independence and their exports contributed to improved trade. The growth and stabilisation figures show that Zambia was unable to capitalise on earlier gains from copper and had to deal with a decline in the terms of trade. The Botswana government managed the income from the newly discovered diamond industry to the advantage of the country. Stable inflation, and a stable exchange rate contributed to the highest per capita growth rate in the world for the 30-year period shown.

It leaves an interesting question. Why did two neighbouring, landlocked, mineral rich countries, which both gained independence from Britain in the mid-1960s, produce such different economic and socio-economic results? Can their growth performance be explained by the difference in the minerals they export? Why did Zambia succumb to the resource curse and Botswana not? And, furthermore, do the neoclassical and new growth theories sufficiently explain the divergent growth paths?

CHAPTER 3
AN EXPLANATION OF ECONOMIC GROWTH DIFFERENCES BETWEEN BOTSWANA AND ZAMBIA

3.1 INTRODUCTION

Differences in economic growth between countries have been the focus of economic research for a long time. Much work, even as far back as the classical economists of the eighteenth and nineteenth century (Adam Smith, Thomas Malthus, David Ricardo and Karl Marx), has been done to explain why some countries prosper while others stagnate. This chapter outlines broadly the progress made in development thinking since the time of classical economists and establishes whether the augmented Solow growth model, and other models from the growth literature, sufficiently explain growth differences between Botswana and Zambia.

One of these "other factors", and one which applies to Botswana and Zambia in particular, is the difference in economic growth that results from the endowment of natural resources. Because of the importance of resource dependence in the two countries, this factor, namely the resource curse hypothesis, will be discussed in a separate section. In studies done on the hypothesis (for example Neumayer 2004, Sachs and Warner 1995a, Stevens 2003), Zambia regularly features as an example of a country that has fallen prey to it, whereas Botswana turns out to be the opposite.

Both countries have an abundance of natural resources and are resource dependent in their exports, but achieved different outcomes in terms of economic growth. Questions such as why Zambia has fallen prey to the resource curse and Botswana not, will feature in section 3.5. In chapter 2 it is shown that an increasing nominal copper price cannot explain the stagnation in the Zambian economy. The declining real copper price probably explains the declining terms of trade due to the importance of copper in the export market. With copper being such an important factor in the economy, it is important to establish the nature of the transmission mechanism between the copper price and economic growth. Section 5 explores two possibilities: Dutch disease or government's reaction to an unstable copper price.

3.2 CLASSICAL, NEOCLASSICAL AND THE 'NEW' GROWTH THEORIES

As mentioned in the introduction, preoccupation with the problem of economic growth and development is not exclusively the domain of modern economic thought. Great economic thinkers of earlier times were also concerned with the nature and causes of the growth of the "wealth of nations". For Adam Smith, the father of classical economics, economic growth would take care of itself if the rules of the free market were obeyed. Smith supported a laissez-faire government because, according to him, political institutions would only limit people from making full use of their talents and the available natural resources. Smith supported the idea that governments should provide little else than incentives necessary to make sure that market participants engage in productive activities[10]. The rest should be left to the "invisible hand" of the market that would secure the optimal outcome for a particular economy by rewarding those that contribute to economic growth and punishing those that do not act in the best interest of the market (Landes 1990).

Differences in economic development between nations were ascribed to differences in the endowment of labour, capital and especially land. It was accepted that those nations more richly endowed with natural resources were bound to be richer. Today we know this is not necessarily true. One only has to look at Africa where most countries are richly endowed with natural resources, but where these resources are more often associated with stagnation rather than prosperity.

Smith's theories were developed and refined in the decades after the appearance of *An Inquiry into the Wealth and Poverty of Nations* in 1776, by people like Thomas Robert Malthus, David Ricardo and John Stuart Mill. Malthus' work on the relationship between population and economic growth, together with Ricardo's explanation of diminishing returns in the use of land, focused attention on the conflict between population growth and resources. However, their fear that food production would not keep up with population growth was shown to be misguided towards the end of the 19th century when the use of machinery in agricultural production increased productivity in the use of land. Better ways of transportation opened new possibilities for trade and made food and raw materials available to the more populous countries.

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[10] It is interesting to note that Smith already had some of the ideas that were later formalised within the New Institutional theory.

Economic growth was no longer seen as a problem and the importance of economic growth as a field of research diminished. Economics came to be dominated by static neoclassical value theory under the influence of Alfred Marshall's *Principles of Economics* (1890). Marshall treated growth and development as natural phenomena, with issues that are now recognised as central elements in the growth process, i.e. a nation's institutions, its technology, and its history, as autonomous (Abramovitz 1991). It was only after the two world wars and the Great Depression that the need to study something else than general equilibrium became apparent.

Under-investment

After World War II economists focused their attention on theories that could show how newly independent poor countries could grow and catch up with developed countries. Thinking was influenced by the Great Depression and the apparent successful industrialisation of the Soviet Union through forced savings and investment. With an abundance of labour due to the Depression and the Soviet Union's economic performance in mind, Sir Arthur Lewis (1955) suggested a model where machinery was the only constraint. If more factories could be built, it would not only absorb the labour, but also contribute to production and hence to economic growth. In his view growth was proportional to investment in these factories, and to secure investments, a country had to increase its domestic savings (Easterly 2001).

Lewis described development as the process of transforming a country from a net 5 percent saver and investor to a net 12 percent saver and investor. For Lewis and other development economists, poor countries were unable to make the required investments because they could not save enough. This lack of savings to invest was called a "finance gap", and could be filled with either donor money, investments from abroad, or export income from mineral resources (Easterly 2001). W.W. Rostow (1960) contributed to this line of thinking with his theory on the stages of economic growth. In Rostow's take-off stage, leading sectors, such as a rapidly growing export market, or an accelerating flow of technology, drives the take-off. Once these leading sectors begin to grow rapidly, the take-off occurs. For this take-off to occur, however, Lewis's finance gap had to be filled. According to Easterly (2001), Rostow tried to demonstrate to the Third World that communism was not the only effective state organisation that could launch a take-off[11].

[11] The subtitle of Rostow's Stages book was "A non-communist manifesto".

Following from this, one cure for underdevelopment would be for Western nations to provide Third World nations with aid to fill the financing gap between their national savings and the investment necessary for the take-off.

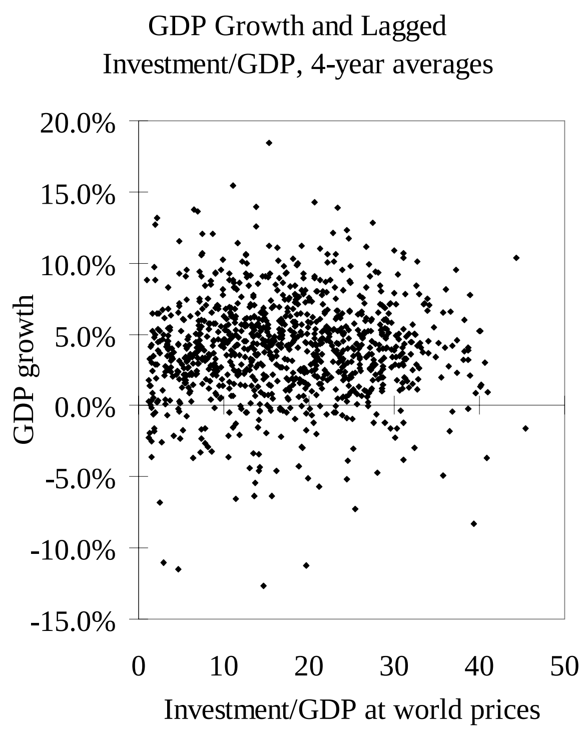
Unfortunately the incentives to use aid in a manner that would benefit the country in the long run, do not necessarily come easily. Too often the reality is that aid does not finance investment, but rather increased consumption. Easterly and Levine (1998) found on average no relationship between aid and investment. They suggest that if no incentive existed in a country to invest in the future, aid is not going to change that. If citizens were used to consumption at the cost of investment, they will do likewise with aid. Aid can even have the additional drawback that it can provide the incentive to lower domestic savings, and, the larger the finance gap, the more eligible the country becomes for aid (Easterly and Levine 1998).

Easterly (2001: 42) describes the "most spectacular failure" of the financing gap model by comparing Zambia's actual average income to what it would have been if filling the financing gap had worked as predicted. He predicts that Zambia would have been an industrialised country with a per capita income of $20 000. With a per capita income of $380 in 2003, this is hardly the case. Easterly shows that Zambia's investment rate went down after it received aid and that those investments did not yield growth in any case.

Zambia is not alone in this lack of growth due to investment funds. Figure 26 shows no correlation between investment per GDP and GDP growth. Both Nigeria and Hong Kong increased their physical capital stock per worker by over 250 percent from 1960 to 1985. The results of this massive investment were different: Nigeria's output per worker rose by 12 percent during that period, while Hong Kong's rose by 328 percent. Again, this is an extreme example, but serves as a reminder that investment is a necessary, but not a sufficient, condition for high growth rates.

Capital growth does not necessarily translate into output growth unless the investment was made in productive activities (Easterly 2001). In the case of Hong Kong the investment was made in industrial diversification and in Nigeria in the production of oil. Hong Kong's investment generated income and growth, while the investment in Nigeria was wasted.

Figure 26: GDP Growth and lagged investment/GDP, 4-year averages



Source: Shirley (2004: 7)

Lack of technological innovation

Nobel laureate Robert Solow's contribution to the debate regarding investment in capital goods was to argue that diminishing returns would decrease output as more machines per person are introduced. Poor countries with a small amount of capital per head should then grow faster than rich countries with a lot of capital per head, leading to the convergence of per capita incomes and living standards across the world (Thirlwall 1999).

Although a logical argument, many industrial economies have been able to realise sustained economic growth per worker for more than two centuries. This led a number of scholars to investigate the factors that attributed to economic growth over many decades in the United States. Although they used different data sets, they all reached the same conclusion: only a small fraction of US per capita growth could be attributed to total input growth per capita and only a small fraction of labour productivity growth could be attributed to growth of capital per worker. An overwhelmingly large fraction (approximately 90 percent) was due to the advancement of what they called "total factor productivity", the contents of which were at that stage unidentified and unmeasured (Abramovitz 1991).

Solow’s explanation for this paradox was technological change. He explained this in two famous papers (1957, 1962), in which he emphasised the importance of technological progress as the ultimate driving force of sustained economic growth. According to his explanation, growth in the long run was a function of technical change, and not of savings or investment. Higher saving would yield higher growth, but only temporarily before it ran into diminishing returns.

Following Solow’s papers, theoretical work on technological change was resumed in the early 1980s. At that stage cross-sectional studies were inspired by increasing concerns about the economic performance of the poorer regions of the world, increased availability of standardised data, enabling reliable econometric work, and studies that have shown no sign of convergence of per capita incomes across the world economy.

Work done by Robert Lucas (1988) and Paul Romer (1986, 1990) relaxed the assumption of diminishing returns to capital. With constant or increasing returns to capital there can be no presumption of convergence of per capita incomes across the world. Lucas and Romer created renewed interest in the link between investment and economic growth by particularly emphasising the importance of investment in ideas and human capital. According to them, research and development prevents the marginal product of capital to fall and the capital-output ratio to increase. Technological progress and human capital formation were endogenised within the general equilibrium models of growth, in what came to be known as the ‘new’ (endogenous) growth theory (Abramovitz 1991).

Lack of education

The new growth theory had interesting consequences for developing countries. It emphasised the importance for a country to develop its stock of human capital and the importance of obtaining the benefits from the international exchange of ideas that accompanies an open economy. It was especially Paul Romer (1993: 71) who highlighted the importance of ideas in the development process: “ideas are therefore the critical input in the production of more valuable human and nonhuman capital. But human capital is also the most important input in the production of new ideas. Physical capital (a computer for example) is often used in an ancillary way, but a trained person is still the central input in the process …”. Romer reminds us, however, that investment in formal education takes a long time to produce benefits. He suggests that integration in the world markets should be considered because it offers large potential gains when using someone else’s ideas. “And someone else's ideas are basically costless to use”.

In development thinking, education was for long seen as the cure to all ills. The secretary general to UNESCO, Federic Mayor, put it as follows: "the level of education of the overall population of a particular country… determines that country's ability to share in world development, …to benefit from the advancement of knowledge and to make progress itself while contributing to the education of others. This is self-evident truth that is no longer in dispute" (quoted in Easterly 2001: 72). The 1997 World Development Report (World Bank 1997: 52) notes that "many attribute a good part of the East Asian countries' economic success to their unwavering commitment to public funding for basic education as the cornerstone of economic development".

Unfortunately the growth response to the educational expansions of the last four decades has been disappointing. What was not taken into account when emphasising education, is the fact that education per se does not cause economic growth. If educated people do not have the opportunity to use their skills in a productive fashion, the investment in education will render little profitable output. If people can earn a good living simply by, for example, lobbying government for favours, investment in education will show no long-term benefit (Easterly 2001).

Furthermore, what should not be lost sight of is the importance of the type and quality of education. In South Korea, for example, the emphasis was on technical and scientific education and it has paid them high dividends. In Africa, however, large expenditure (relative to GDP) on education did not result in growth. African countries with rapid growth in human capital over the 1960 to 1987 period – countries like Angola, Mozambique, Ghana, Zambia, Madagascar, Sudan and Senegal, were growth disasters.

Geography

In the late 1990s geography became a popular explanation for growth disasters. Geography refers to the climate, disease burden, transport barriers, which include distance from developed markets and the landlockedness of countries, and natural resource endowment. Scholars who advocate geography as the main determinant for economic growth and development, are, for instance, Bloom and Sachs (1998), Gallup, Sachs and Mellinger (1999), McArthur and Sachs (2001). Two books, one by economic historian David Landes (The Wealth and Poverty of Nations (1998)) and the other by ecologist Jarred Diamond (Guns, Germs and Steel (1997)), also explore the origins of economic development from a geographical perspective. For Bloom and Sachs (1998: 211) an "extraordinarily disadvantageous geography" lies at the root of Africa's poverty. They do not argue that Africa is fated to be poor because of its geography, but that "economists neglect the role of the forces of nature in shaping economic performance in general, and for Africa in particular".

Although the Hecksher-Ohlin theory suggested that trade patterns will follow the path of relative factor availability, Bloom and Sachs (1998: 113), for instance, suggest a much more interventionistic approach: "good policies should be tailored to geographical realities". If agricultural productivity is low due to climatological reasons, growth should be led by outward-oriented industry and services. They base their evidence on the fact that only a few countries in the tropics have made significant breakthroughs in economic growth in the past twenty-five years and in almost all cases this happened through the promotion of manufacturing or service sector exports. The reason why they suggest that economic growth should be promoted through manufacturing and services is because technologies in manufacturing and services can transfer across climatic zones much more readily than technologies in agriculture. The greatest tropical success stories[12] are small island economies with almost no agricultural sectors[13] and rapid growth in manufacturing and service sector exports.

Most of the supporters of geography highlight the fact that good policies could overcome the fate of bad geography. Hausmann and Rigobon (2002: 46), for instance, state, "there is still much we do not understand about the links between geography and economic growth. But what we do know suggest that the challenges of economic development must be examined from a very new perspective. Denying the impact of geography will only lead to misguided policies and wasted effort. Geography may pose severe constraints on economic growth, but it need not be destiny". In other words, geography does not predestine the level of economic development as long as the policies take the constraints it impose into account. Brazil, for instance, benefits from its tropical location by being able to harvest some field crops twice a year.

To conclude this section, it can be said that thinking about a panacea for economic growth has changed much over time. Although it was found that most of the factors discussed above are not sufficient explanations for economic growth, they still play important roles in the process of economic growth and development. They cannot be discarded when thinking about economic growth, but not one of them is presently seen as the sole explanation for growth differences.

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[12] In a world ranking of countries by GNP per capita, only three of the top thirty lie in the tropics: Brunei, Hong Kong and Singapore and their geographical locations leave them ideally suited for growth through trade.

[13] The sugar industry in Mauritius provides an exception to this phenomenon.

The following section applies the augmented Solow model to Zambia and Botswana to determine to what extent it explains the growth differences between these economies.

3.3 EMPIRICAL REASONS FOR GROWTH DIFFERENCES ACCORDING TO NEOCLASSICAL THEORY

The augmented Solow model is used instead of the textbook Solow model is because the former was found to explain a greater percentage of the variation in cross-country per capita income. In the textbook Solow model economic growth is studied by assuming a standard neoclassical production function with decreasing returns to capital. It shows that saving and population growth rates determine a country's steady-state level of per capita income - the higher the rate of savings, the richer the country, the higher the population growth, the poorer the country. These variables were found to explain more than half of the cross-country variation in income per capita (Mankiw, Romer and Weil 1992).

Due to the importance of human capital[14], Mankiw, Romer and Weil (1992), and others such as Barro and Sala-i-Martin (1992), added a proxy for investment in human capital in an augmented model. In the augmented model savings, population growth and human capital are considered to be responsible for economic growth over time, given that the initial level of GDP must also be taken into consideration. The latter is referred to as the convergence term.

The cross-country economic data is taken from the Penn World Tables (mark 6.1) (Heston, Summers and Aten 2002), unless stated otherwise. The data set contains 76 countries of which 22 are from Sub-Saharan Africa.

Convergence term

The convergence hypothesis states broadly that countries will converge towards similar output per capita ratios as factors of production seek the optimum rate of return in a competitive system. Initially, backward economies will grow faster as all the countries converge towards a shared steady state. According to Knack (2003: 8) evidence over a broad range of countries suggest that relative backwardness presents an opportunity for

[14] Human capital was found to be over half of the total US capital stock in 1969 (Mankiw, et al. 1992).

nations: "the lower a nation's per capital income, the greater is this opportunity to grow rapidly through borrowed technology and new investment".

A weaker form of the hypothesis – conditional convergence – predicts convergence of countries to their own steady state level of income as determined by their savings rate, population growth rate, levels of human capital and so on, rather than converging towards the levels of technological leaders. This leaves room for negative growth rates due to unfavourable rates of savings, fertility, or human capital. It is the weaker form of the convergence hypothesis which seems consistent with the cross country experience (Mankiw, et al. 1992).

In 1960 Zambia was 58th in a ranking of countries from rich to poor in the sample and if the convergence hypothesis holds it would be expected, ceteris paribus, that Zambia would be amongst the faster growers. As shown in Chapter 2, was not the case. Even within SSA, Zambia performed worse than expected from its relative poverty in 1960. At 64th on the list in 1960 Botswana was therefore poorer than Zambia at the time, but has since turned out to be a fast-growing economy.

From these, and other, differential performances, it can be concluded that although relative backwardness in some cases appear relevant, the explanation for the difference in the performance of Botswana and Zambia must be sought elsewhere.

Savings rate

An economy's savings rate indicates the rate at which the formation of physical capital can be financed in a closed economy. But because of openness, the savings rate does not capture the rate of capital formation, and hence the growth literature uses the investment rate as the appropriate indicator of capital formation. Table 14 compares the investment share of GDP in Zambia and Botswana with that of the SSA and the total samples during the early years of independence.

Table 14: The investment rate (average 1960-75 [15])

Country/group	Investment rate	Ranking of growth	
		World	SSA
Zambia	0.17	33	4
Botswana	0.15	41	7
SSA	0.11		
World	0.17		

According to this indicator Zambia was performing better than Botswana for the 1960-75 period. The investment rate in Zambia was average compared to the total sample but high for a SSA country. If it is taken into account that Botswana had already started to outperform Zambia in the first half of the 1970s (see Figure 8), the investment rate does not account for Zambia's poor economic performance. This result shows how misleading it can be to explain the economic performance of a country with reference to the determinants identified in cross-country regressions. A more in-depth study is necessary to find reasons for unproductive investments.

Population growth

Both the steady state and the growth rate of the economy are inversely related to the population growth rate in the augmented Solow model. There is no causal claim in this statement, indeed the reverse applies: there is a feedback effect from the growth effect to the population growth, as is well established in the growth literature (see for instance Jones 1998). Table 15 shows population growth rates for Zambia and Botswana as well as the SSA and world samples.

[15] The average of a limited period (the first number of years after independence) is used to take care of a possible problem of endogeneity. Investment is necessary for capital investments, but after a number of years the capital investments (if they were in productive investments) will deliver an income that can then be used to finance capital investments.

Table 15: Population growth rate (1960-65)

Country/group	Population growth	Ranking of growth World	SSA
Zambia	2.8	23	6
Botswana	2.6	29	8
SSA	2.5		
World	2.2		

In both countries population growth was higher than the world average, and also slightly higher than the average for SSA.

Human capital

Mankiw, Romer and Weil (1992) demonstrated the explanatory power of including a proxy for human capital investment in the Solow model. Primary school enrolment in 1960 is used in Table 16 as a proxy for human capital investment in a cross sample comparison to control for the feedback effect.

Table 16: Primary school enrolment

Country/group	Primary school enrolment	Ranking of growth World	SSA
Zambia	0.42	64	11
Botswana	0.42	64	11
SSA	0.44		
World	0.74		

From Table 16 one would predict a low steady state and low transitional growth rate for Zambia and Botswana on account of the low level of the initial human capital endowment. Again it seems there is more to a country's growth than is revealed by cross-country studies.

In summary, the augmented Solow model would have predicted uninspiring economic growth for both Zambia and Botswana due to low investment in human capital and high population growth, which would have lowered their expected growth rates.

In the following section other factors from the empirical literature are used in an effort to explain growth differences between Botswana and Zambia.

3.4 OTHER FACTORS FROM THE EMPIRICAL GROWTH LITERATURE

Work done by Doppelhofer, Miller and Sala-i-Martin (2000) and extended by Burger and du Plessis (2004) identified seven variables that have been robustly related to growth for the same sample of countries used in the previous section: initial GDP (discussed above), a tropical dummy, primary school enrolment (discussed above), a demographic shift variable, Sachs and Warner's trade openness proxy, the black market premium, and a neighbourhood dummy. This sub-section discusses those variables in this list that had not been discussed so far.

Tropical dummy

The tropical dummy indicates the extent to which a country's climate could be described as tropical. Sachs and Warner (1997b), amongst others, have argued that this characteristic is one of the most powerful explanatory factors of cross country growth performance, based on theories such as the adverse impact on growth due to the poorer soil quality and also the prevalence of tropical diseases like malaria.

With the exception of Botswana (with tropical index value of 0.5), Madagascar (with index value of 0.9) and South Africa (with tropical index value of 0) all of the SSA countries in the sample are classified as fully tropical. If the geographical theories of economic growth were correct this would partly explain the underperformance of SSA as a group, but it would offer no explanation of Zambia's relative underperformance within the SSA group.

Demographic shift variable

The demographic transition that countries made in the last century has been identified as one of the driving forces behind the movement from stagnation to growth (see for instance Galor and Weil 1999, 2000). It is argued that a reduction in fertility rates and population growth enable economies to apply a larger share of factor accumulation and technological progress to growth in income per capita. This happens because there is a more intensive use of the stock of capital and land, an enhancement of investment in human capital, change in the age distribution of the population, and a temporary increase in the size of the labour force relative to the population as a whole (Galor 2004).

The demographic shift variable relates the growth rate of the working age population to the growth rate of the total population. Burger and du Plessis (2004) find a robust and significant effect, in other words, the demographic transition is robustly related to growth. Table 17 shows a sample comparison of the demographic shift variable from Zambia and Botswana. The variable shows the growth rate of the economically active population (between ages 15 and 65) minus the growth rate of the overall population (Sachs and Warner 1997b).

Table 17: Demographic transition (1965-1990)

Country/group	Demographic transition	Ranking of growth World	Ranking of growth SSA
Zambia	-0.18	70	16
Botswana	0.43	20	1
SSA	-0.09		
World	0.2		

Both on an international and on a regional comparison, Zambia's demographic transition was debilitating, whereas, according to the indicator, Botswana has accomplished the demographic transition.

Sachs and Warner's trade openness proxy

Sachs and Warner (1997b: 18) argued that closed trade policies have been "…cutting Africa off from the growth dynamism of world markets". In the growth literature trade openness is credited with enhancing both static (allocative) and dynamic efficiency. But there is also a discipline effect, whereby governments of open economies are more directly limited in the pursuit of potentially unorthodox policies by the market discipline of the international financial markets. Table 18 provides a sample comparison of the Sachs and Warner (1997b) openness variable for Zambia and Botswana.

Table 18: Openness[16]

Country/group	Openness	Ranking of growth	
		World	SSA
Zambia	0	51	8
Botswana	0.42	27	1
SSA	0.06		
World	0.38		

On the Sachs and Warner measure of openness Zambia had a highly closed regime from the 1960s until the 1990s. This is consistent with the Artadi and Sala-i-Martin's (2003) observation that African economies have been considerably more closed than economies in other regions. Alternatively, Botswana was markedly more open and not only outperformed the other SSA countries, but was even better than the average for the world sample. One can assume that its membership of SACU and the accompanied inability to set its own external tariffs contributed to this performance.

Black market premium

Underdeveloped financial markets are, evidently, an important contributing factor to poor economic growth, notably in Africa. While there are no comprehensive indicators of the financial sector development, the black market premium is a frequently used proxy (see, for example, the survey in Ndikumana 2001). The variable is an indication of how well the financial sector is developed, in other words, if a financial system is not adequately developed to provide the services that are demanded, people will turn to the black market for financial transactions.

[16] The OPEN6590 variable is the fraction of years during the period 1965-1990 in which the country is rated as an open economy according to the criteria in Sachs and Warner (1995b). An economy is deemed to be open to trade if it satisfies four tests: (1) average tariff rates below 40 percent; (2) average quota and licensing coverage of imports of less than 40 percent; (3) a black market exchange rate premium that averaged less than 20 percent during the decade of the 1970s and 1980s; and (4) no extreme controls (taxes, quotas, state monopolies) on exports.

Table 19: Black market premium

Country/group	Black market Premium	Ranking of growth World	SSA
Zambia	0.56	7	5
Botswana	0.12	36	12
SSA	0.26		
World	0.18		

Table 19 indicates that Zambia's black market premium for foreign exchange was not only high internationally (7th highest) but also high within SSA. This result intimates that the financial markets in Zambia might have been a significant constraint on growth over the sample period. Again, Botswana performs better than the world average.

Neighbourhood effect

This variable from Sachs and Warner (1997a) records the average annual growth of neighbouring economies between 1970 and 1989. The intuitive explanation is that there are positive spillovers from having fast growing neighbours. It would also have been indicative if an index was available for indicating the political stability between neighbouring countries (if neighbouring countries did not get along politically, it would possibly be detrimental for their growth). Unfortunately no such index is available. Table 20 provides an international comparison on neighbourhoods.

Table 20: Neighbourhood[17]

Country/group	Neighbourhood	Ranking of growth World	SSA
Zambia	-1.2	72	20
Botswana	-0.05	61	12
SSA	0.07		
World	1.4		

On this measure both Botswana and Zambia were not only in one of the least conducive neighbourhoods in SSA for economic growth, but in one of the least conducive

[17] This variable measures growth of neighbouring countries. It was derived by first calculating aggregate GDP per-capita, measured in purchasing-power-adjusted dollars, of all countries that border a given country. Standard growth rates were then calculated from the aggregate GDP per-capita of this group of countries between 1970 and 1989 (Sachs and Warner 1997a).

neighbourhoods anywhere in the world, with Zambia in a weaker position than Botswana[18]. With both economies relatively close to South Africa (especially Botswana), one would have expected a higher ranking in SSA. This variable is therefore read with caution.

In summary, the neighbourhood and demographic shift effects contributed to modest expectations of growth in Zambia for the period under consideration, though neither of these variables was open to direct influence by the Zambian government. Although not directly related to government policy, the demographic shift variable is endogenously determined by government policy—for instance access to schooling for women. Botswana's demographic shift variable would have predicted high economic growth for Botswana.

The black market premium and openness measure are both due to government policies and in both these instances decisions made by the Zambian government could have had a negative impact on subsequent growth. On the other hand it seems that the Botswana government has made policy choices regarding these variables that are more supportive of long-term economic growth. Furthermore, both the black market premium (on the financial development side) and the openness proxy (on the trade regime side) capture important institutional features that are dealt with in more detail in the following chapters.

3.5 THE RESOURCE CURSE HYPOTHESIS

The way resource abundance turns out not to be a blessing for economic growth, was discussed more than two centuries ago by Adam Smith (1981 [1776]: 562):

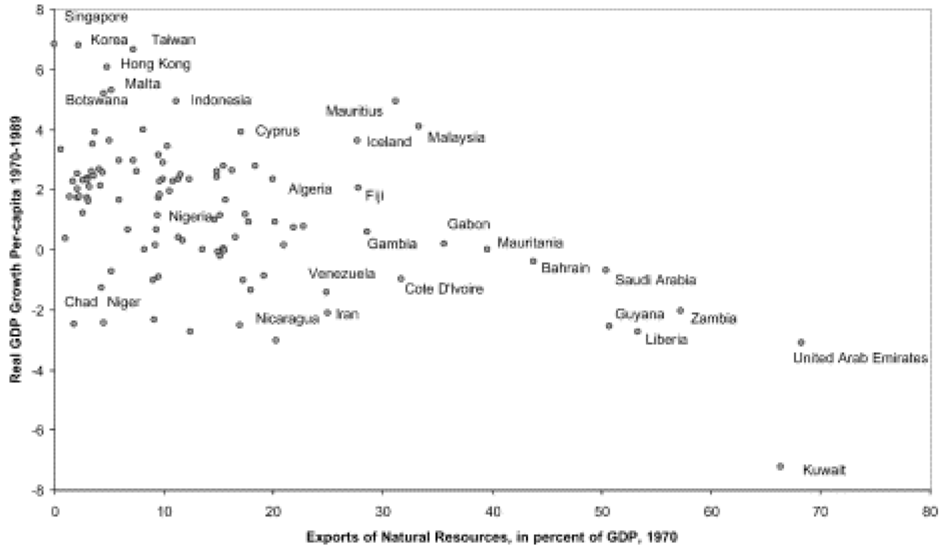
> Projects of mining, instead of replacing the capital employed in them, together with the ordinary profits of stock, commonly absorb both capital and stock. They are the projects, therefore, to which of all others a prudent law-giver, who desired to increase the capital of his nation, would least choose to give an extraordinary encouragement….

During the last number of decades empirical evidence has been added to expand the discussion. It was shown that natural resource-abundant economies have tended to grow slower in the post-world-war II period than economies without substantial resources. It was especially Sachs and Warner (1995a, 1997a, 2001) who have done important work in this regard. They show that none of the countries with extremely abundant natural resources in 1970 (their base year) have grown rapidly during the next 20 years. Their empirical

[18] Chapter 7 discusses the effect of neighbours on transaction costs.

evidence indicates the negative relationship between economic growth and exports of natural resources presented in Figure 27.

Figure 27: Growth and natural resource abundance 1970-1989



Source: Sachs and Warner (2001: 829)

The Asian tigers, such as South Korea, Hong Kong and Singapore are all resource-poor, while growth losers, such as Nigeria, Angola, Venezuela, Mexico and Zambia are all resource-rich. Table 21 shows how resource poor countries have on average outperformed resource rich countries since 1960. Amongst the resource rich countries, the ones with hard minerals have done the worst. The phenomenon that resource poor countries outperform resource rich countries has been termed the "resource curse".

Table 21: Relative performance of resource rich countries

Resource endowment	Number of countries	GDP per capita 1970 ($)	GDP per capita growth 1960-90 (%/year)	GDP per capita growth 1970-93 (%/year)
Resource poor				
Large	7	196	3.5	3.7
Small	13	343	2.5	2.1
Resource rich				
Large	10	574	1.6	1.3
Small				
Non-mineral	31	250	1.1	0.7
Hard mineral[a]	16	304	0.8	-0.2
Oil exporter	8	831	1.7	0.8
All countries	85	362	1.6	1.1

Source (Auty 2001: 4)

[a] Auty includes both Zambia and Botswana in this category

The work of Sachs and Warner has spurred an extensive and growing literature on the subject, for instance Auty (2001), Ross (1999), Sala-i-Martin and Subramanian (2003), Robinson, Torvik and Verdier (2002), Gelb (1988), Tornell and Lane (1999), Sarraf and Jiwanji (2001) and Stijns (2001). Most of the literature states that an abundance of natural resources is not necessarily to the advantage of the country, and they mention a variety of reasons why this is so. Stijns (2001: 2), for instance, is critical on the robustness of Sachs and Warner's results. For him it is unsatisfactory that they "practically leave us with the impression that developing countries should leave their natural resources undiscovered and/or unexploited".

The literature that is critical about the direct link between resource abundance and low economic growth, draws on examples of countries with an abundance of resources that have not fallen prey to the resource curse. Examples of growth winners that are richly endowed in resources are Canada, Norway, Chile, Thailand, Malaysia and Botswana. As Robinson, Torvik and Verdier (2002: 7) argue: "For every Venezuela and Nigeria, there is a Norway or a Botswana". Indonesia provides an interesting example of a country that seemed to have overcome the resource curse, but not being able to avoid the Asian financial crisis in 1997-1998. It can, therefore, not be concluded that resource abundance itself is the sole problem.

If resource abundance is not the problem, the concentration of the country's exports in one commodity may explain the curse. It is suggested in the literature (Prebish 1950, Singer 1950) that countries with a high resource dependency are more likely to fall prey to the resource curse because the price of manufactured goods move inversely with those of primary products in the long run. Auty (2001) suggests that the reason small resource abundant countries on average performs worse than large resource abundant countries (Table 21), is because large countries are likely to be less dependent than small ones on one or two primary exports. Large countries also find it easier to diversify into manufacturing due to a large home market.

Botswana and Zambia are both classified as small mineral rich countries and both are highly mineral dependent. It is therefore not possible that any of the abovementioned reasons can completely explain their different growth paths. This requires a closer look at their mineral dependency. In this regard use is made of the distinction by Auty (2001) between exogenous and endogenous explanations of performance divergence. Exogenous explanations tend to be deterministic and neglect the role of domestic policies, whereas endogenous explanations take the latter into account. It is difficult to make a clear distinction between these two explanations because the effects are often interrelated. For the purposes of this chapter the changes in the terms of trade, volatility in the price of the commodity, and Dutch Disease are viewed as exogenous explanations. Internal explanations focus on the government's spending decisions and the macroeconomic policy implications of the exogenous events.

3.5.1 Exogenous explanations of performance divergence

Terms of trade and volatility

In 1950 Prebisch and Singer were the first to write about the deteriorating terms of trade exporters of primary products experience. They emphasised that the fundamental nature of primary products and manufactures would, in the long run, cause primary product prices to fall relative to those of manufactures. They argued that this is inevitable due to an increasing use of synthetics, shrinking raw material content of finished products and the low elasticity of demand for raw materials. Primary product specialising countries would therefore see a deterioration in their terms of trade because they are the producers of increasingly cheaper primary products and the consumers of increasingly expensive manufactures (Blattman, Hwang and Williamson 2003).

Botswana is in the advantageous position of exporting a commodity of which prices are kept artificially high by the monopoly power of the Central Selling Organisation[19]; hence, the improving terms of trade (Figure 19) is not surprising.

Figure 19 also shows the declining terms of trade for Zambia. Since Zambia is very reliant on copper as export product (see Table 5), it seems logical that the changing price of copper would explain the movement in the terms of trade. And indeed Zambia's declining terms of trade because of the falling real copper price often features in explanations of Zambia's economic decline (for example Neumayer 2004, Sachs and Warner 1995a, Stevens 2003).

On the import side, Zambia is typical of many oil-importing, low-income countries. The unit value of imports rose very sharply after 1973 and then again in 1979 as a result of the hike in energy prices. This index was also affected by the unprecedented inflation in OECD countries in the 1970s and the fact that exporters to Zambia charged increasing mark-ups on prices in anticipation of delays in obtaining payments (Gulhati 1989). Figure 20 shows an overall decline in the real copper price, but especially a collapse after 1973. This means that the slight rise in the nominal price of copper did not match the rise in the cost of other products. Inflation had increased more than the price of Zambia's main export product. This provides an explanation for the deterioration in Zambia's terms of trade.

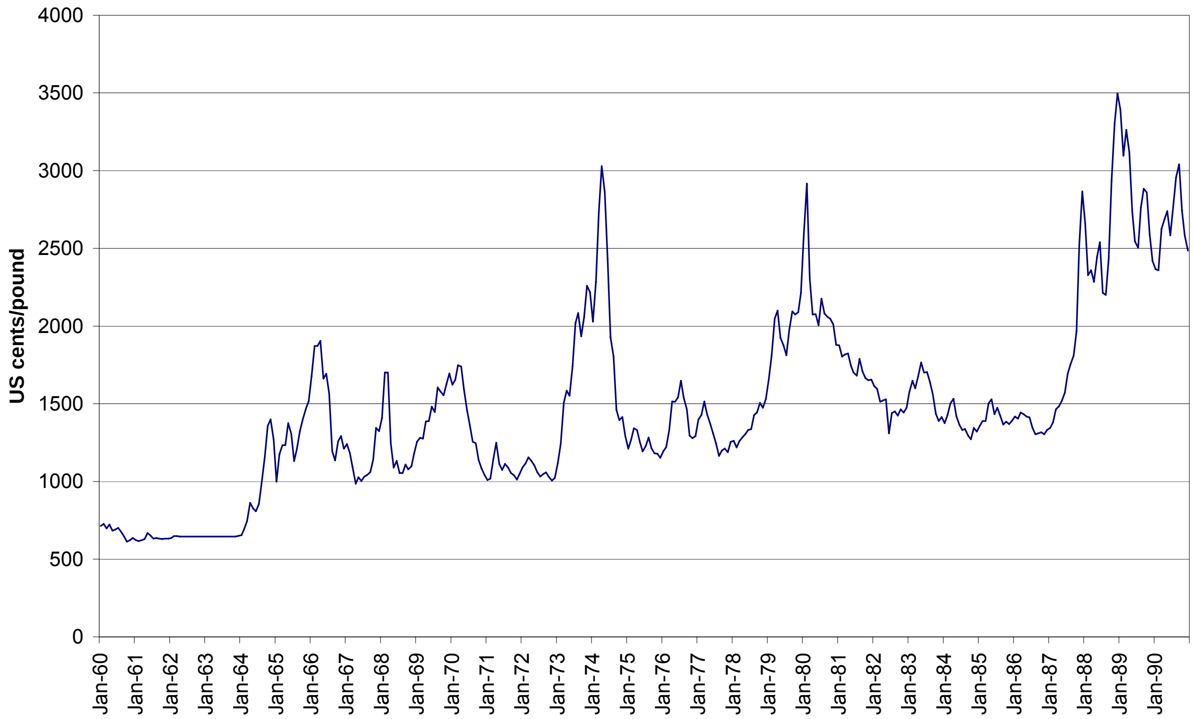
But what is the transmission mechanism between the movement in the price of copper and the resulting economic growth? A group of theories built around the terms of trade suggest that it is not the trend, but the volatility of commodity prices that translates into detrimentally volatile terms of trade. Work by Sala-i-Martin and Subramanian (2003), Aron (1999), and Bleaney and Greenaway (1993) suggest that it is especially true for countries that have a high level of concentration in exports. Volatility affects economic growth through the uncertainty it creates. If the tradable resource is important for export revenue and especially for government revenue, the developing country might be subjected to extreme external shocks, affecting the balance of payments, the exchange rate, and fiscal policy. These effects can be detrimental to the performance of the economy.

Since copper plays an overwhelming role in its exports, Zambia is extremely vulnerable to instability in world copper prices. Also, most of the Zambian government's revenue came from the copper industry, which made it highly susceptible to large trade shocks from fluctuating world copper prices. The dollar price of copper has been volatile (Figure 28), especially since the middle sixties, averaging 71$ during the first half of the

[19] The Central Selling Organisation is the diamond marketing arm of De Beers, responsible for the marketing of a high percentage of the world's diamonds.

1960s, $133 during the second half of the 1960s, $147 during the 1970s and $184 during the 1980s.

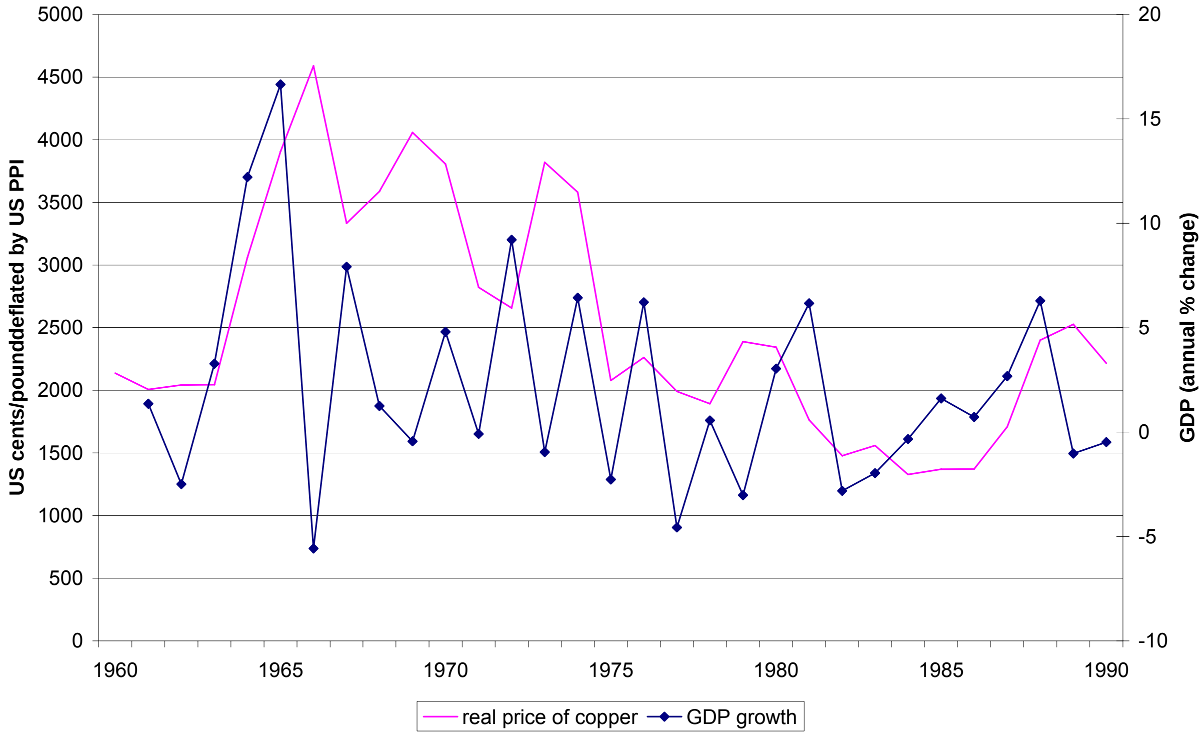
Figure 28: Nominal price of copper (monthly)



Source: International Financial Statistics (IMF various years-a 11276C.ZZF...)

If there were a direct correlation between volatility and economic performance, one would have presumed a correlation between the price of copper and economic growth in Zambia. But there seems to be no clear evidence of a correlation between the world copper price and the economic growth in Zambia. Figure 18 graphically shows the correlation between the nominal price of copper and economic growth in Zambia to be negative. If the same exercise is done with the real price of copper (Figure 29), a positive, but no statistically significant relationship is found.

Figure 29: The real dollar price of copper and economic growth in Zambia



Source: World Development Indicators (World Bank 2002a) and International Financial Statistics (IMF various years-a 11276C.ZZF...)

Furthermore, if the price of copper is related to other metal prices (see Figure 30) copper has done worse than the other metals in the late 1960s and early 1970s, but since then it's performance is similar to that of other metals.

Figure 30: Index of copper prices relative to the all metals index

Source: International Financial Statistics (IMF various years-a: IFS 00176AYDZF..., IFS 11276C.DZF...)

This is not suggesting that the price of copper is unrelated to economic growth. With a country that dependent on copper, there must be some relationship between the price of copper and economic growth. It just shows that for almost half the period, the nominal price of copper was neither deteriorating in absolute (Figure 28) nor relative terms (Figure 30). It can, therefore, be concluded that statistically the copper price cannot be correlated with the poor economic growth in Zambia. If there is a relationship between resource dependence and economic performance, other factors than the movement in the price of the resource need to be discovered.

Dutch Disease

Many studies seeking to explain the resource curse emphasize the failure of resource-abundant economies to promote a competitive manufacturing sector. This phenomenon is often termed the "Dutch Disease", referring to the discovery of gas in the North Sea off the coast of the Netherlands in the 1960s and the subsequent decline in the Dutch manufacturing sector. Dutch Disease is a resource boom that has two effects: the exchange rate appreciates because of a growing resource exporting sector and this leads, secondly, to a relative price effect and the movement of resources from non-booming to booming sectors.

The resource movement is detrimental to the prosperity of a country if it is from a dynamic sector like manufacturing to a less dynamic sector like services. The movement occurs when an increased income from mineral exports leads to an increase in the demand for both tradables and non-tradables (Auty 2001). If the domestic economy is unable to provide in this increased demand, imports of tradables will raise. Furthermore, if the currency appreciates, there will be an increase in the price of the non-tradables relative to the tradables. Resources will shift from the tradable sectors to the non-tradable sectors, causing an increase in imports and a decrease in exports. The non-booming tradable sector may find it hard to expand and therefore the country will find it hard to diversify its exports even if government favours such a move.

Furthermore, if one assumes increasing returns to scale in manufacturing, but not in the resource sector, the country will stagnate. This is due to shifts of factors of production away from sectors generating learning by doing towards the booming resource sector. The curse may therefore be explained as an abundance of natural resources that makes the economy specialise in the less dynamic sector (Matsen and Torvik 2003). It is no small wonder that Abramovitz (1995: 25-26) describes a country's natural resources as a "constraint on potential". This, however, need not be the case.

Recent work done by Wright (2001) and Wright and Czelusta (2002) shows that the United States was the world's leading mineral economy in the same period the country became the world leader in manufacturing (roughly between 1890 and 1910). According to them other resource-based economies have performed poorly, because they failed to develop their mineral potential through appropriate policies. By 'appropriate policies' Wright (2001: 5) means: "large-scale investments in exploration, transportation, geological knowledge, and the technologies of mineral extraction, refining and utilisation". The mineral rent should therefore be spent on productive investments, which affirms the argument that much depends on internal matters, like government spending[20]. Wright and Czelusta (2002: 31) conclude that "minerals are not a curse at all in the sense of

[20] Wright and Czelusta (2002) shows, for example, that Australia lagged behind other developed countries in engineers per capita in the 1880s, and that this coincided with a decrease in the relative pace of learning in the Australian minerals sector. Pessimism about the minerals industry led to an embargo on the export of iron ore to ensure its availability to the domestic sector. When the policy regime changed in the 1960s the embargo was lifted and the state encouraged exploration and the construction of new ore terminals. This not only led to the discovery of previously unknown iron ore deposits, but also numerous other metals.

inevitability; the curse, where it exists, is self-fulfilling". This will be discussed in the following section.

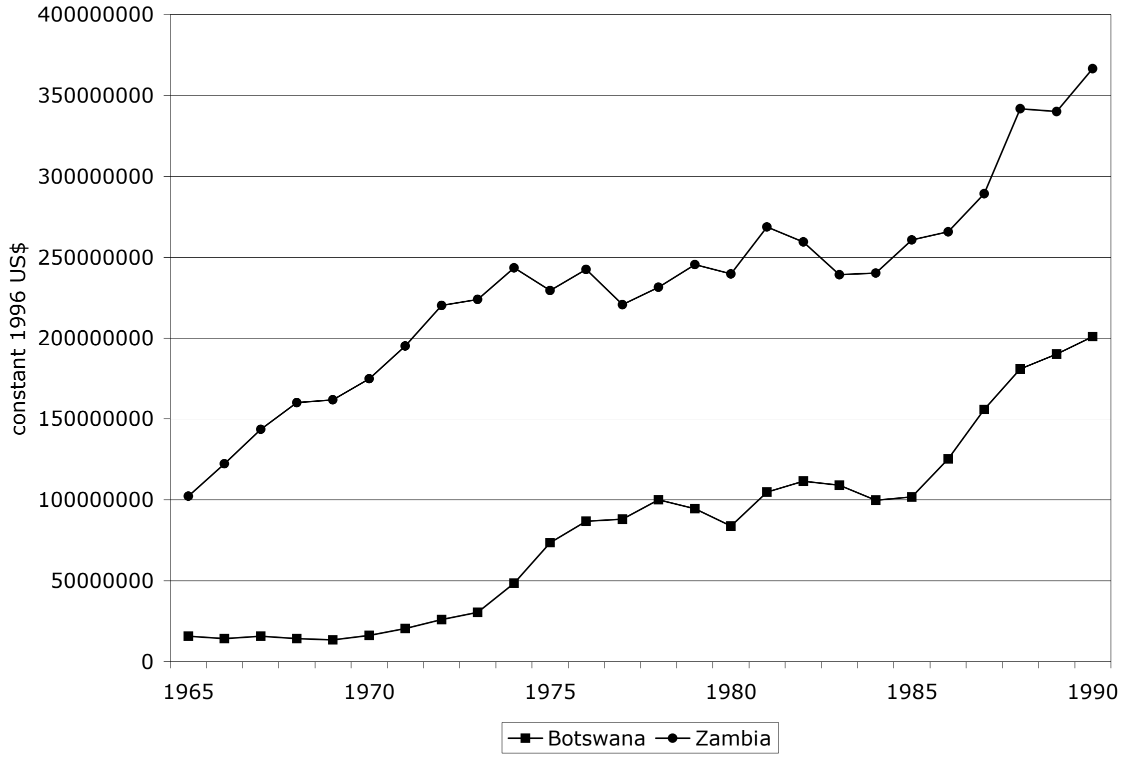
In both Botswana and Zambia the non-booming tradable sector was agriculture at the time of independence. In relative terms agriculture contributed much more to GDP in Botswana at independence than in Zambia, but this contribution declined over time. The agricultural potential in Zambia is much higher than in Botswana, where low rainfall is a constraint. Because of climatic differences, these two countries' agricultural value added per hectare cannot be compared directly, but work done on agriculture highlights important differences.

In absolute terms value added per hectare of agriculture in Botswana and Zambia has not changed much over time (see Table 6). Aron (1999) regards the stagnation of agriculture in Zambia (observed by her in declining export revenue, but also observable in stagnating value added per hectare from the middle seventies to the middle eighties) as possible evidence of Dutch disease. But one reason for the decline in agricultural production in Zambia, which is elaborated on in Chapter 6, was the shortage of productive men in the rural areas. Furthermore, Aron observes that the political climate (with the government supported by a food-subsidised urban constituency) and agriculture dominated by gloomy expatriate-dominated producers, combined with transport and pricing problems, add to this stagnation. Although government repeatedly declared its intention to promote agriculture, the sector received only 3 percent of total government expenditure during 1975-80. Maize prices were fixed to assure a regular supply of food at low prices for the Copperbelt and urban areas, while the farmers had to pay prices for manufactured goods that reflected the high protection against imports the government had given the industrial sector (Gulhati 1989).

With such a confluence of debilitating factors it is difficult to blame Dutch Disease for having a primary impact on the agricultural sector in Zambia.

Both Botswana and Zambia increased their manufacturing value added in absolute terms over time (see Figure 31). Zambia was, however, more able to diversify its economy into manufacturing than Botswana. As mentioned in Chapter 2, the Botswana economy was not substantially more diversified in 1990 than it was at independence, with the manufacturing sector persisting at around 5% of GDP. But no Dutch Disease effect can with certainty be linked to either Zambia or Botswana.

Figure 31: Manufacturing value added



Source: World Development Indicators (World Bank 2002a)

There exist other reasons than the Dutch Disease in both countries why the sectoral shift did not take place (some of these reasons are discussed in Chapter 2). The movement in their respective exchange rates, for example, are discussed in the following section. In Zambia an overvalued exchange rate (see Figure 24) and cheap capital policies (for instance negative real interest rates, and low tariffs and taxes on capital imports) created a capital and import-intensive manufacturing sector, which was vulnerable to falls in foreign exchange earnings during negative shocks (Aron 1999).

In the following section more will be said about the spending of the mineral rent by the respective governments— whether it was spent on productive investment or not.

3.5.2 Endogenous explanations of performance divergence

Macroeconomic policy responses

One way to reduce the effects of Dutch Disease is to prevent the currency to appreciate. In Botswana the Pula was first pegged to the US Dollar when it was created in 1976. After the South African Rand was floated in 1979, it was pegged against a basket of the Rand and IMF Special Drawing Rights. This move was beneficial for the Botswana economy, because it kept the currency from appreciating due to high export incomes from diamond mining. With the South African Rand depreciating due to political and economic instability, the Pula has depreciated since its inception (as in shown in Figure 25). With the currency valued less than would have been the case if it was allowed to find its own value, substantial amounts of foreign exchange reserves were accumulated (Leith 2002).

Twice, in 1979 and 1980, the Pula was revalued to counter the effects of imported inflation, before the trend was reversed with the slump in the diamond sales in 1981 and 1982. The Botswana government did not refrain from a devaluation of 10 percent in 1982 as part of a package of adjustment measures. This was the first time the value of the Pula was below that of the US dollar. Further devaluations were undertaken in 1984 and 1985 to compensate for the continuing appreciation of the Pula against the Rand during a period when the Rand was depreciating rapidly against the US Dollar (Hermans 1997).

Exchange rate policy in Zambia was largely passive between 1964 and 1976, but under various fixed regimes. The Kwacha was first fixed to the UK pound, then to the US dollar, and later to IMF Special Drawing Rights. The Kwacha appreciated against the currencies of most of its trading partners from 1971-76 due to the appreciation of the currency it was pegged to at that stage, namely the US dollar. The Kwacha depreciated very rapidly after it was allowed to move freely after 1980. Therefore, as will be discussed below, the problem in the Zambian economy was not an appreciating currency like one would expect under Dutch Disease, but rather a currency that was not allowed to depreciate after real income from the copper industry started to falter in the beginning of the 1970s.

Adding to an overvalued exchange rate, the Zambian government was unable to manage aggregate demand. Political independence witnessed a massive increase in both public and private consumption and investment. At first it was possible to finance these levels of consumption and investment because export income exceeded expenditure on imports. The unsustainability of these expenditures, however, became apparent when the income from copper mining started to fall in 1973. The surplus on the current account of the balance of payments was exhausted and foreign exchange reserves came under pressure (Gulhati 1989). At that stage government had the choice to devalue the currency, but probably because it saw the lower price as temporary and/or a depreciating currency as bad for its reputation, it was decided to take the alternative route of restoring financial balance by imposing import restrictions and also by financing the deficit through external borrowing. The positive trade balances that are mentioned in Chapter 2 were therefore the result of trade restrictions and not due to a movement in the currency.

Strict capital and trade restrictions were imposed to protect the reserves. In 1972 a restrictive import licensing system was introduced: certain categories of imports were banned, but capital and intermediate goods imports continued under license. The licensing was further tightened in early 1975 and reinforced by the tariff structure (Aron 1999). This did, however, not restore the financial balance and financing had to come from external borrowing.

One of the conditions the IMF had stipulated for lending money to Zambia was that it had to devalue its currency. The Kwacha was devalued by 20 percent in 1976 and again by 10 percent in 1978. These depreciations, however, were not enough and government relied even more on import bans, quantitative import restrictions administered by the Ministry of Commerce and Industry and administrative allocation of foreign exchange by the Bank of Zambia. These arrangements proved ineffective and only contributed to the misallocation of resources.

According to Gulhati (1989), if the Kwacha had been allowed to depreciate freely, it would have sent a clear signal throughout the economy to cut back on imports and to produce new export items. Unfortunately this was not allowed. Imports contracted moderately and there was little incentive to diversify the structure of exports. This resulted in a collapse of the Kwacha when it was allowed to be market-determined in the first half of the 1980s.

The government misjudged the income from the copper industry and because of the pattern of adjustment and financing it had chosen, the Zambian economy has stagnated since the 1980s. As with many other countries in the region, the debt problem arose mainly because the government regarded the external shocks of the 1970s as temporary. The adjustment required was postponed and external borrowing closed resource gaps. Subsequently, the country accrued payment arrears and has had to request debt rescheduling from creditors at regular intervals (Ndulo 1999). This left the country in a trap of over-indebtedness and rapid inflation. Furthermore, the strong preference to reduce investment rather than consumption postponed much needed new projects and replacements (Gulhati 1989). This left the economy increasingly unproductive and inefficient.

In other attempts by the Zambian government to make adjustments in the economy to cope with the declining copper income, it was severely restrained by the trade union movement. For example, due to the declining income from the copper mines in the 1970s, government proposed closing down unprofitable mines. The Mineworker's Union of Zambia (MUZ) opposed such a move through a series of strikes. Government accommodated their opposition through an attempt to maximise gross foreign exchange revenues. It emphasised quantity of exports rather than cost minimisation and efficient production (Gulhati 1989). Moreover, when government tried to restrain wages and reduce consumer subsidies, it led to demonstrations on the Copperbelt and in Lusaka by the Zambian Congress of Trade Unions who opposed increases in the prices of bread, cooking oil, and other items. The government reacted by revoking its decision to restrain wages and reduce consumer subsidies.

A clearer picture is starting to unfold regarding the link between the copper price and economic growth. The policy responses of the Zambian government to a lower income from the copper industry increased instability in the economy, rather than making the necessary adjustments to deal with the lower income. The currency was not allowed to provide the necessary signals to reduce imports, and in the following section it is shown that government's spending plans were not adjusted to the new levels of income, either.

Government's spending decisions

It often happens that in "boom times" it is almost impossible for governments to retain control of public expenditures when public revenues greatly exceed normal commitments. Projects are begun and expenditure commitments made, none of which are easy to reverse when the boom ends. Additionally, if government decides to spend even more than the windfall income, it adds to possible debt repayments that might occur after the boom (Deaton 1999). It seems that the safest route to take is to regard this income as temporary. This is what the Botswana government did, and for which it is sometimes criticised (see for instance Good 1992, Good 2004). The Zambian government was not similarly restrained in their spending patterns and spent too much too quickly.

Zambia is, of course, not alone in having done this. Tornell and Lane (1999) show that in each resource boom they studied, government spending rose sharply in response to an improvement in the terms of trade. This happens because not only is there an additional source of revenue but, at the same time, international credit restrictions are eased. This is particularly important in developing countries where the additional revenue mostly accrues directly to government. What government decides to do with this higher income is crucial for what will happen to the economy once this income is no longer available. Whether government sees the higher income as temporary or permanent is important for the decision they make on whether to save the additional income, to invest it in productive activities, or to increase consumption.

Hausmann and Rigobon (2002: 8) provide a good reason for the phenomenon of spending too much too quickly: "an individual would choose to smooth consumption, however, when there is a common-pool problem each constituency will ask for a larger share of the pie in good times, fearing that if they don't, other constituencies might take it away". In other words, there is political pressure to spend quickly.

Gelb and associates (1988) studied the question of whether the type of political system has a consistent influence on spending patterns. They found that the time frame of governments and the degree to which political power is centralised are important determinants of the exploitation of a windfall cycle. Their example of Trinidad and Tobago shows how hard it is to handle oil rents cautiously for a sustained period in the face of powerful interest groups. Although the political system in Botswana was democratic and there was always the possibility (although extremely small) of losing the next election, there were no powerful interest groups outside government. This is unlike the situation facing the Kaunda government who operated in a one-party state, but could not withstand the pressure from, for example, the trade union movement in the country[21].

There was considerable political pressure in Botswana to spend everything available to the treasury, but this was avoided successfully due to government's commitment to its National Development Plans. All proposed government spending are made known through the publication of these plans. Once a plan is voted into force by parliament, it is illegal to implement any additional public projects without going back to parliament (Sarraf and Jiwanji 2001). This system has proven to be effective in restraining government spending when revenue increased and prevented the inception of projects for which no provision was made to cover the total costs over time. An important assumption in these plans, and one which differs from the Zambian plans discussed below, is the assumption that the boom will be temporary.

Hill (1991) found that both public and total consumption relative to GDP were negatively associated with booms in the diamond sector, showing that the Botswana government's attitude was to save a large proportion of revenue from booms, thus treating it as a temporary windfall. Any excess revenue during boom periods was used to build up foreign exchange reserves at the Bank of Botswana and budget surpluses were available to be drawn on in years when revenues were low. International reserve accumulation thus closely mirrors booms and busts in the diamond sector (Hill 1991). This policy avoided government having to drastically cut expenditures during bad years, and it reduced inflationary pressures. The government justified the reserve accumulation because

[21] These points are elaborated on in Chapter 8.

projections of future export earnings suggested that this level of surplus would not continue.

A related question is whether the rate of return on international reserves has in fact exceeded that on domestic investment. Government was convinced that the rate of return on domestic investment would be pushed below the rate on international reserves in the short run if greater amounts of boom income were allocated to domestic investment. Hill (1991) explains that the Botswana government was cautious of the ability of the economy to absorb the additional income. For example, increased investment expenditure in the face of a shortage of trained personnel could lead to increasing costs, either through increasing domestic wages or by hiring expatriates. Since the availability of skilled manpower was a large constraint in Botswana, government expenditure beyond the capacity of the country would result in a rate of return lower than what could have been earned on alternative investments. Investments could have been in education, but that also requires skilled labour as an input, and for education there is a time constraint as well. Investment in international reserves is highly liquid and the funds can be reallocated to domestic investment in the future as these constraints are relaxed.

The Botswana government's prudent spending saved it from being unable to service recurrent spending during periods of lower income. The building of reserves created the ability to react to declines and cushion declines in the price of diamonds. According to Hill and Mokgethi (1989: 174) Botswana "avoided many of the economic problems that have plagued other primary commodity exporters by adopting appropriate, stabilising, macroeconomic policies". The question can be raised whether the government was too prudent in its spending patterns and should have been more expansionary. It is hard to make a sound judgement on such an issue, but Lewis and Mokgethi (1983) assume that higher spending would only have resulted in more expatriates flowing into the country and a worsening of the bottlenecks that were already a problem in various parts of the economy.

Furthermore, during 1981-1986 when the industry went through a depression that caused Botswana's foreign income to drop[22], the government could respond by using some of the accumulated savings to avoid any drastic declines in expenditures (Coetzee 1986). Faced with uncertainty concerning the duration of the diamond crisis, the government took the precautionary view that it might be a long-term crisis rather than a temporary one. This resulted in the creation of a package of adjustment policies, which included limiting

[22] The diamond sales that went through the Central Selling Organisation (CSO) at that stage dropped from a peak of $2.7 billion in 1980 to a low of $1.3 billion in 1982 (Harvey and Lewis 1990).

increases in lending, increasing the prime lending rate, and freezing wages and salaries (Sarraf and Jiwanji 2001). Lewis and Mokgethi (1983) find it difficult to criticise the conservative spending of the government, especially if compared to the high growth figures realised.

In Zambia public expenditure is also driven by National Development Plans, but unlike the Botswana plans, the Zambian NDPs lack detail on specific projects. Another problem which is highlighted by Aron (1999), is that the forecasts in the First and Second Plans were unrealistic. This created expectations about future incomes that were not realised. Because of the absence of a coherent mining policy, ad hoc measures were taken and these created an environment of uncertainty in the Zambian economy. For example between 1964 and the early 1970s, six different taxes were imposed to tax windfall revenue and different measures were imposed to increase control over the mining sector. The result of these measures was an uncertain environment for investors, which created a disincentive for production, development and exploration.

For Lewis (1984) a country that exploits its mineral resources has to decide how to divide the income generated from the exploitation between current consumption and productive investment. In times of high incomes the Zambian government did not accumulate savings to cushion the impact of any fall. Instead of saving additional income, government increased expenditure on socio-economic services like health, education and infrastructure (Hwedi 2001). The increased spending on social services can be justified, but government went one step further and also increased investments in projects that mainly increased its status as a powerful sovereign state. An example is the building of a railroad to Dar es Salaam, which is discussed in chapter 7. Furthermore, the increased spending on luxury goods and higher wages cannot be justified.

Government imported luxury goods and compensated workers—especially the mineworkers—with high wages. The index of average real earnings of African workers in the formal sector rose sharply by 33 percent in 1967 and by a further 15 percent in the period up to 1973. These trends can be explained by government policy. In 1966 the Brown Commission suggested that the pay scales of African and non-African workers should be unified. This was done, not by decreasing non-African wages, but by raising the wages of Africans to the same level. These developments pitched Zambian wages at very high levels (especially those in the mining sector).

Expenditure was also aimed at public sector employment. According to Gelb, Knight and Sabot (Gelb and associates 1988) the average annual growth rate in public employment in Zambia in the period 1966-80 was 7.2 percent, while private employment on average contracted by 6.2 percent per year. This is an example of what a lack of the necessary restraints on government can lead to. Government increased its wage bill by increasing wages and creating additional employment in boom times, which are very hard to decrease in times of lower income. Burdette (1988) explains that it was hard for government to decrease the number of civil servants, because some were employed for political reasons and not because they were needed to increase production. To minimise the cost of the civil service, members of government would have had to reduce their own salaries as well, and that would not have been a popular thing to do.

With the declining economic situation in the 1970s capital expenditure was cut back sharply, but the recurrent expenditures that were created through high salaries and employment persisted during the negative shocks. Furthermore, Aron (1999) explains that government still had to finance the large, import-dependent and inefficient parastatal sector it had previously created. Government did this by drawing on scarce foreign exchange, subsidies and cheap loans. In the absence of well-defined development plans these expenditures were not taken into account and were made on the assumption that the copper price would remain high.

For any country, a declining terms of trade is difficult to handle. Adding to this a main export product that shows a volatile nominal price, only complicates the situation. If one could choose between managing the Botswana or Zambian economies, the Botswana situation seems to be a far easier choice. But that does not negate the fact that the way the Zambian government managed the instabilities and lower income, added to the detrimental growth path that is observed for Zambia. For reasons still to be explored in the following chapters, the Zambian government played a substantial role in the economic stagnation of the country.

3.6 CONCLUSION

At different stages in the development of economic thought growth differences were explained by, for instance, a lack of investment, a lack of technological innovation, a lack of schooling, and bad geography. These factors all proved to be important in the growth process, but did not supply a sufficient explanation for growth differences.

In the empirical growth literature the neoclassical theory provides the augmented Solow model as an explanation for growth differences. If the model is applied to Botswana and Zambia it predicts, however, uninspiring growth for both Botswana and Zambia due to low investments in human capital and high population growth rates. Also the other factors from the empirical growth literature explain only part of the growth differences. For instance the neighbourhood dummy would have predicted a low level of economic growth for Botswana. As is often the case with empirical growth models, the models still leave much unexplained about an individual country's behaviour. What seems to be an interesting point from these applied empirical studies is that it shows Botswana to outperform Zambia on those factors over which governments have control.

This observation is strengthened in the section on the resource curse hypothesis. It was firstly established that the copper price *per se* does not offer an explanation for the economic decline in Zambia. Furthermore, both Botswana and Zambia were unable to diversify their economies, but due to reasons other than Dutch Disease. These "other reasons" are found in endogenous explanations for the resource curse. The endogenous reasons include the macroeconomic policy response to a resource boom and, importantly, how government spends the income received from the resource boom.

Lewis (1984) notes that a resource boom is fortunate for a country because of the high income it receives, but that it does not necessarily solve the other development problems a country has to face. These problems have to be dealt with by government. "Good governance" seems to be the key to the ability of societies to take advantage of the opportunities presented to them by resource abundance.

The question raised is why the Botswana government made economic decisions that in the end benefited the country, whereas the opposite occurred in Zambia. The Botswana government, although under immense pressure to spend, imposed a long-term view on its expenditure, whereas the Zambian government had a much more short-term horizon. For instance, increased public employment in Zambia created short-term advantages for the government, but the government did not take future costs into account. Why this difference?

The fact that Botswana remained a democracy, while Zambia turned into an autocracy does not explain this phenomenon fully. One would expect a democratic government to have a much shorter-term horizon than an autocracy. Why was the Botswana government so secure in its position that it did not refrain from making unpopular decisions, like for instance building up reserves rather than spending revenue on social projects? In the same vein, why was the Zambian government insecure and unable to cut back on expenditure in times of lower income?

To answer these questions, a theoretical base is required. The search for an explanation for growth differences, and specifically one that focuses on the role government has to play, leads to the theory of the New Institutional Economics.

CHAPTER 4
CONTRIBUTION OF THE NEW INSTITUTIONAL ECONOMICS TO AN UNDERSTANDING OF ECONOMIC GROWTH AND DEVELOPMENT

4.1 INTRODUCTION

Currently it is widely accepted that institutions —broadly defined as the generally accepted rules of the game in a society— are the best explanation for growth differences. The question is whether differences in institutions are able to explain the growth differences between Zambia and Botswana. But before this question is addressed, this chapter first focuses on the theory of the New Institutional Economics (NIE)[23].

High quality institutions are those that induce growth-enhancing behaviour, and can be both informal (e.g., cultural, self-enforcing agreements) and formal (e.g. legal rules enforced through third parties). The generally accepted rules create incentives for the players of the game, and if these incentives are growth enhancing, the country will grow, otherwise not.

Rodrik (2004) identifies 'universal principles of sound economic management' that are necessary for a country to perform well. These principles include allocative efficiency, macroeconomic and financial stability, and are called "universal" because "in a sense it is hard to see what any country would gain by systematically defying them" (Rodrik 2004: 14). To achieve these principles, a country needs to have, for instance, secure property rights, the rule of law, appropriate incentives, prudential regulation and incentive compatibility. Unfortunately there is no clear-cut way of how to achieve these because they are the outcome of a combination of formal and informal institutions. To determine the combination of institutional arrangements that eventually leads to the universal principles, country studies have become increasingly important in development economics.

Section 2 defines institutions and section 3 outlines institutions that are necessary for high quality growth, i.e. those that lower transaction costs and those that protect and enforce property rights. Section 4 focuses on reasons why flawed institutions persist over time. A discussion like that is necessary because, although the importance of growth-

[23] The old institutional economics originated in America with the work of Thorstein Veblen (1857-1929). Other scholars within the old institutionalist school include John R. Commons, John K. Galbraith and Warren J. Samuels. The dissertation concentrates on the NIE, which has little in common with the OIE.

enhancing institutions is widely accepted, poor and underdeveloped countries are still present in the world economy. Significantly, if a country has growth retarding institutions, it is possible to change them, but to what degree? And because natural resources play a significant role in Botswana and Zambia, section 6 explores how an abundance of natural resources effect government's actions.

4.2 INSTITUTIONS DEFINED

The NIE can be traced back to the work of Ronald Coase on transaction costs, drawing especially on his *The Nature of the Firm* that was published in 1937. The recognition that was given in this work to transaction costs for the first time provided a reason for the existence of institutions. Research on the NIE reached a critical mass by 1975 with work done by scholars like Oliver Williamson, James Buchanan, Douglass North, George Stigler and Richard Postner[24]. During the 1990s empirical evidence started to support the initial theories.

North (1990: 3) defines institutions as "the rules of the game in a society or, more formally, the humanly devised constraints that shape human interaction". Sjöstrand (1993: 9) defines institutions as a "human mental construct for a coherent system of shared norms that regulate individual interactions in recurrent situations". The purpose of institutions is therefore to steer individual behaviour in a particular direction through the incentives it creates. Furubotn and Richter (2000: 6) quote a more elaborate definition of Ostrom which describes the actions that are created by institutions:

> Institutions can be defined as the set of working rules that are used to determine who is eligible to make decisions in some arena, what actions are allowed or constrained, what aggregation rules will be used, what procedures must be followed, what information must or must not be provided, and what payoffs will be assigned to individuals dependent on their actions… All rules contain prescriptions that forbid, permit, or require some action or outcome. Working rules are those actually used, monitored, and enforced when individuals make choices about the actions they will take….

Institutions can both be formal (e.g. rules, regulations, the constitution) and informal (e.g. norms, culture, codes of conduct). It is much easier to describe and be precise about

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[24] The award of the Nobel Prize in 1986 to Buchanan, 1991 to Ronald Coase and in 1993 to Douglass North has confirmed the importance of the NIE for Economics.

formal than informal institutions. Formal institutions are often divided into political, judicial and economic rules, where (for instance) these refer to the structure of the polity, the role of the judiciary when it comes to contract enforcement, and property rights. Informal institutions are created by the transmission of information from one generation to the next one and make it possible for people to perform everyday tasks without having to think about every task that needs to be performed or the terms of exchange at each point and in every instance. While formal institutions may be clear on what it expects of a person, every situation a person encounters involves a certain amount of discretion and it is informal institutions that will determine the person's discretionary reactions.

Although a major role for institutions is to provide stability and certainty to society, it does not imply that they do not change. Formal institutions may change overnight but informal constraints embodied in customs, traditions and codes of conduct are much more resistant to deliberate policy changes (North 1990). David Landes (1990), for instance, mentions the influence of religious values on people's willingness to change. The characteristic of informal institutions to survive changes in formal institutions makes it a source of path dependency and causes institutional change to happen more gradually than instantly. There can be a total change in formal rules in a society, but many aspects will stay the same because of the prevailing informal institutions. As North (1990: 91) notes:

> although a wholesale change in the formal rules may take place, at the same time there will be many informal constraints that have great survival tenacity because they still resolve basic exchange problems among the participants, be they social, political, or economic. The result over time tends to be a restructuring of the overall constraints – in both directions – to produce a new equilibrium that is far less revolutionary.

There is a body of economic literature that focuses primarily on this type of incremental change, i.e. the theory of path dependency[25]. It provides us with an explanation of how small changes can lead to a non-optimal solution. Once a development

[25] The first article to call the attention of economic historians to the issue of path dependency was Paul David's "Clio and the Economics of QWERTY" (1985). In this article David attempts to explain how the peculiar organisation of letters on the typewriter keyboard became standardised and fixed and why an accidental set of circumstances caused the outcome to persist, even in the face of more efficient alternatives. This illustrates the peculiar fact that incremental changes in technology, once begun on a particular track, may lead one technological solution to win out over another, even when, ultimately, this technological path may be less efficient than the abandoned alternative would have been. The importance that path dependency gives to the role of history is one of its most important contributions.

path is set on a particular course, the learning that has taken place by the role players in the economy, and the informal institutions that were created, may reinforce the course. Path dependency makes it possible to explain why colonialism or the type of agriculture, for instance, can have such long-lasting effects on economic growth and development[26]. An important observation on path dependency (and one which will again be referred to in Section 4.2) is made by North (1990: 98) when he describes it as follows:

> Path dependency is not a story of inevitability in which the past neatly predicts the future, but links decision-making through time. We cannot understand today's choices (and define them in the modelling of economic performance) without tracing the incremental evolution of institutions.

Informal institutions not only influence the way people will respond to a change in formal institutions, but it can also contribute to the change in formal institutions. If informal institutions change over time, it may become necessary to alter the formal institutions to accommodate the change in informal institutions. The end of slavery is an example where the custom became unacceptable even before slavery was officially banned. Whichever way change happens, in conclusion it can be said that formal institutions can change, but only incrementally due to the presence and countervailing influence of informal institutions. This makes the study of the relationship between formal institutions and the performance of an economy inadequate without taking into account the influence of informal institutions. Economic activity can only be understood if formal institutions are viewed in conjunction with the prevailing informal institutions (Sjöstrand 1993).

Because informal institutions create a memory for all the role-players in the economy, formal institutions cannot be duplicated in countries in the expectation that it will bear the same results. For instance, in most cases, colonies were left with formal rules at independence that were forced onto them by a departing ruler. Often the colonies had no time to assimilate these rules and the existing informal institutions did not necessarily support them.

The role-players in an economy are called organisations in the NIE. They are bound by some common purpose to achieve certain objectives and include political bodies (political parties, a city council, a regulatory agency), economic bodies (firms, trade unions, family farms, cooperatives), social bodies (churches, clubs, athletic associations), and educational bodies (schools, universities). North (1996, 1997) sees institutions as the rules of the game and organisations as the players. In a capitalist society entrepreneurs are the main players.

[26] This refers to a discussion that follows under the heading Colonialism on p97.

Institutions will determine the choices these entrepreneurs make (for instance what to produce), and consequently the direction of change in an economy. In other words, these entrepreneurs respond to incentives.

Unfortunately, there is no reason to believe that incentives themselves are efficient or that they respond quickly or efficiently to changes in economic circumstances. North (1990, 1995) explains it with the following two analogies:

> the Mafia will develop different skills than will General Motors executives. If the institutional framework makes the highest pay-off for 'pirate' organisations, then organisational success and survival will depend on the successful learning of being better pirates (North 1995: 21).
>
> If the maximizing behaviour of firms consist of sabotaging competitors, or for labour organisations in engaging in slowdowns, or for farmers in restricting output in order to increase the price of their products, then economic growth will be slowed down (North 1990: 78).

For economic growth to occur the institutional structure must make it attractive for the role-players to invest in productive activities. If productivity-raising activities had the highest pay-off, then the economy will grow. Unfortunately, all countries have incentives that stimulate productive activity as well as those that slow it down; even the most productive economies in the modern world have a mixed institutional framework. For a country to develop, the signals that lead to an increase in productivity must overshadow those that hamper development.

4.3 INSTITUTIONS FOR HIGH-QUALITY GROWTH

Shirley (2003), among others, focuses attention on two sets of institutions that create the appropriate incentives for entrepreneurs to invest in productive activities: those that foster exchange by lowering transaction costs and encouraging trust, and those that influence the state to protect private property rather than expropriate it.

The first set of institutions describes the protection of property rights and includes contract and contract enforcement mechanisms, commercial rules, norms, habits and beliefs favouring the accumulation of physical and human capital. The second set of institutions forces a government to support the first set of institutions and include electoral rules, laws governing freedom of speech and education, constraints on powerful groups from exploiting their position, and the management of conflict. Both these sets include what Rodrik (1999) describes as "institutions for high quality growth".

Because of their importance to institutional economics, and therefore also to the explanation of growth differences, the theory of transaction costs and property rights will be discussed in the following two sections. The application to Zambia and Botswana will be made in Chapter 7, while the constraints that forces governments to support these growth-enhancing institutions will be discussed in a similar fashion in Chapter 8.

4.3.1 Transaction costs

One of the simplifying assumptions in the neoclassical theory is that information is costless. If this is the case, role-players in an economy can engage in transactions without incurring costs. Parties to an exchange can continue bargaining until all misallocations are eliminated and the economy is in equilibrium. Game theory illustrates this possibility of reaching self-enforcing cooperative solutions, but only under the strict assumptions of perfect information, that the game lasts indefinitely into the future, and that it continues to be played between the same parties. Under these perfect conditions decisions regarding the application of scarce resources in the production process, and the production decision itself, will depend on the price mechanism. For example, if the price of labour decreases relative to the cost of capital, labour would be substituted for capital and more labour intensive products will be produced until the price of labour once again equals the price of capital (North 1990).

If all the game theoretical assumptions apply, as they do in neo-classical theory, transaction costs are zero. Coase, in *The Nature of the Firm* (1937), has shown these assumptions to be weak, and not a true reflection of the real world. He explained that firms would not expand inevitably, because at some stage the costs of organising an extra transaction within the firm become higher than the costs of carrying out the same transaction in the open market or by organising another firm. The costs that are referred to are transaction costs, but where do they come from?

In this section on transaction costs, a distinction is made between economic transaction costs and political transaction costs. Furubotn and Richter (2000) also distinguishes between market and managerial transaction costs. The latter two are typically the costs of using the market, and costs related to personnel management, public relations and lobbying. It also includes all costs related to the management of labour and the costs of intra-firm transportation. But for the purpose of this study, they are considered part of economic transaction costs.

Economic transaction costs

Economic transactions are transactions that are necessary for the formation and maintenance of the institutional framework in which economic activity occurs. Theoretically, these transaction costs can be zero where repetitive exchange takes place between parties that completely trust one another and where full knowledge of the product traded exists. In all other instances information is incomplete and asymmetrically held by the parties to the exchange.

In a world of impersonal exchange, exchange takes place with multiple individuals and they do not have much knowledge about each other. Often the exchange is only a once off happening and not repeated at all (North 1990). Under such circumstances economic transaction costs are positive.

North (1990) and Coase (1937) provide a step-wise summary of where they see transaction costs to originate:

- Parties that want to engage in a transaction have to find each other, and determine whether the other party is able and willing to fulfil the transaction. They have to communicate and exchange information regarding the transaction and there must be certainty about the terms of exchange. In other words, negotiations have to take place between the trading parties.
- Before the transaction can be completed the goods must be described, inspected, weighed and measured.
- Ways to settle disputes have to be explored. Often lawyers are consulted to draw up contracts, and in some cases compliance needs to be enforced through legal action and breach of contract may lead to litigation.

These costs, the cost of acquiring information, the cost of protecting rights and the cost of policing and enforcing agreements, have come to be known as economic transaction costs and are merged in Kenneth Arrow's definition of transaction costs as the "cost of running the economic system" (as quoted in Furubotn and Richter 2000: 40).

Coase (1937: 390) also points out that the process of "running the economic system" is complicated by the limited ability of individuals to process data and formulate plans. North (1995) calls this a limited mental capacity to process information. Because real-world decisions operate under these restrictions, they will be less efficient than the decisions made in neoclassical theory.

Niehans (1987) expands on North and Coase's transaction costs that are determined in the market (e.g. legal fees, credit rating search) to costs that are unobservable (e.g. the cost of uncertainty in the market). Unlike the observable costs the unobservable costs are difficult to identify and measure. And it is often these unobservable costs that restrain trade, like for instance in SSA where the deficient state of the transport and communications infrastructure create difficulties for the trading partners. Another unobservable cost present in SSA is the bad neighbourhood. It was empirically shown (see for example, Collier and Gunning 1999b) that being in a bad neighbourhood reduces economic growth. Uncertainty created by the neighbourhood can, for instance, deter international investors from investing in the region because the transaction costs of securing the investment becomes too high relative to the profit.

Location of a country is important for determining economic transaction costs, primarily for two reasons. Firstly, neighbouring units provide an easily accessible market for goods and secondly, and this is most important for landlocked countries, they provide access to other markets. With access to markets seen as one of the main engines of growth, both these reasons are important for growth and development.

Even as far back as Adam Smith, economists realised that productivity gains achieved through specialisation are the secret to the wealth of nations. But for these gains to materialise, producers must have access to markets where they can sell their specialised output and buy other goods - the larger the market, the greater the scope for specialisation. Through specialisation each country can make the most of its comparative advantage. This notion is supported by a large number of international cross-sectional analyses that show a strong correlation between trade and economic growth. The fact that Botswana and Zambia are located in sub-Saharan Africa, the poorest region in the world, creates a problem. With the exception of South Africa, most other economies are too small to be able to import a significant amount of goods.

For landlocked countries (of which Botswana and Zambia are both examples) neighbours are important even if they do not provide a market for products, because of the access they have to provide to other markets. For Chowdhury (2003) access to a harbour is important because water-transport provides access to a more extensive market than what land-carriage can supply. The Newly Industrialised Countries (NICs) provide an excellent example of growth due to trade-orientated policies and their favourable geographical location for trade. According to Chowdhury (2003) four of the five world’s largest handling ports are in the NICs. Hausmann and Rigobon (2002) confirms this by saying that maritime transportation is particularly suited to the bulky, low-value-added goods that developing nations tend to produce; therefore countries lacking cheap access to the sea will be shut out of many potential markets.

Hausmann and Rigobon (2002) found that nations with populations far from a coastline also tend to be poorer and show lower rates of economic growth than coastal countries. A country whose population is farther than 100 kilometres from the sea grows 0.6 percent slower per year than nations in which the entire population is within 100 kilometres of the coast.

The relative lack of control over the development of infrastructure, transport management and policies by the exporting country, adds to the problem of increased transport costs. These aspects of transportation will be shaped by the transit country according to its own ability and needs. In most cases the transit neighbours are themselves developing countries, often of broadly similar economic structure and scarcities of resources.

Transportation across borders places an extra burden on governments in landlocked countries of having to coordinate infrastructural expenditures with neighbouring countries. This coordination is especially complex if a country does not have good relationships with its neighbours. Botswana has had the advantage of being a member of the Southern African Customs Union (SACU), which gives access to the more developed South African market and infrastructure. Alternatively the Zambian government had to locate alternative routes for Zambia's external trade after independence, due to political conflict with South Africa, Angola, Mozambique and also Rhodesia (now Zimbabwe). With no other options at that stage, Zambia created another route for its international trade to Dar es Salaam in Tanzania. Zambia could afford it because it was still earning a high profit from its copper exports, but the creation of the route placed an unnecessary drain on the country's income resources.

Even if neighbouring countries get along politically, landlockedness may still act as a barrier to trade. Landlocked countries face high transportation costs (i.e. economic transaction costs) since they must pay road or rail transport costs across at least one international boundary in addition to sea freight costs, and these aggregate costs can make products uncompetitive in the international market. Local companies that need imported inputs for their production process will similarly be at a disadvantage when eventually exporting the goods. Although air shipments can help overcome many of these problems, only certain low bulk/high value goods can be transported economically by air[27], and most countries still import and export the majority of goods by sea (Collier and Gunning 1999b, Sachs and Warner 1997b).

Most developing countries are commodity exporters and Sachs and Radelet (1998) argue that a 5 percent increase in a country's cif/fob[28] ratio reduces the long-term growth of the share of non-primary manufactured exports in GDP by around 5 percent per annum. On average landlocked developing countries require almost twice as much of their export earnings for the payment of transport and insurance services in 1995 than the average for developing countries, and three times as much as the average of developed economies. They also show that landlocked countries pay between 25 percent and 228 percent more for similar export shipments to Northern Europe than their coastal neighbours, even though the overland distances are a small proportion of the total transport distances. For the 80 coastal economies, the average was 11.8 percent, while for the 17 fully landlocked countries the average was 17.8 percent. For Zambia the additional cost to ship to Northern Europe by road through Tanzania was 136 percent and by rail 72 percent (Radelet and Sachs 1998).

Political transaction costs

Economic transactions are assumed to take place against a well-defined political background. In this political sphere, politicians, bureaucrats and interest groups interact, and political transaction costs are created during this interaction. Furubotn and Richter (2000) also include the costs associated with the maintenance of the state: like for instance expenses for external and internal security, the administration of justice and the provision of a basic level of education.

Governments always have to deal with these costs, but from time to time extra costs are incurred when the structure of the political system, for instance, changes.

Having established the difference between economic and political transaction costs, the next step is to establish ways to minimise these costs. The minimisation of transaction costs is important, because together with technology employed, transaction costs determine

[27] Like for instance diamonds from Botswana.

[28] Cost, insurance, freight (cif) reflects the value of imports plus the cost of insurance and freight to the port of entry. Free on board (fob) is the cost of production including transport costs to the border of the country.

production costs. Transaction costs are not an indication of market inefficiency, but to be efficient a market needs to minimise transaction costs.

The minimisation of transaction costs

Without transaction costs there are no constraints on the trading volume. But, realistically, the effect of positive transaction costs is pervasive in an economy. The reason why the minimisation of transaction costs is important is shown in the following words of Coase (1994 [1991]: 9):

> Businessmen in deciding on their ways of doing business and on what to produce have to take into account transaction costs. If the costs of making an exchange are greater than the gains which that exchange would bring, that exchange would not take place and the greater production that would flow from specialisation would not be realised. In this way transaction costs affect not only contractual arrangements but also what goods and services are produced.

Niehans (1987) agrees with Coase by suggesting that the higher the transaction costs, the greater becomes the incentives for individuals to economise on transactions. In such high transaction-cost situations incomplete or even missing markets are to be found. In the absence of organized capital markets, for example, people in developing countries may devise "social" means of pooling savings through credit rings or savings societies. In the absence of secure contracts, they mobilize family ties, religious groups or ethnic associations in support of commerce and trade. In the absence of effective states, capable of providing public goods, people are likely to join religious associations, fundamentalist groups or revolutionary parties in an effort to secure them (Bates 1995). Missing markets, and the means people find to overcome their absence, makes it complicated for developed countries to invest in or trade with these countries.

It is therefore necessary to reduce transaction costs. Although it is impossible to reduce transaction costs to zero, long-term economic growth depends on the minimisation thereof.

Unfortunately, there is no prescribed way of minimising transaction costs. North (1995) explains that each country has to find its own solution. To use Olson's analogy[29],

[29] Mancur Olson (1996) used a mental exercise to explain why institutions explain why some nations are rich and others poor. He found that natural resource endowments couldn't explain the difference in economic prosperity between two neighbouring countries, but that institutions

borders will indicate differences in transaction costs. And this is one source of difference between countries: the way they solve the problem of transaction costs.

In the Coasian tradition it can be said that one way of lowering transaction costs is through the establishment of firms. With the emergence of firms, the cost of acquiring information is greatly reduced because one contract can substitute for a series of contracts, and the cost for parties to find one another is greatly reduced.

Transaction costs will also be lower where transactions are repeated between the same parties, but that can only apply to a limited number of transactions. In the real world exchange takes place amongst multiple individuals and with very little information known about all of them. This creates a necessity to find ways for individuals to trade without being familiar with each other (North 1990).

Contracts between trading parties are a logical solution to this problem. By stipulating the legal requirements of transactions, the legal system not only lowers the cost of transacting, but also gives an indication of the costs involved in the transaction (Coase 1994 [1991]). An important part of contracts are their enforcement. If they are not enforced properly, they serve no purpose. The issue of enforcement are elaborated on p93.

Other examples of formal institutions that may reduce transaction costs include the management of conflict, maintenance of law and order, a clear view on macroeconomic policy and the regulation of the market. According to Williamson (1985) the economic institutions of capitalism have the main purpose and effect of economizing on transaction costs. The absence of these formal institutions will raise transaction costs.

Informal institutions, however, have the effect that countries solve the problem of transaction costs differently. Informal institutions make people interpret formal institutions differently. And as mentioned earlier, these informal institutions are partly culturally derived and in part acquired through experience. They will therefore differ between countries, and cause participants to react differently to formal ways of lowering transaction costs.

In conclusion it can be said that whatever method is used to lower transaction costs, it results in the development of institutions. When it is costly to transact, institutions matter. Whether these institutions are efficient or not, will determine the eventual cost of

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are a more likely explanation.

transacting in the country. And whether these institutions are growth enhancing or growth retarding will determine whether the country will grow or not.

Williamson (1985: 17) reminds us, however, that institutions serve more functions than just to reduce transaction costs: "Main purpose is not, however, to be confused with sole purpose. Complex institutions commonly serve a variety of objectives." One other objective is the protection of property rights.

4.3.2 Property rights

Douglass North and Robert Thomas (1973), among many others, have argued that the establishment of secure and stable property rights have been a key element in the rise of the West and the onset of modern economic growth. The reason for this can be traced back to the previous discussion of transaction costs. Transaction costs increase as economies develop and in effect cause trading partners to become personally more unfamiliar with each other.

An important way of lowering transaction costs in exchange is through the creation of property rights, because they make it possible for people to trade with unfamiliar partners while expecting them to honour their agreements. If this were not possible, the cost of finding familiar trading partners will in most instances obstruct the transaction. Therefore, property rights can contribute to economic growth through the lowering of transaction costs, because everyone in a transaction will have a reasonable expectation of the reaction of the other participants. The existence of property rights will result in an increase in the number of transactions and consequently contribute to economic growth.

Because property rights play such an important role in the economic growth and development of a country, the protection or negligence thereof provides evidence in the explanation of growth differences between countries. And it is for this reason that the NIE pays much attention to the origins and nature of property rights.

Four categories of property rights (which can either be linked to a fixed asset or labour) are distinguished. Firstly, there are user rights, which provide the owner the right to use, transform or even destroy an asset. Secondly, there is the right to transfer ownership of an asset, i.e. to alienate or sell an asset. Thirdly, there is the right to earn an income from an asset and negotiate the terms with other individuals (Eggertsson 1990). Therefore, the protected property can be sold for a profit, improved through investment, or destroyed by the rights holder.

Rodrik (2001: 92) places emphasis on a fourth category, namely the importance of control rights:

> the key word is control, rather than ownership. Formal property rights do not count for much if they do not confer control rights. By the same token, sufficiently strong control rights may work adequately even in the absence of formal property rights[30].

Property rights impact on the performance of an economy in a number of ways. It determines who the players in the economic game are because it determines who gets what and when. In other words: which individuals have access to what scarce resources. Once this is established, the players have the opportunity to decide what to do with their economic goods, in other words "it establishes the incentives that determine human behaviour in the economy" (Furubotn and Richter 2000: 31).

Furthermore, individuals are willing to maximise the value of the property if they can control, sell and earn an income from that property. Kasper and Streit (1998: 205) explain that people are better motivated to make use of their assets by "toiling, labouring and experimenting with them, precisely because they could have confidence that they would appropriate the rewards of their efforts and their risk taking". In other words, to be persuaded to make an investment, role-players have to be sure that they have control of their property and the benefits thereof. No entrepreneur will have the incentive to accumulate or innovate if there is no certainty that they will be able to control the return to that asset (Rodrik 1999).

The development of a manufacturing sector, for instance, necessitates fixed capital in plant and equipment, uninterrupted production, a disciplined, appropriately trained labour force, and a developed transport network. To make sure these factor and product markets function smoothly, property rights need to be secured. And if they function well, a surplus will be produced that will benefit those in society with a deficit (North 1991).

Empirical work on the correlation between property rights protection and economic growth uses data from the Political Risk Services, a private company that assesses the risk that investments will be expropriated in different countries. These analyses (Acemoglu, et al. 2001, Acemoglu, Johnson and Robinson 2003b, Hall and Jones 1999, Knack and Keefer 1995), show that countries with more secure property rights have higher average incomes.

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[30] See for instance the example of China (Qian 2003).

Two objections to these results are common. Firstly, that there may be an omitted variable, like for instance geography, that may explain why countries are poor and why their property rights are not secure. And, secondly, that the results merely prove that rich countries are able to enforce property rights.

Acemoglu, Johnson and Robinson (2001) suggest that one solution to test for these objections is to find a source of variation in economic institutions that have no effect on economic outcomes. Their suggestion is to "look at a natural experiment". The two experiments that they consider are, firstly, the growth differences between the southern and northern parts of Korea, and secondly, European colonisation and the reversal of fortunes many of their colonies experienced.

In the second experiment, which is more applicable to this dissertation, Acemoglu and his co-authors (2003b) take different forms of colonisation that European countries imposed on much of the world as a change in institutions, whereas other factors, like geography, remained constant. Their findings suggest that the institutions imposed by the colonisers had nothing to do with initial income (e.g. that only rich countries can afford good institutions), but rather that the higher the initial population density or the greater the initial urbanisation, the worse the subsequent institutions, including both institutions right after independence, and today. They attribute this situation to the fact that in these areas Europeans —if they did not settle in the colony— extracted resources without respecting the property rights of the inhabiting majority.

Enforcement of property rights

There is little uncertainty in the NIE literature about the importance of protecting property rights. And because property rights have economic value it must be enforced in a way that is clear to everybody in the society. In the absence of the protection of property rights, many exchanges would not take place and markets would remain primitive and underdeveloped[31] (Azfar 2002).

The protection of property rights is therefore crucial in the process of economic growth and development. But as Popper notes (quoted in Furubotn and Richter 2000: 7): "You cannot construct foolproof institutions" and "Institutions are like fortresses. They must be well designed and properly manned". How to "man" property rights will be different in

[31] It is shown in Chapter 7 that mining firms in Zambia decreased investment in the copper mines when they did not trust the government of President Kaunda.

each country. Firstly, because countries will unlikely have exactly the same formal rules and secondly, due to the diversity of their informal institutions.

Enforcement is established by law and/or custom. Law is a formal institution, and as mentioned before, not all people respond the same way to formal institutions because of the prevalence of informal institutions (customs). If the parties to the transaction respect property rights and mutual trust predominates in society, enforcement costs will tend to be low. The level of transaction costs will therefore depend on the behaviour of the individuals involved in the transaction. If the parties to exchange have comparatively uniform ideas about the seriousness of the transaction, enforcement costs are lower (Furubotn and Richter 2000).

Furthermore, enforcement implies a certain cost to the individual. To exclude others from using one's property without authorization implies costs to the owner. To prevent for instance breaking and entering, people incur exclusion costs like locks on doors, fences, burglar alarms, and information-protection systems for computers. Where this is done by collective action (legislation, police) a large part of the exclusion costs are borne collectively and has considerable cost advantages for property owners over individual protection (Alston 1996, Furubotn and Richter 1991). According to the World Bank (2002b) the poor bear the greatest burden of unprotected property rights, because they find it hard to protect them against crime.

North (1990) identifies enforcement at three levels, i.e. self-enforcement, enforcement by a second party, or third party enforcement. When two parties know each other through repeated dealings, they will most likely live up to the agreements of the arranged contract because they find it beneficial to do so. But such self-enforcing constraints are a long and slow process that requires time to develop[32]. If one of the parties to exchange decides not to honour the agreement, the other party can decide to have no further exchange with the defaulting party. Punishment in such a case becomes a public good where the costs of searching for a new trading partner are born by the individual.

In a complex, modern society self-enforcement will most likely be unsuccessful. In most transactions the parties do not know each other that well and do not depend on each other for future dealings. The costs incurred by the parties in order to secure the transaction will probably exceed the advantage gained from the transaction. This is also

[32] North (1990) laments the rapid transformation of Africa from tribal societies to market economies as an example where not enough time was allowed for the process.

true in the case of second-party retaliation. "It is costly to find out that a contract has been violated, more costly to be able to measure the violation, and still more costly to be able to apprehend and impose penalties on the violator" (North 1990: 58). Therefore, if it is taken into account that there are economies of scale in policing and enforcing agreements by a third party, the latter becomes the best option for the enforcement of formal rules.

Third-party enforcement essentially means the development of the state as the coercive force that monitors formal institutions and enforces them. North (1981: 21) sees the state as an organisation with a "comparative advantage in violence". Although not ideal, the advantage of third party enforcement is that economies of scale reduce the unit cost of enforcement. Therefore a large modern society cannot do without the help of the state and an important reason for this is the costliness of enforcement.

Through its role as protector, government also has an important role in the process by which various property institutions emerge. Sened (1997: 7) observes, "There is nothing natural about property rights". Samuels (1994: 181) summarises it as follows: "government does not protect property because it is property; it is property because government protects it". Unfortunately the political process is not necessarily efficient. Property rights emerge because they serve the interests of particular individuals, whether government officials or entrepreneurs. Both these groups will challenge the other party to change the institutional structure to fit it to their own needs (Sened 1997).

It is unlikely that rights will emerge or persist unless they serve, directly or indirectly, the interests of the authority that protects and enforces them. Government thus has an important role to play in the establishment and security of property rights.

Unfortunately, this "monopoly on power" provides government with the ability to infringe on property rights itself. As Djankov, Glaeser, La Porta and Schleifer (2003: 4) put it: "a government capable of protecting property against private infringement can itself become the violator and thief". If a government is strong enough to control conflict, it is also strong enough to use its power against the citizens it is supposed to protect. Djankov and co-authors (2003) describe working economies as somewhere between the two extremes of a government that controls too little and allows the economy to plunge into disorder, and a government that controls too much and ends up as a dictatorship.

By disorder Djankov, et al. (2003: 7) mean the "risk to individuals and their property of expropriation in the form of, for example, murder, theft or violation of agreements, or the ability of private violators to escape penalties through the subversion of public institutions, such as the courts, through bribes and threats". It also includes the risk to individuals and their property of expropriation by the state and its agents in the form of taxation. Alternatively property rights can also be infringed upon through expropriation by the state, by the overuse of regulations, this being an example of the *modus operandi* of a dictatorship.

Some phenomena, such as corruption, are reflections of both disorder and dictatorship: in so far as individuals pay bribes to avoid penalties for harmful conduct, corruption is a reflection of disorder, but in so far as officials create harmful rules to collect bribes from individuals attempting to get around them, corruption is a cost of dictatorship[33] (Djankov, et al. 2003).

According to Acemoglu and Johnson (2003) the imposition of legal rules will position an economy somewhere between the spectrum extremes of disorder and dictatorship (e.g. greater formalism may correspond to less disorder). Changes in institutions, on the other hand, would induce shifts of the frontier, so that with deteriorating institutions, a society will suffer higher costs of both disorder and centralised control.

Similarly North (1981) distinguishes between a "contract theory" of the state and a "predatory theory" of the state. According to the contract theory, a legal framework created and maintained by government institutions facilitate (by reducing transaction costs) the making of private contracts that result in economic transactions. According to the predatory theory on the other hand the state acts as an instrument for transferring resources from one group to another. North (1990: 58) sees this as a fundamental dilemma in economic development: "if we cannot do without the state, we cannot do with it either". On the one hand government needs to protect property rights, but this also provides it with enough power to make decisions that are not to the advantage of the majority of the country.

One reason why it is possible for the state to expropriate property is because no individual can write an enforceable contract with the state, which is discussed in the next section.

[33] The World Bank (2002b) also describes corruption as a regressive tax, because the demands for bribes and unofficial fees for services hit the poor the hardest.

4.4 HOW INSTITUTIONS DETRIMENTAL TO GROWTH PERSIST OVER TIME

In order to explain the inability of countries to converge to levels of developed countries or to explain examples of 'reversals of fortune', which has been the Zambian experience, a number or reasons why flawed institutions have the ability to persist over time are discussed in this section. Different, and sometimes interrelated, explanations are discussed.

Colonialism

In the last number of years extensive research has been done on the link between colonisation and post-colonial economic prosperity. It is especially the work of Acemoglu, Johnson and Robinson (2001, 2003b, 2004) that have linked different types of colonisation to geographical realities, and these to post-colonial institutions. A study of former European colonies by Acemoglu, Johnson and Robinson (2001) revealed that the institutions in almost all these former colonies were influenced by their colonial past. In particular those institutions dealing with private property that constrained local elites and rulers were more likely to be created by Europeans in order to protect their own property rights when they settled in large numbers (e.g. in The USA and Australia).

Again, when the Europeans were interested mainly in extracting resources, and did not settle, no participatory institutions emerged resulting in the creation of extractive institutions only. In places where the disease environment was not favourable to European health and settlement, and especially where they were a small minority relative to a large indigenous population, they did not have the incentive to develop good economic institutions because "such institutions would have made it considerably more difficult for them to extract resources from the rest of society" (Acemoglu, et al. 2004: 49). It was therefore to the advantage of the Europeans to create extractive institutions.

In neither Botswana nor Zambia were there large settlements of Europeans during colonial rule. But due to the fact that copper was extracted during the time of colonial rule in Zambia, institutions supporting these extractions were created, while in Botswana such institutions were not created since no valuable resources were known to exist before independence.

In another article Acemoglu et al. (2002) link their previous findings to current macroeconomic instability. They document a robust relationship between the historically determined component of post-war institutions and volatility (as well as the severity of economic crises and economic growth): "countries that inherited worse ("extractive") institutions from European colonial powers are much more likely to experience high volatility and severe economic crises" (Acemoglu, et al. 2002: 51).

They describe the effect of high European settler mortality and economic outcomes after independence as follows:

> Former colonies, which experienced higher European mortality more than 100 years ago, are today more likely to suffer high volatility (as measured by the standard deviation of the growth rate), severe output collapses (as measured by the largest output drop in any year) and low growth.

Their interpretation is that in places where the Europeans did not settle, they set up more intensely extractive institutions that concentrated power in the hands of a small elite. These countries typically ended up with weaker institutions. Societies with weak institutions not only grow less slowly in the long run, but also experience greater growth volatility.

One conclusion is that history matters. Initial advantages or disadvantages and interim shocks can have long-lasting effects on growth, and these effects can be compounded. Thus, with secured property rights and participatory institutions like those in Botswana, one would expect a virtuous cycle of investment, falling costs and higher economic growth (Aron 1996, North 1990). The opposite was true for Zambia at the time of independence. Zambia inherited a system of extractive institutions that was transplanted into post-colonial Zambia. Another applicable example is used by Acemoglu et al. (2004: 62) when comparing Mexico and the United States of America:

> In Mexico there were very different initial conditions during the colonial period with a large indigenous population and rich silver mines to exploit. This led to a much more hierarchical and authoritarian balance of political power and very different colonial economic institutions. These conditions fed into the different institutional structures at independence—the United States with its constitution, checks and balances and federalism, Mexico with its much more centralized, unchecked, unbalanced and absolutist state. These different political institutions then led to very different economic institutions and economic outcomes after independence. Thus, in some ultimate sense, the source of different political institutions was different initial conditions during the colonial period.

One can thus draw the conclusion that extractive colonisation is a story of inevitable stagnation for colonies that were subjected to it. Fortunately for these colonies, "path dependency is not a story of inevitability". The choice of institutions seems too important to be denied. Colonialism destroyed old institutions and created new ones, but what happened in the countries after independence was the result of choices made by those with political power. Acemoglu, Johnson and Robinson (2004: 35-36) describe it as follows: "even if institutions have a tendency to persist, their persistence is still a choice, in the sense that if the agents decided to change institutions, change would be possible".

In a sense this is easier said than done, because, informal institutions created during colonial times influence the post-colonial decisions, and formal and informal institutions from the pre-colonial period in turn influenced these. The important point is that although colonialism is not a story of inevitable stagnation, stagnation can be explained in terms of post-colonial decisions embedded in experiences gained during colonisation.

But although difficult to change, it still remains possible for post-colonial governments to change exploitive formal institutions that were created during the colonial period. Changes in formal institutions can come about through legislative change, such as the passage of a new law, or court decisions that alter the common law, or changes in the regulatory rules, or ultimately constitutional changes.

Acemoglu, et al. (2004) describe a number of examples where countries radically changed their legal systems, such as Japan after the Meiji restoration, Russia after the Crimean War, and Turkey under Mustafa Kemal in the 1920s. Another example might be the introduction of central planning of the economy. Though many countries adopted this way or organizing their economies, some abandoned it while others, such as North Korea and Cuba, still maintain it.

The idea of institutional change can also be described within the framework of colonialism. The different types of colonialism and the institutions it created were the choice of the colonial powers. When the colonisers did not settle, they chose economic institutions simply to extract resources from the native population. When they settled in large numbers, economic institutions and policies emerged in order to protect them in the future and encourage investment and prosperity. These actions of the economic and political agents, although not necessarily to the advantage of the indigenous population, were taken in a rational fashion.

Although not an exploitive institution created during colonial times, the embedded institution of chieftaincy in Botswana serves as an example of an institution that was changed with independence to benefit post-colonial democratic structures. As discussed in Chapter 6, the chiefs lost most of their executive power at independence, ending up in a consulting position in the House of Chiefs. The only way chiefs could participate in governing the independent nation was to give up their chieftaincy and be elected in the democratic process.

In conclusion it can be said that, "although institutions are the incidental outcome of history, at some point people will start to ask why these choices were made" (Acemoglu, et al. 2004: 35-36). These choices are the result of history, informal institutions and, as is discussed on p102, the pressure from interest groups that benefit from upholding the old formal institutions. Informal institutions do not change at the same speed as formal institutions, but serve as a "memory" of things that happened in the past[34]. The formal institutions created during colonial times, *per se*, are therefore not to be blamed as a source of stagnation in the independent country. It is the combination of informal institutions created during colonial times and the choices made after independence that are to blame.

Ideology

The question of why post-colonial economic and political players choose policies that only benefit a small group, although these policies are detrimental to the country as a whole, needs to be answered. One possibility is that policies are based on some form of ideology, for instance, the "Zambian Humanism" that Kaunda supported. In the mid-1960s, when most African colonies gained their independence, socialism was the fashionable ideology to adopt. The capitalist west was seen to be the enemy of most African countries, so it was more acceptable to side with the supporters of socialism. It may be construed that this type of socialism was to the disadvantage of Zambia. In Botswana a capitalist system was adopted at independence, and the biggest role-players were wealthy cattle owners. The smooth functioning of a capitalistic system was therefore to their advantage.

Again, as for colonialism, one can consider the inevitability of path dependency. It is not so much the choice of ideology at independence that is important, but whether a country continues on that road even if it produces stagnating economic results. Why do countries persist on the road to stagnation? Acemoglu et al. (2004) uses the example of South versus North Korea to argue that much can be explained by the self-interest of the leaders. He argues that the choice of different ideologies can explain the divergence in economic institutions straight after independence, but even when the choice of the north proved to be a failure in the 1980s, the leaders of that country still clung to it. The ideology they have chosen provides them personally with a higher rate of return than the alternative,

[34] It is shown in Chapter 6 that the "memory" of colonialism in Zambia was much more negative than that of Botswana which was only a colonial protectorate.

and therefore they tend to stick to the ideology that is detrimental to the majority of the population.

Again the conclusion is similar to the one reached under colonialism as the reason for the existence of bad institutions. Societies may choose economic institutions that are detrimental for society as a whole because of a history of extractive institutions. Institutions may differ across countries because of ideological differences. But these theories do not satisfactorily explain why societies stay on a road to stagnation. Different beliefs and ideology often play important roles in economic decisions, but it is not enough to explain long-term stagnation.

If a country was subjected to colonialism or had chosen an ideology that leads to the stagnation of the country, government can alter the influence of both through a change in policy. Government choices are important for the economy. Why is it so hard for government to change bad policies? One reason might be the inability of the polity to commit to their decisions when they have unconstrained power.

The inability of the Polity to commit

From an institutional perspective governments have, broadly defined, two roles to play in an economy: they can make or change formal rules, and they can enforce them. The success, to which these roles are performed, depends to a large extent on the degree of power governments enjoys. If they have unconstrained power, governments can make policy choices, for example, that benefit themselves rather than society at large. The reason for this stems from the fact that governments *per se* cannot be an impartial enforcer of agreements between themselves and the citizens. To explain the situation, it is necessary to review government's general role as enforcer of contracts.

In economic exchange the parties to the exchange are held responsible for their decisions through an array of enforceable contracts. These include contracts between workers and employers, borrowers and lenders, etc. The reason why these contracts are effective is because there is an authority, a third party, with the power to enforce them. Workers have trust in their contract with their employer, because by default the state, and its agents, the courts, would be the impartial enforcers of the contract. If, however, one of the contracting parties has any suspicion that the state might support the other party to a greater extent and refuse to punish that party if and when it fails to make a payment stipulated by the contract, then a contract will have little value. For contracts to have credibility the presence of an impartial enforcer is important. In the section on enforcement, government was established as the most cost-efficient agent to play the role as impartial third party.

However, when it comes to contracts that government or social groups controlling the state would like to write with others (e.g. the citizens), there is no impartial third party to enforce that contract (Acemoglu 2002). When there are no checks on government, on politicians, and on elites, private citizens do not have the security of property rights necessary for investment.

If government has unconstrained power, private citizens are unable to protect themselves against possible exploitation (Acemoglu and Johnson 2003). And for citizens to undertake investments, they have to be certain that they will be able to take delivery of the income from that investment. The problem is that the political elites – those in control of political power – cannot commit to respect the property rights of the producers once the investment is undertaken.

Bad institutions can therefore persist if government has unconstrained power. If government wants to change from a path of bad institutions, role-players will find it hard to trust that promise, because they have no means of enforcing that promise (Acemoglu, et al. 2004). This situation can be improved if a constitution or independent judiciary control the actions of the state. This point is elaborated on in Chapter 8.

The situation in this section describes a government with too much power, but what if government has too little power? The following section focuses on a situation where too little power withholds the government from making decisions that benefit the majority of the population.

Social conflict

Related to the commitment problem is the fact that government may not necessarily have enough power to change bad institutions. If governments have too little power, powerful groups in society will be able to influence their decisions. By also taking the previous section into account, the complexity of the situation becomes apparent. A government with too little power will be unable to improve bad institutions, but alternatively an overly powerful central government directly conflicts with the objective of restraining the sovereign.

The idea of too little power is explained by what Acemoglu, Johnson and Robinson (2004) call "a social conflict view". They explain that choices made regarding economic and political institutions are not always by and to the benefit of the entire society, because the groups that control political power make them. Those with political power (not necessarily the reigning government) will determine which economic institutions will come into effect and eventually have important implications for economic performance.

Where does political power come from and who wields political power? Political power comes from two sources:

- First, an individual or group can be allocated *de jure* power by political institutions, like the constitution.
- A second type of political power accrues to those individuals or groups who either have economic power, or are able to destabilise society through collective action. This can be called *de facto* political power (Acemoglu and Robinson 2003).

Actual political power is the joint outcome of *de jure* and *de facto* power, and this is where social conflict is created. While a government may be committed to make decisions that would create an environment conducive to productive investments through the protection of property rights, they are also influenced by the bargaining strengths of those affected by the decision. Because their decisions will determine the payoff to the players in the economic game, it is worth the time and money for rent-seeking producers to appeal to politicians, who themselves have to compete for re-election, to keep certain regulations in place or to add new ones. For both role-players (i.e. politicians and those affected by the decision) self-interest seems to be the important issue.

Different groups will choose the economic institutions that maximize their own rents, and the economic institutions that result may not coincide with those that maximize total surplus, wealth or income. For example, although the protection of property rights are to the long-term benefit of society, a ruler may find it to his/her own financial benefit to infringe upon property rights (Acemoglu, et al. 2004). Furthermore, producers are always searching for ways to reduce competition and hence maximise their profits. If they can influence politicians through lobbying, it will be to their financial advantage to influence the political decision-maker to make a decision that is beneficial to the producer, but not necessarily to society as a whole. Such a decision will not increase the size of the economic pie, but rather the slice that accrues to the one with the *de facto* political power (Kasper and Streit 1998). Role-players will devote resources to the changing of institutional constraints as long as the payoff from changing the direction exceeds the payoff from staying with the existing constraints.

The effect of the interaction between *de jure* and *de facto* political power is that the rules (i.e. formal institutions) that emerge from this process will be those that serve the group with the actual political power. This situation *per se* is not necessarily bad. It all depends on whether these rules are growth-enhancing or not. In other words: whether the group with the actual political power has growth-enhancing intentions or not.

Three examples from the literature illustrate the point. The first example is provided by Acemoglu et al. (2004). They describe the differences between Ghana and Zambia, and Kenya and Colombia. In all four countries price regulations were induced, with different outcomes. In the first set of countries the regulations were distortionary, but not in the latter. In the latter countries agricultural producers had more political power and so "could prevent the distortionary policies that would harm their interests" (Acemoglu, et al. 2004: 59)[35]. A second example from De Long and Shleifer (1992) explains the same phenomenon. They found that a government that consists principally of individuals with substantial private wealth and private property would care about more than just state revenue. If the region prospers, it will also be to the benefit of their own financial prosperity. Thirdly, if a society is sharply divided by income lines, the poorer half of the population possibly stands to gain more from redistribution of income than from growth-promoting policies. If the poor is in the majority, they will vote to tax the rich minority. Such an action can be detrimental to future economic growth.

The distribution of political power in society is therefore crucial for explaining good and bad economic institutions. The fear of losing political power due to the actions of those with *de facto* power can lead political groups to oppose institutional change that would have been beneficial for the country. Furthermore, if the initial set of institutions provides incentives to unproductive activity, it will create organisations and interest groups that abide by those incentives and they will use their bargaining power to preserve those institutions. Governments depend on popular support to remain in power and they may find it hard to enact efficient rules if powerful constituents oppose those rules. Government is also constrained by historical decisions. “History matters” and inefficient rules may survive because of the nature of path dependency (North 1990). It is also possible that inefficient rules yield more tax revenue than efficient ones and that government may find it difficult to change those rules.

The lack of effective institutional constraints on the politically powerful implies that there is more to be gained by acquiring political power (Acemoglu, et al. 2002). When the

[35] With Kaunda’s power based in the urban areas, the mining industry and manufacturing were favoured relatively to the agricultural sector. In Botswana the cattle owners were also those with political power, and therefore created economic institutions that protected the property rights of those cattle owners.

political power shifts, the newly empowered groups may then attempt to redistribute wealth (assets and income streams) to themselves and their supporters. This can explain political instability that has been present in most of Africa in the post-colonial era. The groups that lose out politically therefore have an incentive to demand power. If the political process does not function well, this demand may cause instability or more crass measures such as a coup.

Acemoglu et al. (2002: 5) argue that "in institutionally-weak societies, elites and politicians will find various ways of expropriating different segments of the society, ranging from microeconomic to various macroeconomic policies". The problem faced by these institutionally weak (having no institutional barriers) societies is how to constrain those in power. A lack of constraint on politicians and elites increases the incentive of various groups to fight in order to gain power, and enables the incumbents when they gain power to exploit their position, sometimes with disastrous consequences. The problem looking for a solution is how to get the state to behave like an impartial third party. What institutional constraints are needed to achieve this ideal?

A challenge in institutional economics is designing institutions that support private contracts and simultaneously provide barriers against expropriation by the politically powerful. It is hard to find a government with wealth-maximising actors unconstrained by other considerations; therefore governments need to be restrained by some external force. And furthermore, Djankov et al. (2003) explain that good institutions would introduce ways to get rid of bad politicians and bureaucrats. These two issues receive attention in Chapter 8.

The discussion so far on social conflict can be summarised by saying that economic institutions that shape economic outcomes, are determined by a combination of *de jure* and *de facto* political power. It is, however, possible to take one step back and ask the question how these different types of political power originated in a country. Acemoglu et al. (2004) discuss two examples to illustrate the point:

> Agricultural policies in Kenya supported large farms because large farmers could solve the collective action problem and exercise de facto political power. But the main reason for the existence of large farms was that British settlers expropriated the land from Africans during the expansion of colonialism. Thus previous combinations of formal political institutions (colonial institutions) and de facto power (the military might of the British Empire) determined economic institutions, feeding into the future distribution of de facto power even after the nature of de jure power changed dramatically with independence (p 62).

> The Netherlands and England prospered in this period because they had good economic institutions, particularly secure property rights, and well developed financial markets. They had these economic institutions because their governments were controlled by groups with a strong vested interest in such economic institutions. These groups wielded political power because of the structure of political institutions, i.e., they received de jure power in the Netherlands after the Dutch Revolt and in England after the Civil War and Glorious Revolution (p 72).

These examples take the discussion back to the influence of colonialism on post-colonial economic outcomes. The discussions on colonialism and ideology both concluded that they are important, but that choices made by the postcolonial government could improve bad institutions created during colonialism. This is true, but a lot depends on the allotment of the power base in the country. In other words, who has *de facto* and who has *de jure* political power. The social conflict view provides an explanation of why governments choose economic institutions that cause underdevelopment even when they know that it is going to happen. It is because *de jure* political power is influenced by *de facto* political power, and the latter may not necessarily have the economic prosperity of the majority of the country in mind. To complete the cycle, this distribution of political power can be traced back to colonialism. Therefore colonialism does not necessarily lead to stagnation, but it has a lot to answer for about the distribution of power it left the colony with.

In conclusion it can be said that if all the explanations for bad institutions discussed in this section, are taken into account, an economy that has prospered for many years seems to be a miracle. But history provides examples of countries that have prospered for many years, and also countries that have turned from a low growth path onto a high one. The question that needs to be solved at this stage is how bad institutions can be changed in such a beneficial fashion that the abovementioned problems are being taken care of.

4.5 INSTITUTIONAL CHANGE

For Engerman and Sokolof (2003: 30) the definition of bad institutions are "those with institutional inflexibility, whose institutions did not respond constructively to take advantage of the opportunities created by their environment and state of knowledge". Societies with good institutions have institutions well adapted for economic performance in their specific settings because they had implemented a series of institutional modifications or innovations that cumulatively generated improvements in welfare.

It must be kept in mind that efficient institutions, which are responsive to changes in the environment, come neither easy nor fast. The move towards an efficient political process, for example, takes time to develop, especially for countries that have had to shake off a less efficient system, for instance, the burden of colonial rule. Landes (1990) points out that European countries took centuries to reach a point where growth-enhancing institutions outnumbered growth-retarding ones. Because of the memory created by past experience, like colonialism, it will probably take many years to overcome the subordination and humiliation experienced.

Furthermore, for countries to find the "right" mixture of formal and informal institutions, that would induce growth, is a complex process that cannot be duplicated between countries. Every country needs time to find the right mixture, but it is also a process that never ends. For institutions to support economic growth and development, they must change over time as circumstances change. The experience of developments during the past half-century where the best performing countries were those that liberalised partially and gradually supports this view.

According to Rodrik (2001: 98-99) an important reason why gradualist strategies worked in these cases was that they were better tailored to pre-existing institutions at home. Rodrik uses China and Latin America as examples: "China is an excellent example as its astonishing success since 1978 is due to a strategy based on dual tracks, gradualism and experimentation. Compare this with wholesale reforms implemented in Latin America and the formerly socialist countries – their success hinged on the Herculean task of creating a wide range of new institutions in short order and, for most of them, from scratch". The comparison supports the view that market-orientated reform strategies must recognise not only that institutions matter, but also that altering existing institutions takes time and effort. The reason for this is that the greater the fit between market-oriented reforms and pre-existing institutional capabilities, the higher is the probability of success.

A further problem affecting institutional change is that institutions responding to the wrong incentives can be hard to change when the turn-around costs are too high, or if individual attempts to change them causes even more unpleasant consequences (see Toye 1995 for a discussion on female circumcision). Political and economic organisations as well as individuals may have spent a lot of money in the past to be able to operate in the weak institutional environment, and according to Aron (2000) they are likely to maintain and entrench the weak institutional environment. A situation like this creates organisations that become more efficient, but more efficient at making the society even less productive. It is therefore important to have a process through which bad institutions can be replaced by good institutions.

Such a process can come from democratic pressures, from the influence of growth-seeking interest groups such as merchants, from negotiation among the members of the elite, or just from a long-term evolutionary process (Djankov, et al. 2003). The important thing seems to be that the economy and the society must have the flexibility to respond to changes in the economic environment. And the discussion in this chapter has highlighted the important role of the polity in the efficiency of institutions. It is therefore important to have a good government, constrained in its choices, but also strong enough to take the appropriate actions even if this is opposed by strong groups in the society.

An issue related to good governance and one especially applicable to Botswana and Zambia, is the policy choices governments make in the face of natural resource abundance. In chapter 3 the resource curse was raised as a possible reason for growth differences. It was concluded that a lot depends on the policy choices government make. In section 4.6 that discussion is taken a step further, by extending it to institutional theory to determine the theoretical link between institutions and the resource curse.

4.6 INSTITUTIONS AND THE RESOURCE CURSE

Resource dependence creates extra problems for government, for instance an appreciating exchange rate, an unstable income, and the urge to spend the high income on grandiose projects. But as Wright and Czelusta (2002: 3) suggest: "the underlying problems are not inherent in the resources themselves". The way government reacts to these occurrences will eventually determine whether the country will have a growth enhancing experience or not from its resource abundance.

The way government reacts depends strongly on the quality of the institutions in the country. Intuition suggests that if growth-enhancing institutions, like property rights protection or restraints on governments, are absent, governments may engage in policy choices that will secure the ruling elite's personal positions, but these choices will not necessarily benefit the majority of the population. The presence of high quality institutions will make such policy choices unfeasible.

The question is whether cross-country analyses support the link between high quality institutions and good policy choices regarding the expropriation of resources. This link has already been established empirically. To find causality is, of course, always difficult. Do institutions impact on the spending of the funds generated by the resource curse, or does the resource curse impact on economic growth through its negative impact on institutions? Or does it go both ways? There is evidence for both.

Sarraf and Jiwanji (2001) found that some natural resources – especially oil and minerals – exert a complex negative impact on growth because of erosion of institutional quality. Sala-i-Martin and Subramanian (2003) also show that natural resources that are "easy to steal" (like oil and mining) turn out to have a highly adverse impact on growth by allowing corruption chains to be created that end up undermining the favourable institutions such as the rule of law. Both these studies show that the natural resource curse has a negative impact on the quality of domestic institutions and so on long-run growth.

There is, however, also support for the theory that good or bad institutions in the onset of resource exploration will determine whether a country will escape the resource curse or not. Mehlum, Moene and Torvik (2002) suggest that countries with producer friendly institutions will attract entrepreneurs into the extraction of the resources in such a manner that it will lead to higher growth.

Leite and Weidmann (1999) show both theoretically and empirically that strong institutions in the wake of natural resource discoveries are important as a way to curb the associated negative growth effects of, for example, corruption. This is not surprising if it is taken into account that good institutions diminish the perverse political incentives that booms create. Countries with deficient institutions may suffer from a resource curse because there are hardly any checks on their governments.

When resource rents flow into the coffers of the government these revenues allow the government to employ an excessive number of people (supporters) in the bureaucracy and in state-owned enterprises. The increase in Zambia's bureaucracy at a time of contraction in private employment provides an example. It can be hypothesised that the presence of robust institutions in Zambia would not have permitted the use of such political strategies. Just across the border Botswana has not fallen pray to the pressure to spend all the income from the diamond production. Again this reminds of Olson's analogy that borders define different institutions.

An interesting example, in this regard, is discussed by Temple (2003) in his account of Indonesia's problems. The Indonesian government of Suharto inherited poor economic institutions, but was able to spend its mineral rent well. They did this with the help of external consultants (the so-called "Berkeley Mafia"). Unfortunately for Indonesia, these consultants were only concerned about the macroeconomic policy and no attention was paid to the adjustment of defective institutions (for example corruption) in the country and this became apparent with the collapse of the Indonesian economy during the Asian financial crisis in the 1990s[36]. It seems as if good macroeconomic policies without wealth creating institutions can cure the problems related to resource abundance, but only up to a certain point. What need to be taken care of are the underlying institutions.

Robinson, Torvik and Verdier (2002) take a middle-road strategy when they highlight the importance of good institutions rather than trying to explain causality. They divide resource abundant countries into two groups: those that have escaped the resource curse and those that have not. They linked these to the institutional quality index used by Knack and Keefer (1995) and found that the first group of countries rank ahead of the institutional quality of the second, and that they do so in a consistent manner (Robinson, et al. 2002).

It can therefore be concluded that for resource dependence to contribute to long-term economic prosperity, growth-enhancing institutions are necessary. One of the reasons why Botswana and Zambia realised different growth rates, while both being resource rich, can therefore be attributed to differences in their respective institutional matrixes.

4.7 CONCLUSION

The challenge accepted by the New Institutional Economics (NIE) was to determine how societies could be organised to encourage economic growth. What can countries do to secure prosperity?

The institutions needed for economic growth and development are those that lower transaction costs (for example property rights) and those that protect property rights (a constrained polity). This may sound trivial, but there are various reasons why countries find it impossible to adhere to these principles, for instance the unpleasant memory of colonialism, the inability of the polity to commit to previous decisions, and so on.

Countries subjected to colonialism are not destined to become poor because of colonialism *per se*, because post-colonial governments can change the extractive ones imposed by the colonial authorities. Colonialism causes these problems: firstly that it creates a memory of extraction (for example to such an extent that the post-colonial government would go to extreme lengths to rid itself of any colonial influence), and secondly, that colonialism creates powerful groups in society that distorts the *de facto* and

[36] See Temple (2003) for a thorough account of the role of defective institutions in the fall of the Indonesian economy.

de jure power base at independence.

If government has too little power, it may be too weak to change bad institutions (especially if those bad institutions are to the benefit of those with *de facto* power). And then one can ask: who has the greater part of the power and what are their intentions? Alternatively, if government has too much power, it may infringe on the protection of property rights due to a lack of restraints.

Before an in-depth study of institutions and institutional restraints on governments in Zambia and Botswana can be done, the relevance of institutions as explanation for growth differences between these countries needs to be established. This is done in the following chapter by applying empirical institutional evidence to Botswana and Zambia.

CHAPTER 5
EVIDENCE FROM THE EMPIRICAL INSTITUTIONAL LITERATURE

5.1 INTRODUCTION

North (1990: 107) has suggested that "we cannot see, feel, touch or even measure institutions", but he nevertheless encourages quantification of the effect of institutions on transaction costs. Over time different proxies have been suggested to quantify institutional quality. Such measures are, for example, the time required to obtain a telephone or spare parts. A high score on these measures is indicative of high transaction costs. Other measures include civil and political liberties, the size of government, sound money and political measures. One of the earliest cross-country growth studies that attempted to test the importance of property rights and contract enforcement used the Freedom House indices of political freedom and civil liberty and a series measuring various forms of political violence such as coups, revolutions and assassinations. A number of different indices have since been constructed to quantify some of the institutional dimensions emphasised in the new institutional literature.

The purpose of this chapter is to apply relevant measures to Zambia and Botswana to determine whether institutions do indeed provide evidence for growth differences between the two countries; in other words, whether the available institutional measures offer a plausible explanation for growth differences. Many institutional measures - for example, the property rights index of the Heritage foundation – only offer index values since the mid-nineties, rendering them of little value in explaining growth differences between Zambia and Botswana since independence. There are however a few data bases quantifying aspects of both economies' institutions since the seventies.

The Freedom House index of political and civil liberties (conceived by Raymond Gastil (see for example, Freedom House 2004)) are used in section 2 of this chapter. It is available from 1972 onwards and is a widely used (for example, Barro 2000) source of information on political institutions.

In section 3 indices from the Frasier Institute are used. The Frasier Institute publishes an annual international economic freedom report, in which 21 distinct indicators of economic freedom in five groups are scored and then aggregated to give a comparable index value for economic freedom across countries. This data is available at five-year intervals from 1970, but many of the indicators only score Zambia and Botswana from 1975 onwards. Nevertheless, the economic freedom index, especially at the component level, is a rich source of data on trends in the institutional matrix in Zambia and Botswana. The Frasier Institute's economic freedom index was compiled by Gwartney and Lawson (for example, 2003).

In section 4 the Polity IV data base shows data on the *de jure* and *de facto* features of the political systems of a very large panel of countries on an annual basis (from 1964 for Zambia) until 2002. It was compiled by Marshall and Jaggers (2002) who built on the earlier Polity III dataset of Jaggers and Gurr (1995).

These three indices will act as empirical guides to the institutional development in Zambia and Botswana and the role this played in their divergent economic performances.

5.2 THE FREEDOM HOUSE INDEX

Gastil's Freedom House index (Freedom House 2004) scores a large set of countries (142 in 1972 rising to 190 in 1993) on two dimensions: civil liberties and political liberties. The former refers to property rights, the right to organise and to express one freely, the freedom to travel, and freedom of religion and of education. Political liberties refer to the ability of the population to participate in elections and to influence policy, and it also refers to the influence of opposition parties. These two dimensions of liberty are then combined to give a total score for each country ranging from Free, to Partially Free, to Not Free.

On the total Freedom House index Zambia has been graded as Partially Free since the inception of the index. But the evolution of the two dimensions of liberty used in that index shows interesting variation over the relevant period.

Civil liberties in Zambia was scored at 5 (on a scale of 1 to 7, with 1 being "free") in 1972, and remained at 5 until worsening to a 6 from 1981 to 1983, before returning to a 5. The deterioration in civil liberties during the early eighties caused Zambia to drop from the middle of the international table to the bottom third of the countries on civil liberties. This ranking improved during the later eighties, with more freedom granted in the run-up to the elections of the early 1990s.

Political liberties in Zambia also scored 5 in 1972, where it remained until deteriorating to a 6 during the late eighties. The inception of the third Zambia republic in 1992 brought a rapid improvement in political liberties (to score 2). Unfortunately the sample starts too late to capture the decline in political liberties in Zambia during the late sixties and early seventies. Like many other sub-Saharan African countries (see Barro 2000) Zambia lost the semblance of democracy which it enjoyed at independence as it evolved into a one-party state with the Second Republic in 1972.

For Botswana the picture looks somewhat different. For the overall index Botswana was rated Partially Free only for 1973 and since then Free. For Civil Liberties the worst score Botswana realised was in 1973, and only for that year, when it was rated a 4. From 1974 through to the end of the 1980s it attained a 3. Political liberties in Botswana scored a 2 for most of the period, with the exception of 1973 (3) and in the first number of years of the 1990s (1). Unlike Zambia Botswana has remained a democracy.

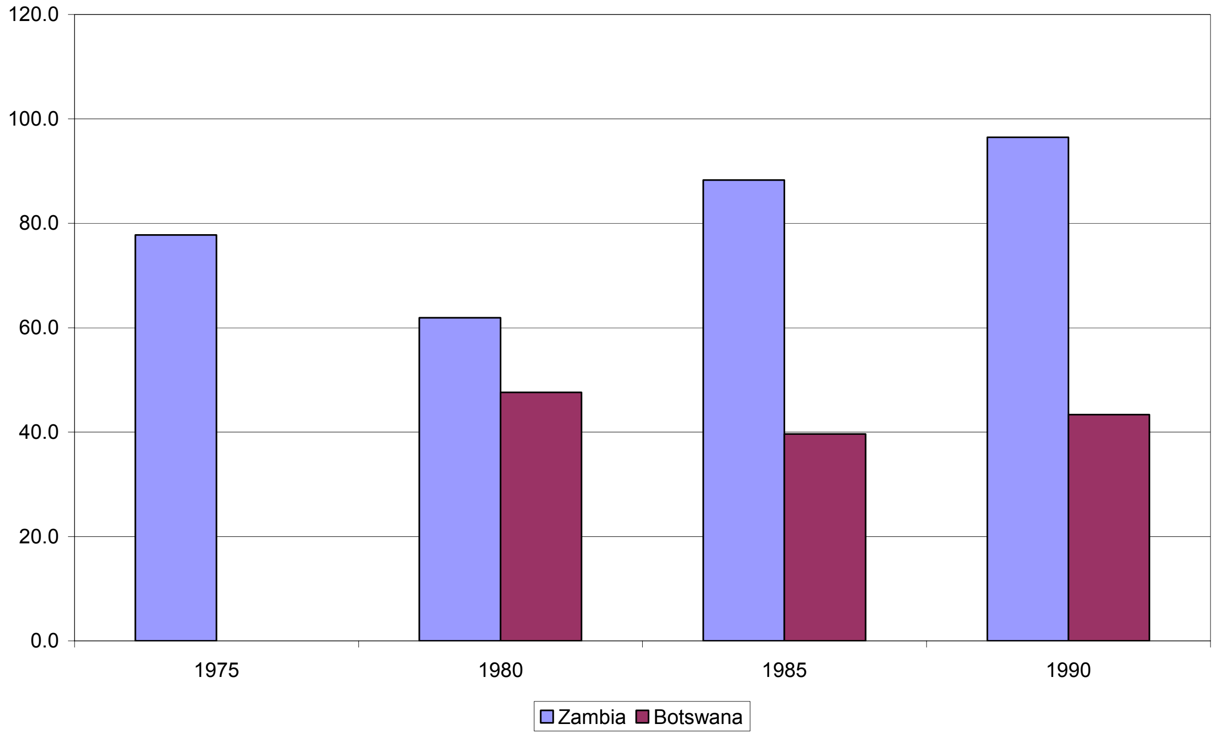
Unfortunately, it is hard to relate this index directly to the security of property rights or to the institutions that protect property rights. It does not capture many of the relevant threats of property and contractual rights.

5.3 THE FRASIER INSTITUTE INDEX

The Frasier Institute has steadily extended the cross-country coverage of its economic freedom index from 54 countries in 1970 to 123 by the mid-1990s. Zambia was first ranked in the 1975-survey when it ranked 56th out of 72 countries on the aggregate index. Therefore, relative to other countries in the survey it was not free. Botswana was first ranked in 1980 and was then ranked 48th out of 105 countries. Figure 32 shows the evolution of this ranking (as a proportion of the total number of countries ranked) at five-year intervals since 1975. On aggregate, the economic freedom in Zambia has been severely constrained - and even suffered periodic decline on an international comparison – since 1975. Indeed the index value for economic freedom in Zambia in 1990 (3.24)[37] was lower than the index value for 1975 (4.66). For the period shown, Botswana has remained more or less constant in relative terms.

[37] An index value of 10 indicates absolute freedom.

Figure 32: Relative summary index of the Frasier Institute



The aggregate index is the weighted average of 21 scores in five major categories, and therefore needs to be unpacked to discover the variations in the sub-indices of the aggregate. Since institutional changes impact differently in the sub-categories of the Frasier index they will be considered separately below.

Size of the government

In the first sub-category the Frasier Institute scores the extent of the government's participation in the economy, using measures such as its share of consumption, and investment, transfers, subsidies, and the top marginal tax rate. This sub-category is graded on the assumption that a larger government impedes economic freedom. Figure 33 shows the relative ranking of Zambia and Botswana in the size of government category relative to the number of countries scored in this category.

Figure 33: Relative index of the size of government

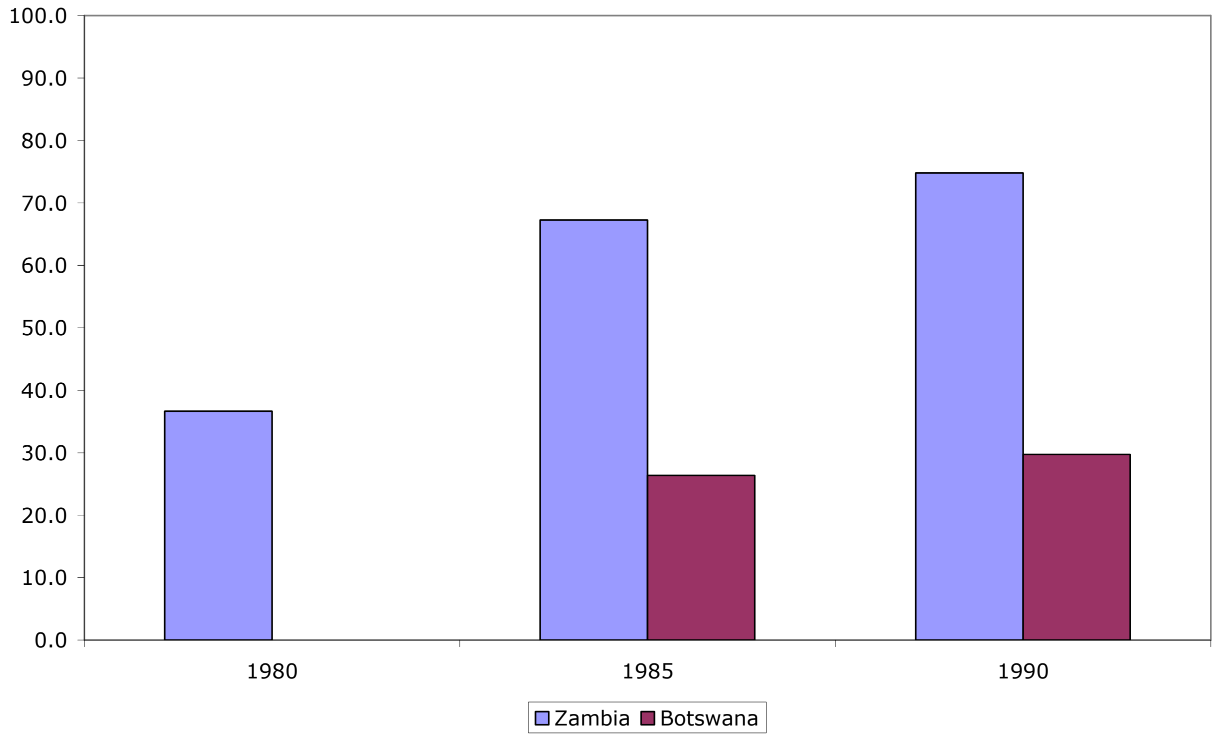
The size of government score for Zambia improves marginally from 1975 through 1990. Throughout the sample period the relative size of government consumption declined, contributing to the modest decline in the government participation observed above. This trend accelerated during the early nineties and was sustained by lower marginal tax rates that contributed to the substantial decline in the relative size of Zambia's government observed during that period.

For Botswana the ranking deteriorated in the first half of the 1980s, but then it improved again. Throughout the sample period the relative size of government consumption declined, but a higher marginal tax rate resulted in an increased score. The Botswana government also increased its investment share in gross investment from 1980 to 1990.

Protection of property rights index

The property rights index combines a number of dimensions, including the independence of the judiciary, impartiality of courts, protection of intellectual property rights, a law and order measure and a judgement on the involvement of the military in politics. Zambia and Botswana's relative ranking on the protection of property rights is traced in the figure below, starting with the first score for Zambia on this sub-index in 1980 and Botswana in 1985.

Figure 34: Relative index of property rights protection



Both in relative terms internationally, but also in absolute terms, property rights weakened throughout the eighties in Zambia. In light of the nationalisation of the seventies it is reasonable to expect that the eighties was a continuation of a longer trend in the erosion of property rights in Zambia[38]. Botswana shows a consistently high level of property rights protection, internationally and in absolute terms. The fact that no nationalisation has taken place in Botswana supports these values.

Sound money

A third component of economic freedom as defined by the Frasier Institute is sound money. It takes into account the growth of money supply minus growth of real GDP, annual inflation, and the freedom of citizens to own foreign currency bank accounts.

In a decentralised system money plays a crucial role in lowering transaction costs but also as an integral part of a functioning property rights system. Not only is money one

[38] The loss of property right protection is discussed in Chapter 7.

of the assets to which property rights can be assigned, but it is also an infinitely divisible asset and as a means of exchange facilitates the divisibility of other assets too. Therefore, when the value of money is eroded (by high and/or highly variable inflation) property rights are undermined in two ways:

> Firstly, money is itself an asset and the erosion of its value represents an infringement on an important part of the portfolio of assets (Buchanan 1993).
>
> Secondly, when the value of money becomes unstable the alienation of all property is more difficult. Since the ability to alienate property is a central characteristic of property rights (North 1989), inflation undermines all property rights.

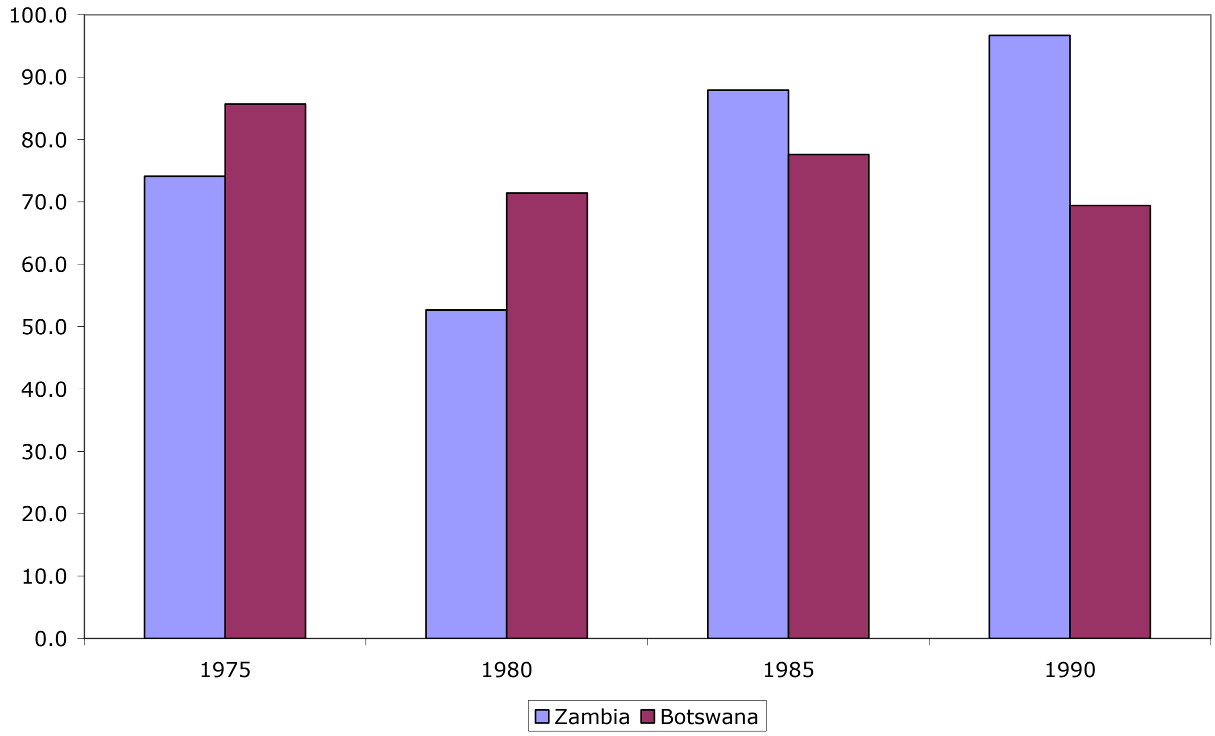
With underdeveloped financial markets, it is expected that people in Zambia and Botswana depend even more on cash as a liquid asset. In such an instance they have less flexibility to secure themselves against the erosion of the value of cash due to inflation.

When the population has access to alternative currencies it limits the power of governments and monetary authorities to mismanage their currencies. Substituting foreign exchange for domestic money balances becomes a rational response for the population when the domestic money is subjected to high and variable inflation (Hayek 1979). Consequently, the Frasier Institute scores the ability of citizens to hold foreign currency as an important composite part of economic freedom, under the rubric of sound money. This part of economic freedom was closed to Zambians for the entire period under consideration; the capital account was only liberalised in the late nineties.

Figure 35 tells the woeful story of the soundness of money in Zambia and Botswana for the period under consideration. Both on international comparison, and absolutely, Zambia experienced a decline in the Frasier Institute measure of sound money since 1980.

After an uneasy start in 1975 Botswana has improved on its score for sound money. At independence Botswana's financial sector was basic. The money in circulation was South African and Botswana initially chose to continue to use the South African monetary system. It was only in August 1976 that the new currency, the Pula, was launched (Leith 2002). In the first half of the 1980s the balance of payments surpluses was realised due to the high income from new diamond mines. This flooded the monetary system with money and increased the growth in money supply.

Figure 35: Relative index of sound money



The major reason for the erosion of economic freedom through monetary mismanagement in Zambia was the spiralling inflation of the eighties and early nineties, discussed in Chapter 2. The improvement in the score for Botswana in the late 1980s can be attributed to the freedom granted to citizens to own foreign banking accounts. Although inflation in Botswana was not at the low levels of developed countries, it was still lower than neighbouring South Africa, and significantly lower than that of Zambia.

International trade

A fourth sub-index of the economic freedom index concerns freedom to trade goods and services internationally. On an international comparison the Zambian trade regime was not particularly restrictive by the mid-1970s (Figure 36), especially with tariffs that were fairly low by international comparison at that stage (Figure 37).

However, the fiscal imperatives changed in Zambia during the course of the seventies and became especially acute during the eighties, with a drop in the income from the mining industry. It is not surprising that trade taxes would present an attractive alternative to domestic sources of government revenue under these conditions (Agénor and Montiel 1999); and that was the Zambian experience during the eighties too, as shown in the Figure 37.

As a member of the Southern African Customs Union (SACU), Botswana is not free to set its own import tariffs. Given the way in which SACU was managed during the study period, the common external tariff in fact was the South African tariff and any changes in this regard reflect changes in South African tariff policy.

Figure 36: Relative index of trade restrictions

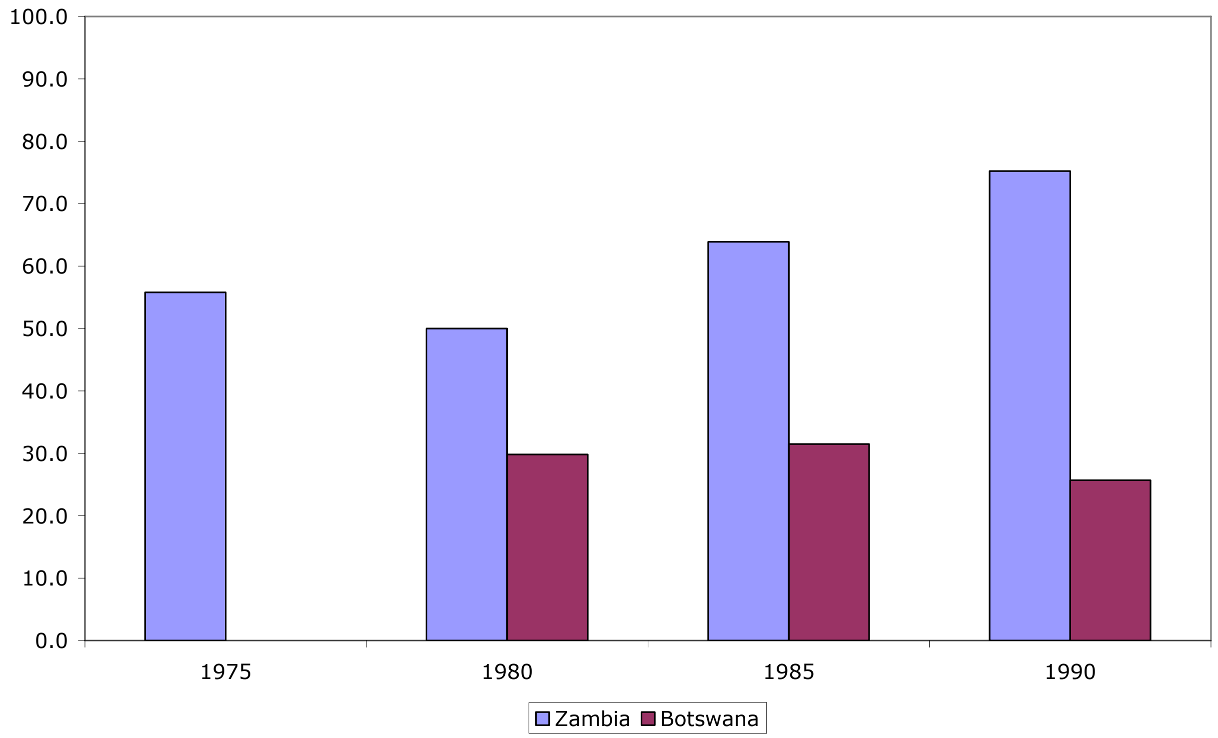
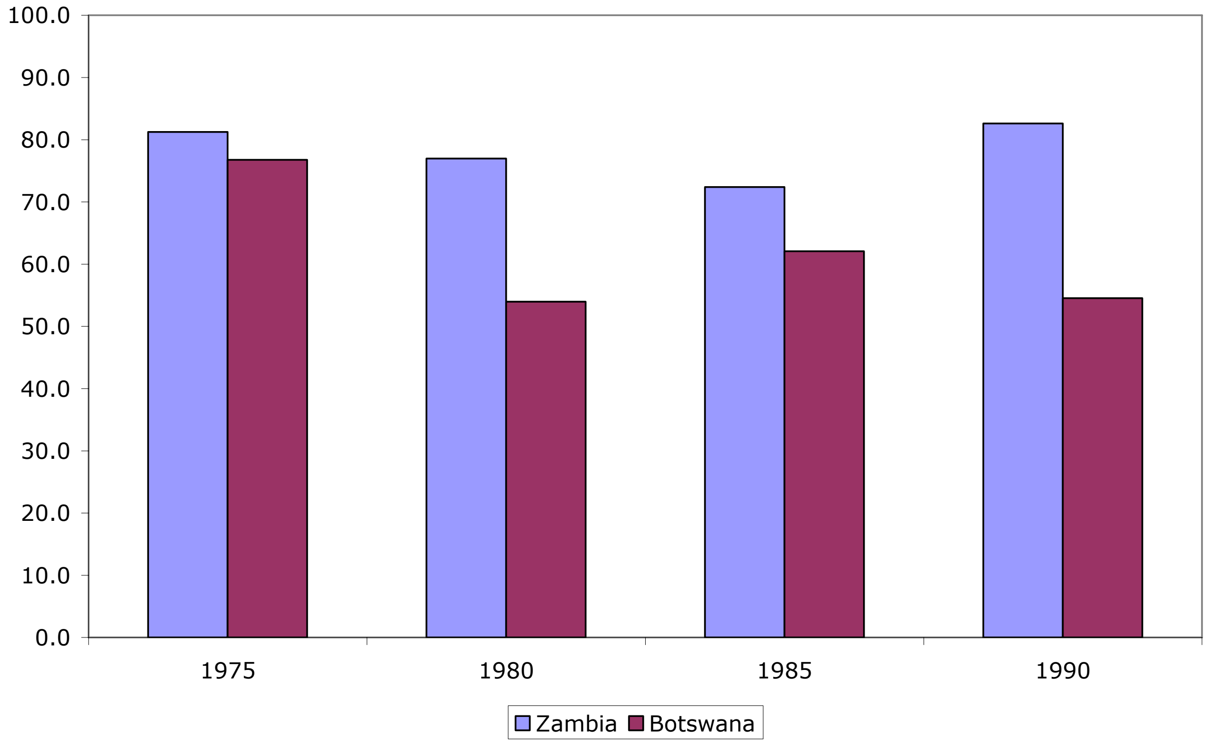


Figure 37: Relative tariff interference with foreign trade

Capital controls on international financial flows remained restrictive in Zambia and Botswana throughout the period, but this was not exceptional for developing countries at the time. Even if the countries' capital controls do not stand out as especially restrictive on an international comparison, the same cannot be said of distortions in the foreign exchange market. The figure below shows Zambia's ranking on an international comparison of black market premiums.

Figure 38: Relative black market premium



Evidently, the black market premium has been relatively higher for Zambia than for Botswana, which is consistent with the misallocation of capital as well as raising transaction costs domestically.

Regulation of business

Finally, the Frasier Institute also grades the extent to which regulations impede economic freedom in various categories, including financial market regulations. Zambian authorities have maintained fairly strict controls on the financial sector throughout the period, with the government-owned banks playing a leading role in the provision of finance. Additionally, interest rates were increasingly regulated to the extent the government's fiscal problems deepened during the eighties, thus leading to negative real interest rates. Figure 39 shows the trend in financial repression through interest rate regulations in Zambia relative to the international sample in the Frasier Institute's database. This is followed by Figure 40, depicting the combined effect of interest rate regulations and bank ownership on the freedom of credit allocation.

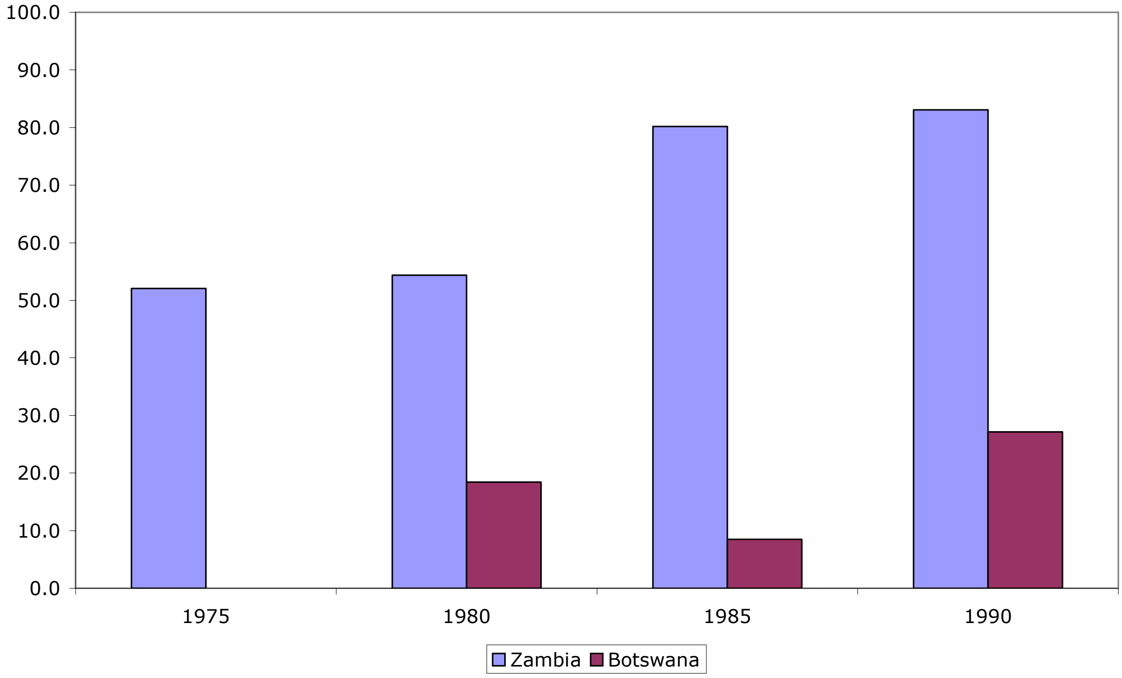
Figure 39: Relative interest rate regulations

Figure 40: Relative restrictions on the allocation of credit

When the Botswana government left the Rand Monetary System its strategy was to regulate interest rates. For several years rates were changed in response to changing circumstances. The substantial balance of payments surpluses in the first half of the 1980s caused regulation to be even more of a problem. Although the regulated commercial bank lending rates were very low in real terms, the banks faced a limited demand for credit that was not expanding nearly fast enough to match the growing deposits. Commercial banks went so far as to refuse interest-bearing deposits, and frequently required depositors to hold some portion of their funds in non-interest bearing current accounts (Leith 2002).

Figure 41 depicts business freedom for Botswana and Zambia. Financial market and other business regulations in Zambia had a restrictive effect, while Botswana exerted relatively low interference.

Figure 41: Relative business restrictions[39]



In summary, regulations in the Zambian economy were of average intensity on an international comparison during the mid seventies, but increased during the eighties in absolute terms (on the Frasier Institute measure) and on international comparison. Botswana, on the other hand has done very well throughout the 1980s. The underdevelopment of the Botswana financial sector remains a disturbing factor.

[39] Included are Ownership of banks, extension of credit, interest rate regulation, credit market regulation, labour force share with wages set by centralized collective bargaining, unemployment insurance, labour market regulation.

5.4 THE POLITY IV DATASET

Whereas the Frasier Institute quantifies various aspects of formal economic institutions, Marshall and Jaggers's (2002) Polity IV dataset does the same on an annual basis for various political institutions in a large cross section of countries. Zambia has been included since 1964 and Botswana since 1966. The measure shows the degree of democracy and autocracy in the country and is built on a range of sub-components that quantify various aspects of the political institutions.

Democracy and autocracy

Version IV of the Polity dataset estimates both the degree of democracy and autocracy in a society and then combines them in an overall Polity score ranging from +10 for full democracy to –10 for full autocracy.

The democracy score is a weighted average of the following dimensions of the political landscape: formal institutions for electing alternative political leaders, formal constraints on the power of the executive, and guarantees of civil liberties to all citizens. Marshall and Jaggers (2002: 14) offer the following definition of a mature democracy: "…[a country] in which (a) political participation is fully competitive, (b) executive recruitment is elective, and (c) constraints on the chief executive are substantial".

Figure 42: Evolution of democracy in Zambia

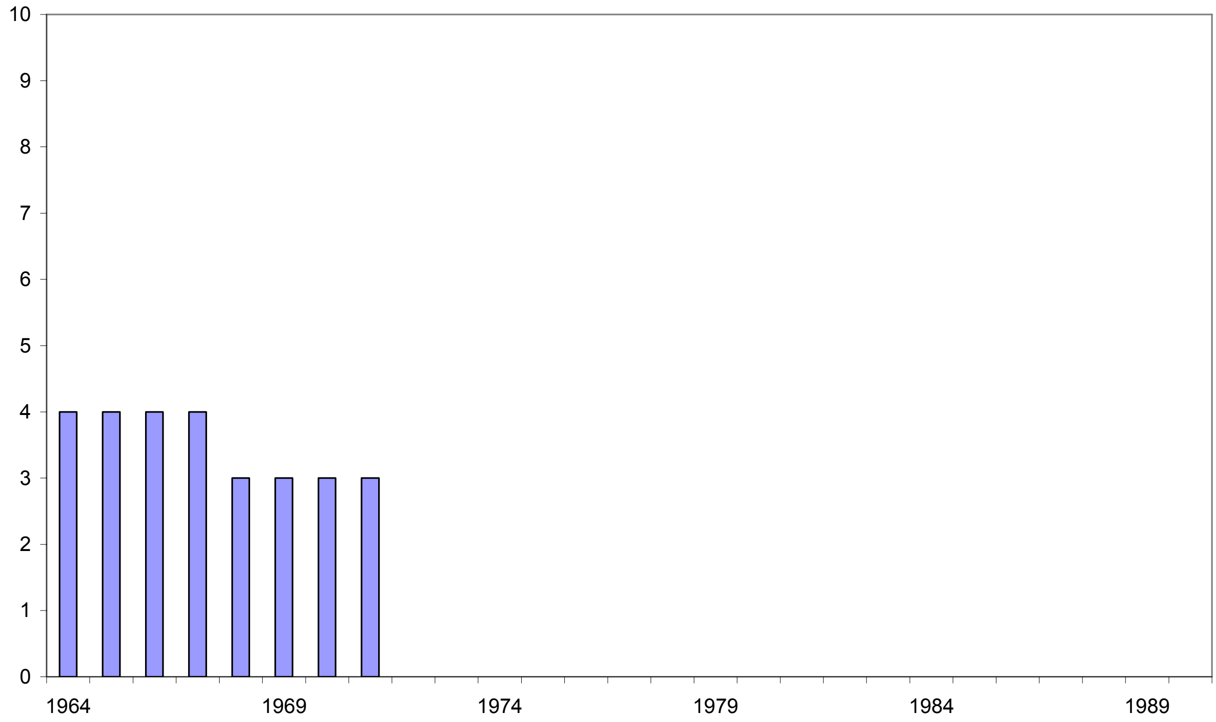
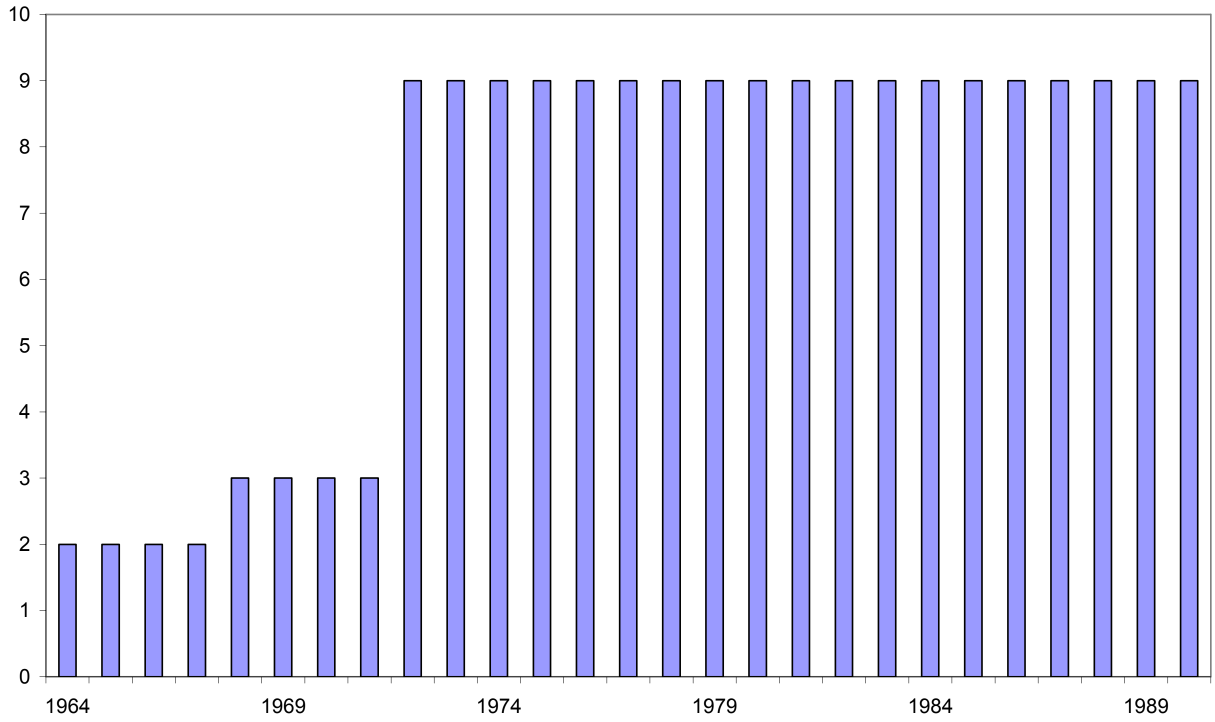


Figure 42 shows the Polity IV measure of democracy in Zambia since 1964. The modest degree of democracy in Zambia at independence was undermined in 1968 and fatally compromised by the Second Republic in 1972. Democracy only returned with the Third Republic in 1991.

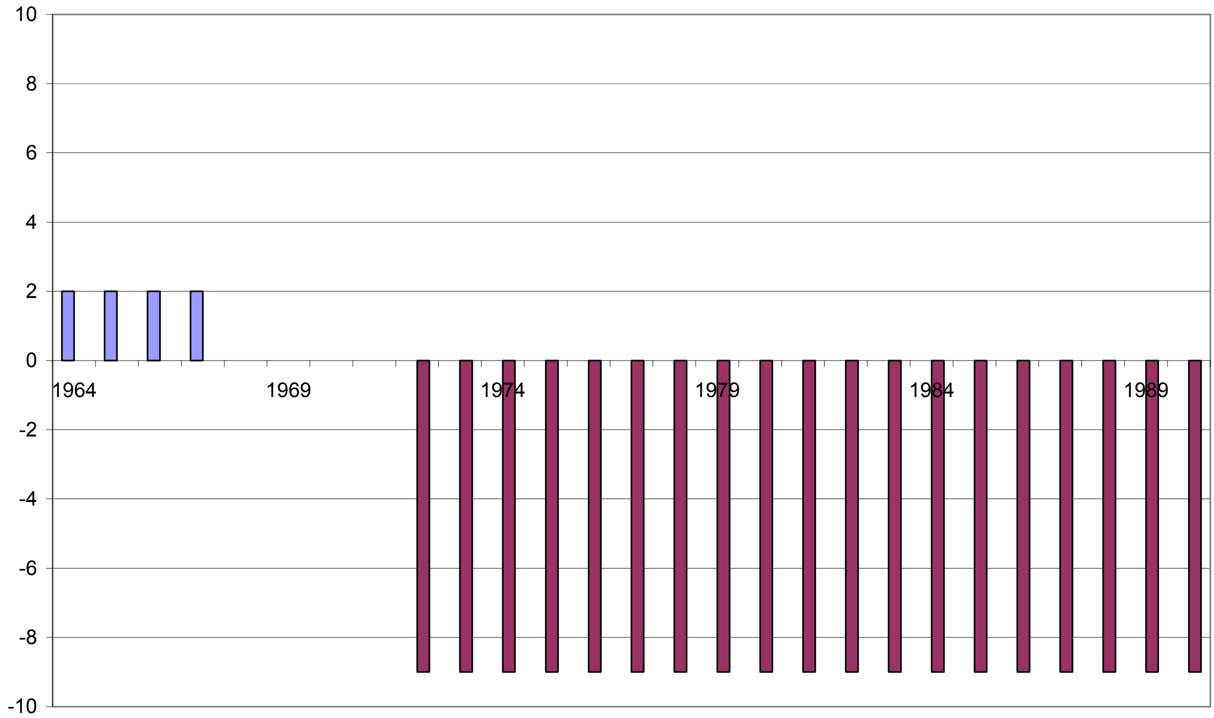
Polity IV's autocracy score is also a range variable measuring institutionalised autocracy. The underlying conception of institutionalised autocracy is a regime which "sharply restrict or suppress competitive political participation" (Marshall and Jaggers 2002: 14). There are also few institutionalised constraints on the exercise of executive power. The degree to which the state directs economic and social activity – "directiveness" in the terminology of Marshall and Jaggers (2002) - is not directly included in this measure. Figure 43 traces the evolution of the autocracy index in Zambia since the sixties.

Figure 43: Evolution of autocracy in Zambia



The figure shows the stepwise move to an extremely authoritarian political structure by the early seventies and which was maintained for almost two decades. This history of autocracy is combined with the democracy score in Figure 44 to give the overall Polity score for Zambia.

Figure 44: Overall polity index for Zambia



For Botswana the dataset tells a very different story (see Figure 45 and Figure 46). Botswana has been a democracy since independence and has improved on its score during the time considered. This is interesting since Botswana effectively operates as a one-party state. But without any repression of other political parties, Botswana scores a 0 for autocracy throughout the period, thus producing an overall polity index that resembles the democracy index. The issue of democracy and autocracy in Botswana and Zambia will be taken further in Chapter 8.

Figure 45: Evolution of democracy in Botswana

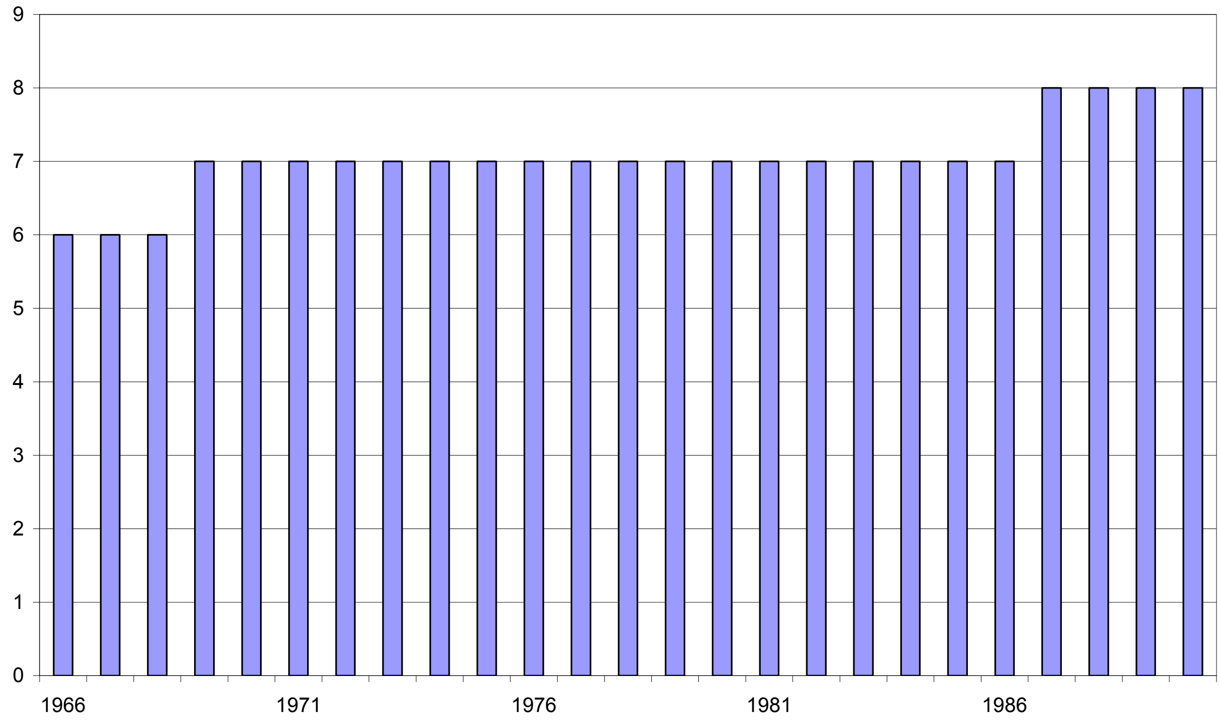
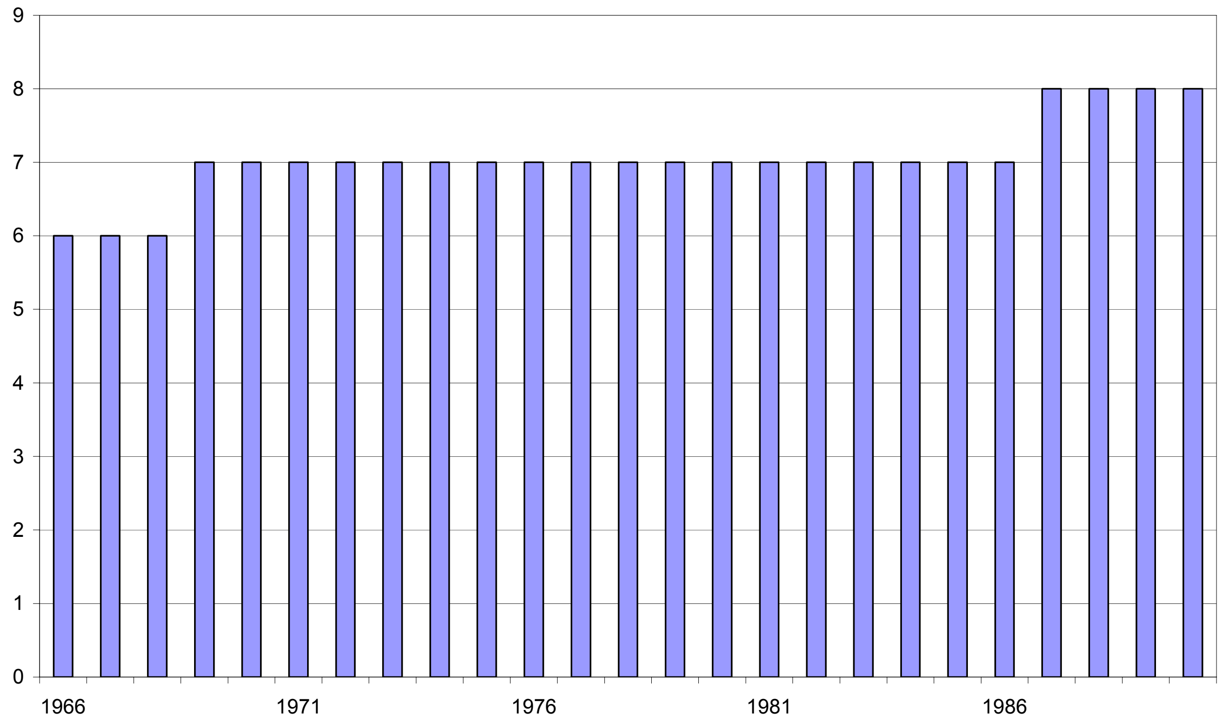


Figure 46: Overall polity index for Botswana

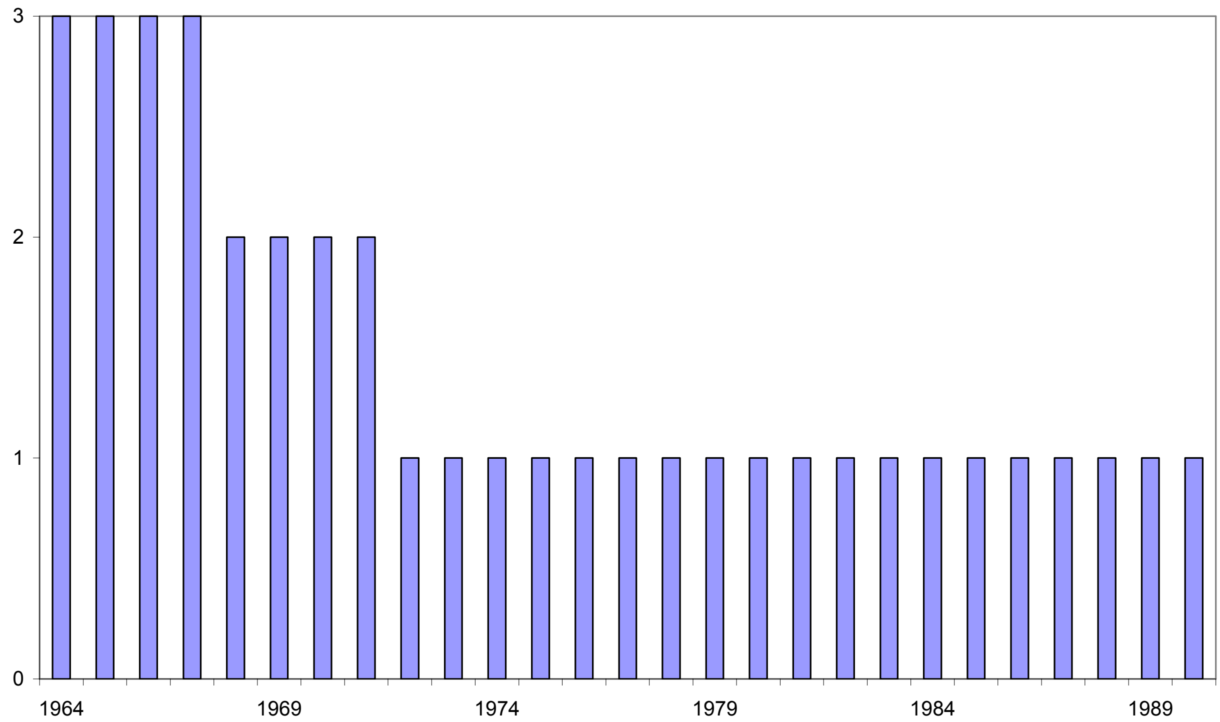


The sub-components of the polity score are analysed in the following few paragraphs.

Competitiveness of executive recruitment

Marshall and Jaggers (2002) score the process of selecting the executive office bearers[40] (called XRCOMP) on a scale of 1 to 3, where 1 means "selection", 2 means "dual or transitional" and 3 "election". Zambia's record is shown in the following graph.

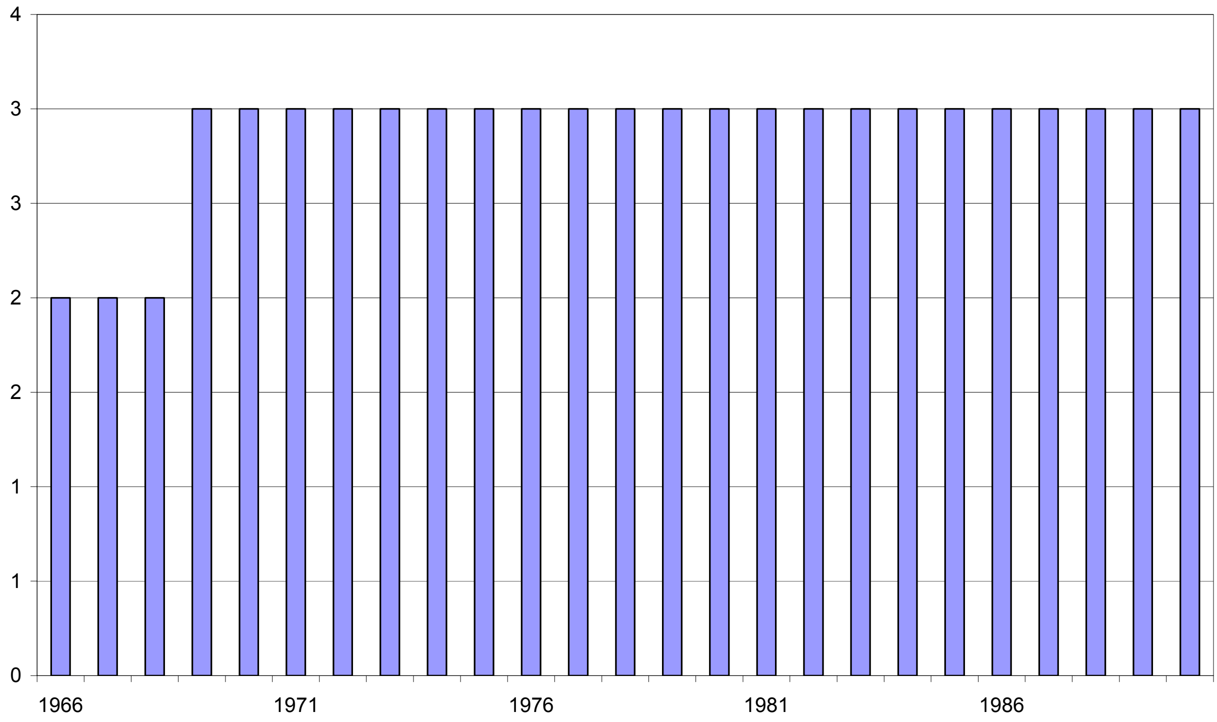
Figure 47: Competitiveness of executive recruitment in Zambia



In 1968 and again in 1972 the recruitment of executive office holders in Zambia become less competitive, leaving Zambia with a long period of little competition for executive power. After Botswana's transitional period, it scored a 3 throughout the period.

[40] XRCOMP measures the extent to which executives are chosen through competitive elections.

Figure 48: Competitiveness of executive recruitment in Botswana



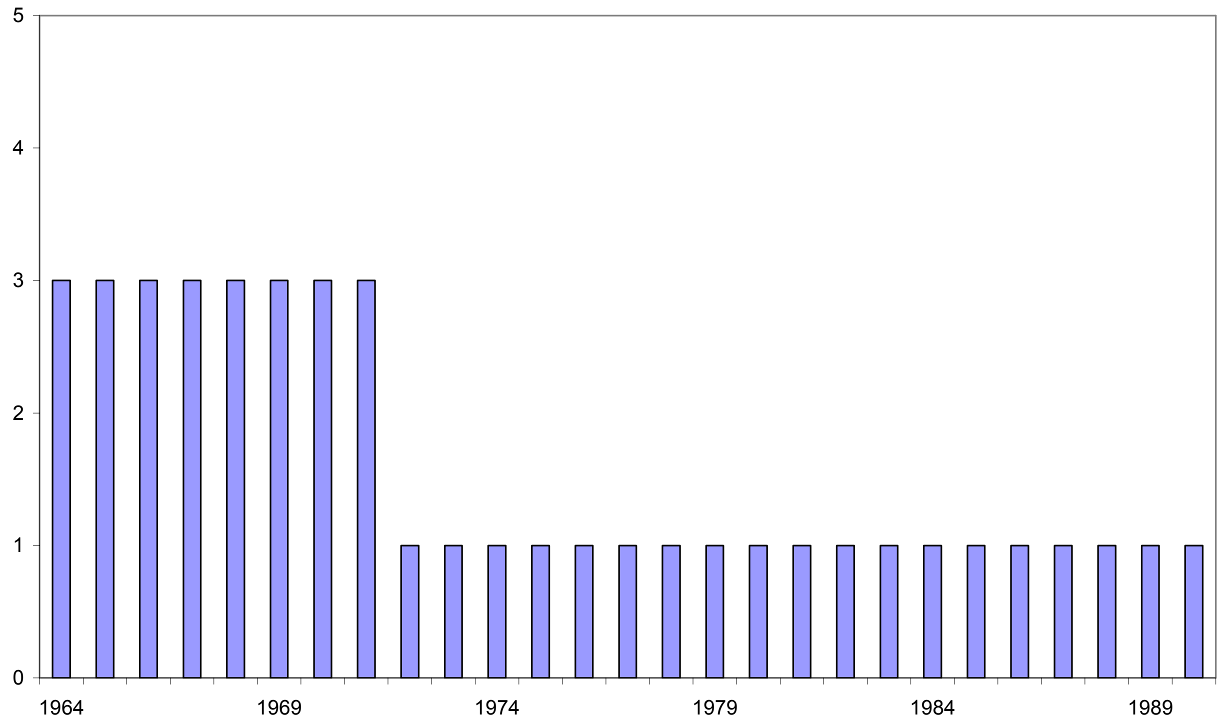
Competitiveness of participation

A second aspect of competitive politics involves the extent to which policy and leadership is open to competitive challenge in the country. Marshall and Jaggers (2002) use a 5-point scale for the degree of competitiveness in policy and leadership (called PARCOMP), where the various grades are defined as below (Marshall and Jaggers 2002: 25-26):

1. Repressed: "No significant oppositional activity is permitted outside the ranks of the ruling party"
2. Suppressed: "Some organised, political competition occurs outside government, without serious factionalism; but the regime systematically and sharply limits its form, extent, or both in ways that exclude substantial groups … from participation"
3. Factional: "Politics with parochial or ethnic based political factions that regularly compete for political influence in order to promote particularist agendas and favour group members to the detriment of common, secular, or cross-cutting agendas"
4. Transitional step
5. Competitive: "…relatively stable and enduring, secular political groups which regularly compete for political influence at the national level…"

Zambia's score on the PARCOMP variable is traced in Figure 49:

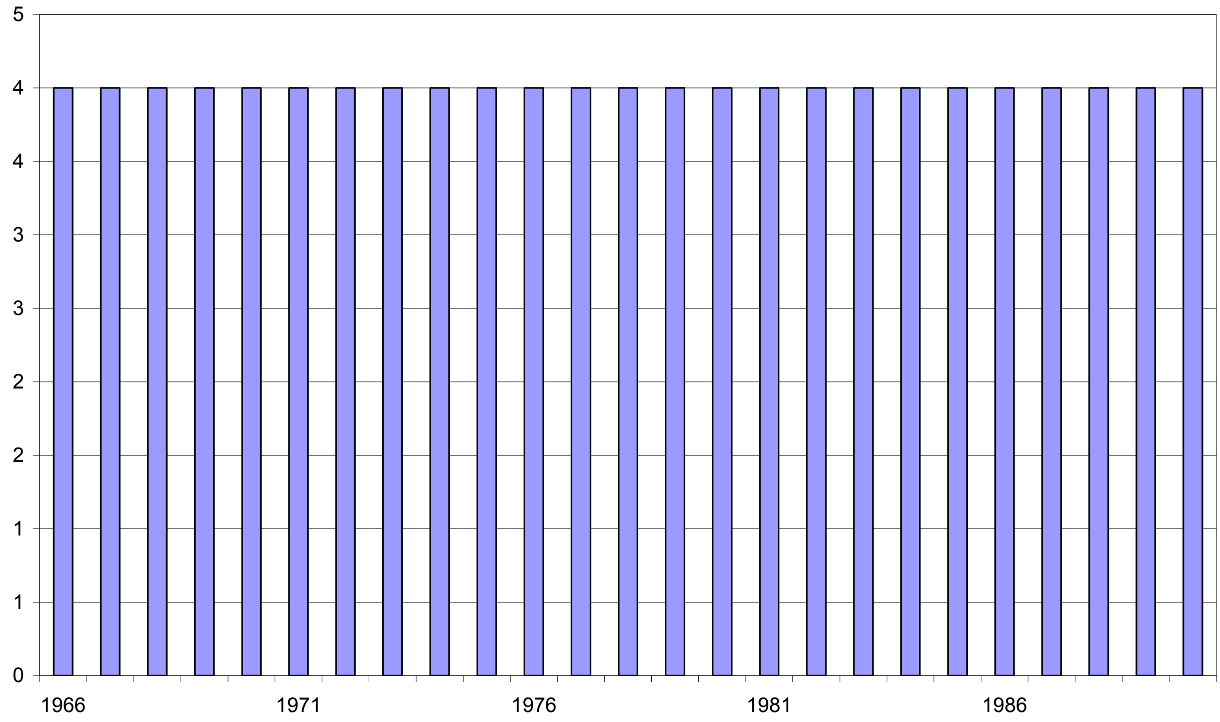
Figure 49: Competition for policy and leadership in Zambia



Even at its most liberal, political competition in Zambia was factional on the Marshall and Jaggers (2002) score. During the Second Republic even that level of competition was absent, with competition for policy and leadership completely suppressed from 1972 to 1991.

Botswana throughout has a "transitional" score, as is shown in Figure 50. A reason for this is probably the lack of well-organised opposition parties, although there are no formal constraints on their development.

Figure 50: Competition for policy and leadership in Botswana



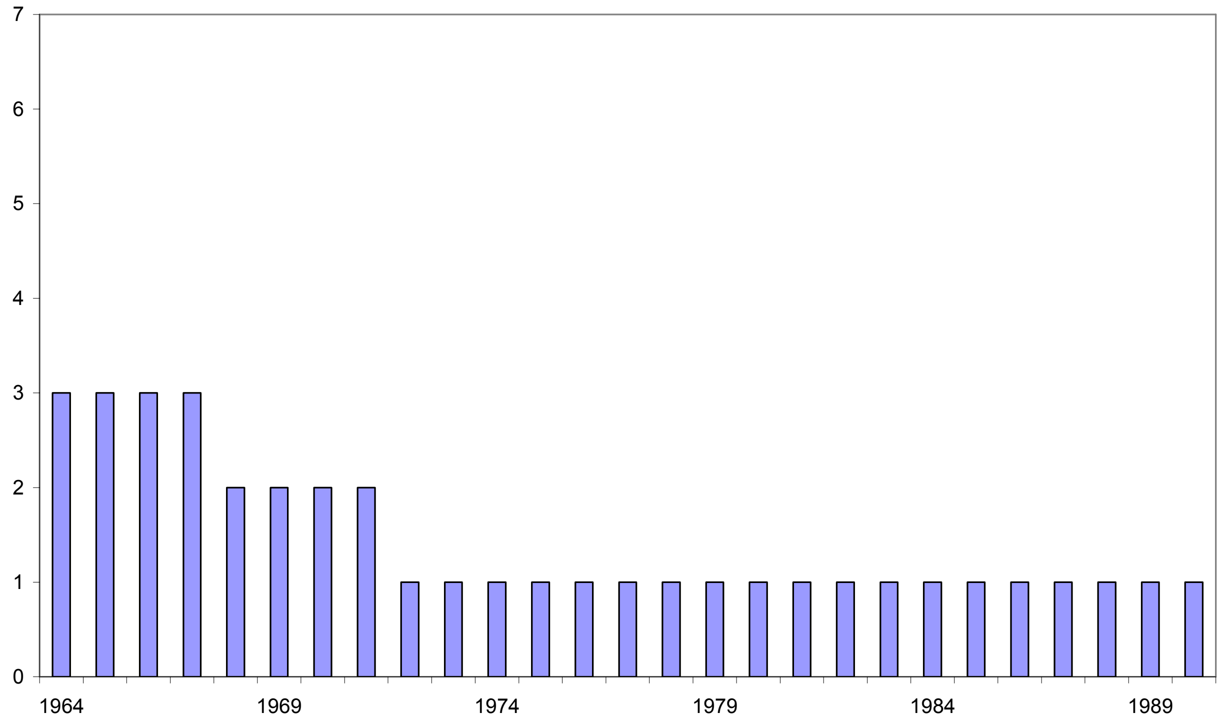
Executive constraints

Marshall and Jaggers (2002) define a measure of executive constraints (called XCONST) which quantifies the extent to which executive decisions are constrained by formal decision rules. This variable has a range from 1 to 7, with the following interpretation (Marshall and Jaggers 2002: 23-24):

1. Unlimited authority: "there are no limitations on the executive's actions"
2. Intermediate category
3. Slight to moderate limitation on executive authority: "there are some real but limited restraints on the executive"
4. Intermediate category
5. Substantial limitations on executive authority: "the executive has more effective authority than any accountability group but is subject to substantial constraints by them"
6. Intermediate category
7. Executive parity or subordination: "accountability groups have effective authority equal to or greater than the executive in most areas of activity"

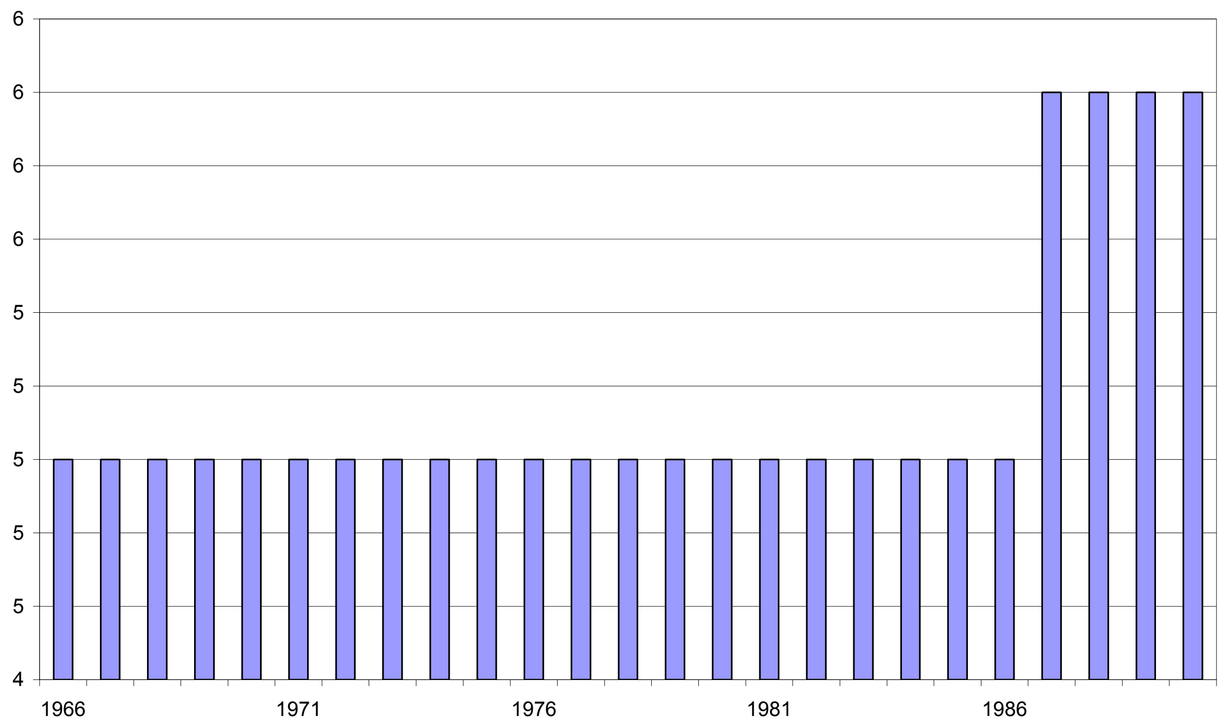
Figure 51 below tracks the XCONST variable for Zambia since the sixties.

Figure 51: Constraints on the executive in Zambia



There is a clear correlation between formal constraints on the executive and competition for the executive, for policy and for political leadership in Zambia. The erosion of formal constraints on the executive was associated with a decline in competitive politics. In Chapter 3 it is suggested that the few constraints on the Zambian government resulted in spending on politically popular projects, such as spending on public employment, and not on projects that would have benefited the majority of the population.

Figure 52: Constraints on the executives in Botswana



Botswana, as shown in Figure 52, started out with substantial limitations on the executive authority, and this increased over time. The existence of constraints paved the way for more competition for policy formulation and leadership. One constraint on the Botswana government discussed in Chapter 3 is the National Development Plans and how they could not be changed without referring them again to Parliament. With the acceptance of and adherence to such constraints, the Botswana government was able to create a stable economy and overcome one of the temptations present in a mineral rich economy: that is, to spend the mineral rent too easily and creating the situation where future recurrent expenditures have to be financed from a different source.

5.5 OBJECTIVE MEASURES OF PROPERTY RIGHTS

The above mentioned subjective governance indicators have attained wide usage in the growth and development literature, and are used by the World Bank and other donors and aid agencies to assess the state of governance in developing economies. One of the drawbacks of these measures is that they are subjective (Knack and Keefer 1995). In response to this drawback, Clague, Keefer, Knack and Olson (2003) have introduced an objective measure called contract-intensive money (CIM).

Contract-intensive Money (CIM)

Various subjective measures have been proposed to gauge the extent to which property rights are protected in an economy. A major objection to the indices is that the respondents may be influenced by outcomes in the economy concerned, scoring successful economies high on the protection of property rights, while scoring failing economies poorly. If this should occur systematically, the subjective indices would pre-judge one of the most important functional relationships in the measurement of property rights protection, i.e. the relationships between the protection of property rights and economic growth and development.

Clague, Keefer, Knack and Olson (2003) propose an objective measure of the security of property rights with the added merit of using widely available data dating back many decades for most countries, even for developing countries, where alternative data is sparse. The argument in Clague et al. (2003) is that the assets used as money in an economy provide a convenient window on the protection of property rights and on third party contract enforcement.

Holdings of liquid assets by firms across countries are still consistent with Keynes' theories of transaction and precautionary demand for money. The CIM-measure makes use of the information provided by the financial sector. If property rights are not adequately protected, people will tend to hold notes and coins instead of contractual money.

Currency (notes and coins outside the banking sector) is the preferred medium of exchange in countries where contract enforcement is weak and property rights are insecure. At the other extreme, in countries with very secure property rights and efficient and unbiased contract enforcement, money balances are most likely to be held in banks and in the form of other financial instruments.

There are three reasons for the a priori plausibility of using portfolios of money balances to indicate the security of property rights and contract enforcement (Clague, et al. 1999).

1. Depositors have to trust both the security of their right to their money balances, held in the bank, as well as the contract rights implied in depositing and withdrawing money. This cannot be assumed in an economy where neither contracts nor property rights are secure.

2. Financial intermediaries also depend on property and contract rights to invest their deposits profitably. The extent of intermediation is, therefore, likely to be influenced by the security of property and contract rights.

3. In regimes where government regulations and prohibitions lead to black markets and where contract enforcement may be problematic – for example in foreign currency, or credit – currency provides highly valued discretionary liquidity.

Clague et al. (1996; 1999) therefore introduced the concept of contract intensive money (CIM) which is the ratio of non-currency money to the stock of broad money, or formally:

$$\text{CIM} = \frac{M_2 - C}{M_2}$$

where:

C : currency outside banks (line 14a in the IFS[41])

M_2: Broad money, defined as: currency outside banks, plus demand deposits (IFS Line 24), plus time deposits (IFS line 15), plus time and savings deposits including foreign currency deposits of residents other than the central bank (Ifs line 25).

A higher relative value of the CIM indicates more secure property rights and contract enforcement. Further, a rise or fall in the CIM at all levels indicates a rise or decline in the relative security of these rights.

Pinkowitz, Stulz and Williamson (2003) supported the findings of Clague et.al. Pinkowitz, et. al. found that firms in countries with more risk and poor protection of investor rights hold more cash. Entrepreneurs there do not use the formal banking sector to protect the value of their money[42].

Furthermore, Acemoglu, Johnson, Robinson and Thaicharoen (2002) show that countries with weaker institutions are indeed less stable. In these less stable countries,

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[41] International Financial Statistics

[42] Pinkowitz, Stulz and Williamson (2003) used a sample of 35 countries over a period of 12 years, and found that firms in countries with poorer institutions hold more liquid assets than they would have if they were located in the U.S. For instance "in a cross-country regression that controls for GDP per capita, financial development, stock return volatility, and inflation, a firm in a country with the worst institutions has from 5 percent to 25 percent more liquid asset holdings in proportion to total assets than a U.S. firm depending on the index of institution quality used" (Pinkowitz, et al. 2003).

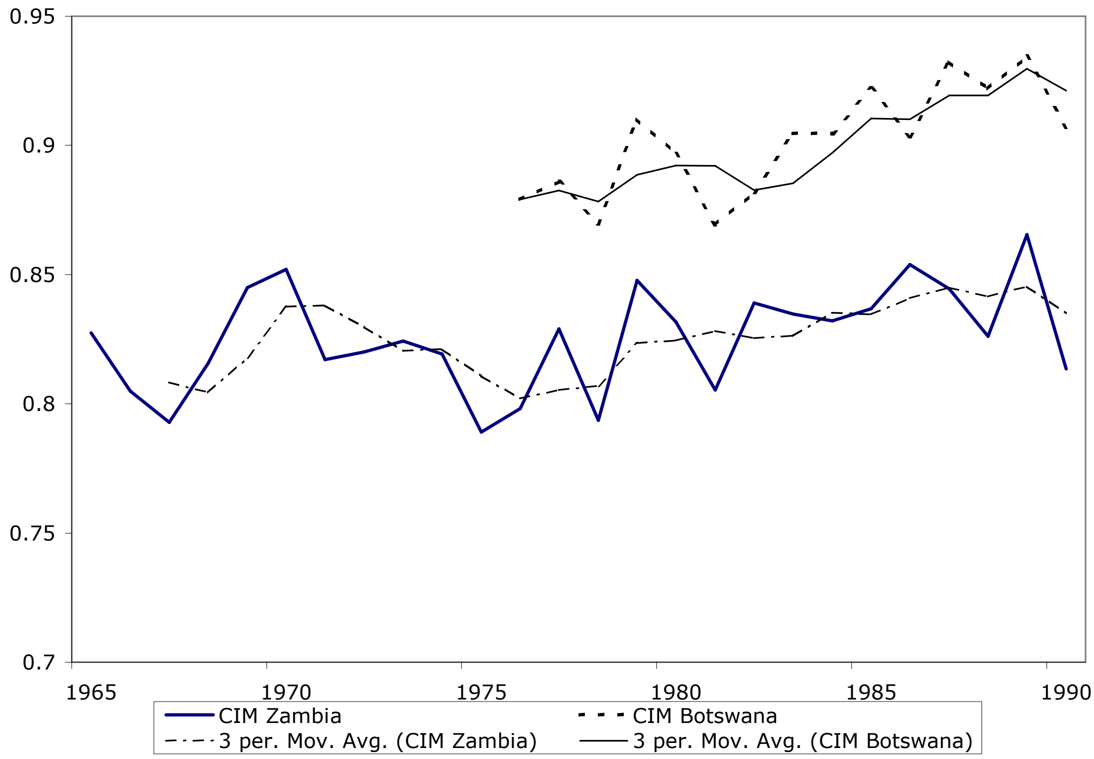
firms are more likely to face disruptions that call for the use of liquid assets. A breakdown in law and order and political intrusion are examples of disruptions for which firms might need extra liquid reserves. Firms in such countries have to be more liquid than comparable firms in more stable countries with better institutions. This is in accordance with Keynes' theory that firms can hold cash to reduce transaction costs and to provide a buffer to absorb adverse shocks.

Since Clague et al. (2003) proposed CIM as a measure of contract and property rights – and not as a measure of financial sector development - it is important to investigate the extent to which their results were driven by the level of financial sector development, inflation, or savings rates. Clague et al. (2003) addressed this issue themselves and found CIM not to be a measure of financial sector development.

One piece of evidence they put forward is the significant correlation they found between CIM and subjective measures of institutional quality. Secondly, support comes from their country studies. Clague et al. (2003) traced the impact of well-known political and economic events on the CIM in Iran, Turkey, Chile, Grenada, Indonesia and Brazil to verify the plausibility of the measure. They show how CIM tracks dramatic political developments that had little to do with the financial sector. And finally they followed this episodic investigation with more formal econometric tests to show that CIM was correlated with other widely used measures of good institutions and good governance and that CIM was positively associated with growth and investment.

The CIM for Zambia and Botswana is plotted in Figure 53. It shows, for example, a decline in Zambia's CIM in the beginning of the 1970s. The fall was probably due to the political events of nationalisation and the move to one-party rule, rather than a decline in financial sector development.

Figure 53: CIM for Botswana and Zambia



Source: International Financial Statistics (IMF various years-a)

From Figure 53 it can be concluded that the economy in Botswana has operated with more secure property and contract rights than Zambia over the sample period. Further, the security of property rights as measured by the CIM was undermined in Zambia during the seventies, and again during the late eighties.

5.6 CONCLUSION

The chapter ends a process that started in Chapter 3, i.e. the search for a plausible explanation for growth differences. With none of the theories mentioned in Chapter 3 able to explain growth differences between Botswana and Zambia, in a consistent manner, Chapter 4 introduced New Institutional theory. In chapter 5 empirical institutional measures displays consistently how Botswana outperformed Zambia.

The Frasier Institute measure, which depicts economic freedom, shows the Botswana economy to be much freer, relative to the Zambian economy. This is especially obvious in the index for property rights protection. And if it is kept in mind how important this measure is within institutional quality, it consequently tells an even more important story. Although the Botswana government interferes, relative to other countries in the measure, quite extensively in the economy, it somehow creates an environment where businesses and international investors feel their investments to be safe. The figures also show a relatively low score on business restrictions.

Zambia has not done the same, with much more government interference and infringement on property rights.

Another important distinction between the countries that is evident from the empirical results, is the difference in government structure. Although Botswana operates basically as a one-party state, it still creates an environment that resembles a true democracy (e.g. competition for polity and leadership receives a high score). Zambia displays a political environment of autocracy and with very little competition allowed for leadership in the country.

It can therefore be deduced that institutional differences have explanatory power for growth differences between Zambia and Botswana. But, the origin and type of institutions need further investigation. And the all-important question is why Zambia was unable to change the growth-retarding institutions it inherited at independence.

Chapters 7 and 8 focus on the institutional policy decisions since independence, but it would be unfair not to take the different colonial histories into account. It is necessary to establish to what extent colonialism can be held responsible for the divergent institutional decisions.

CHAPTER 6
BOTSWANA AND ZAMBIA BEFORE INDEPENDENCE

6.1 INTRODUCTION

The economic picture sketched so far of Zambia and Botswana since independence shows a prospering Botswana and a stagnating Zambia. This was however not the case at the time of independence. At independence Zambia was in a much better position than Botswana to develop economically. For example, it was only in 1970 that Botswana passed Zambia in terms of per capita growth. This, of course, leaves an interesting question to explore. Not only is there evidence of divergent economic performances, but this divergence also started shortly after independence. Was it coincidence or not?

Was this divergence solely due to post-independence policy choices? Or how much can be attributed to these countries' different colonial experiences? The empirical work done on the link between colonial experience and post-colonial economic performance was mentioned in Chapter 4. Empirical work done by Acemoglu and co-authors (see for instance Acemoglu and Johnson 2003, Acemoglu, et al. 2001) has confirmed the existence of a link between a country's past colonial experience and its current level of economic development. The colonial experience of Zambia and Botswana can therefore not be ignored in an explanation of their growth differences.

The most obvious difference between Zambia and Botswana in terms of colonisation – and one linked to their mineral wealth — is the time of discovery of their mineral wealth. At the time of Botswana's independence, the rich diamond deposits were unknown to Britain, which left Britain's interest in Botswana during colonial times at nothing more than the strategic occupation of an area en route to the central parts of Africa. Since the territory had no obvious economic benefit to Britain during occupancy, it was subject to so-called "benign neglect" (Acemoglu, et al. 2003a, Dale 1995). Britain had no intention to develop the area and rather wanted to hand administration to South Africa. The first time that mining concessions were negotiated it was between big mining companies and an elected government representing the Botswana population.

This stands in contrast with Zambia where copper had been extracted on a large scale since the 1920s. Even as early as the end of the 19th century, mining companies had been present in the country. The extraction took place without taking the property rights of the local population into consideration, and therefore Zambia experienced so-called "extractive colonisation" (Acemoglu, et al. 2001). At independence the economic strength in Zambia was in the hands of foreigners.

The purpose of this chapter is therefore to provide an overview of the history of the two countries prior to and during British rule (in Sections 6.2, 6.3 and 6.4). Section 6.5 concludes the chapter.

6.2 BACKGROUND TO THE TRIBAL SYSTEMS IN BOTSWANA AND ZAMBIA

The known history of Botswana goes back to the first millennium when a Khoisan population was present in the region, known as Botswana today. When the Europeans entered the region in the late 18th century, tribes called the "Batswana" were the principal inhabitants. The English called the indigenous population Bechuana, and therefore Botswana was formerly known as Bechuanaland. The Batswana forms one of the three major divisions of the Sotho group of Bantu peoples, and it is commonly accepted that they migrated to southern Africa at the time of the Bantu migrations from the north several centuries ago (Colclough and McCarthy 1980).

There are eight principal tribal groups in Botswana, seven of which are direct descendents of the original Sotho migrants. The Ngwato is by far the largest and makes up about 80 percent of the Batswana. In addition to the eight major tribes, a large number of smaller and related or subjected tribes have lived amongst them in the reserves and under the authority of the Tswana chiefs (Colclough and McCarthy 1980).

The homogeneity of the Batswana was to their advantage when they had to deal with the British. A handful of chiefs could negotiate with the British while representing the whole of Botswana. From these chiefs the Ngwato chiefs not only represented the biggest section of the population, but they were also the most influential throughout the history of the territory.

The tribal situation in Botswana contrasts sharply with that in Zambia where a multitude of tribes each have their own separate history. Present day Zambia consists of seventy-two separate ethnic groups living in nine provinces. They speak a multitude of languages and dialects, but the major ethno-linguistic groups are:

- the Bemba (36.2 percent),
- Nyanja (17.6 percent),
- Tonga (15.1 percent),

- Barotse (8.2 percent) and
- the north-western group (10 percent), which includes the Kaonde, Lunda and Luvale speakers.

Before the Europeans drew a border defining the present-day Zambia, the nation's ethnic groups lived in relative isolation from one another for almost four centuries. The groups had no common language and were organised politically different from one group to another. Some chiefs were major political actors and ruled large kingdoms, while other chiefs were minor officials, little more than village headmen. According to Colson (1959), the Tonga, for example, had no chiefs or other forms of authority before colonial rule started.

Although these groups lived in close proximity to one another, there was no distinctive binding force. And for Burdette (1988: 11) it was this "lack of a common political and social history and shared institutions" that eventually rendered these groups vulnerable to the European invasion. Unlike the case in Botswana the multiple groups in Zambia were unable to create a binding force that was strong enough to withstand the British influence.

Even though the groups in Zambia differed from one another, there is a need to contrast the political set-up in Zambia before colonisation with the situation in Botswana. As a detailed discussion of the politics and authority present in all the different tribes in Zambia at the time before colonisation falls outside the scope of this dissertation, the focus will fall primarily on the Bemba. There are two reasons for this choice: The Bemba represents the largest single group of people in Zambia, and it is also the group in which the first President of Zambia, Kenneth Kaunda, grew up[43].

Between 1500 and 1800 the Lunda and Luba peoples of Congolese origin settled in the northern, eastern, and western parts of Zambia under the leadership of Kazembe. By the end of the eighteenth century they came in direct contact with the people that is today known as the Bemba. With the two groups specialising in different economic activities, they were able to trade their surpluses. The Lunda and Luba mined and smelted copper and iron ore to make ingots for sale to other tribes or traders, while the Bemba not only traded salt and ivory, but were even more renowned as slave traders (Burdette 1988). At first these groups were able to live in harmony, but eventually the competition between them brought them into conflict. Wars between them contributed to the devastating effects of the slave

[43] Kaunda's parents originally came from Malawi, but they lived amongst the Bemba.

trade[44], and by 1870 Kazembe's kingdom was in serious decline, with the Bemba retaining much of its power (Burdette 1988).

The manner in which the political structures developed in pre-colonial Zambia and Botswana had much to do with their location. The Bemba's of Zambia lived in a well-watered area, where the ample amount of rainfall made it possible for them to survive in spite of the generally poor soil. They were self-sufficient, subsistence farmers who grew their own food, but because of the poverty of the soil they had to move their villages to new locations every few years (Maday accessed July 2004). No large villages developed and because it was always easy to move to another location, there was no necessity for a political culture of cooperation to develop.

In contrast, the Batswana lived in large villages from the time of their earliest settlements. They had to deal with regular droughts and depended on surface water (Colclough and McCarthy 1980). Large villages developed around waterholes and because it was not that easy to move to a new location, they had to find ways to solve differences and settle disputes in a peaceful manner. As will be shown below, these tribal capitals were the centres of political and social life of the tribe, and the place where all the important gatherings were held. This tradition of having gatherings that included all men above a certain age, was not present in the Bemba culture.

Both the Tswana and Bemba political systems can in essence be described as a centralised state where a royal family controls the chiefdoms. In the literature (Simon 1970, Whiteley 1951) the Bemba Paramount Chief is described as a person who commands the army, has supreme control of supernatural powers, possesses the most sacred of the tribal relics and who has the right of appointment to lesser chiefdoms. The bases of his political power and authority are both supernatural and secular.

According to Simon (1970:12) "a chief's power to curse, bless, employ forces, etc. is respected (and feared) by his subjects; his authority as an institutionalised leader of both territorial and kinship groupings is acknowledged and accepted. The acquisition of this 'respect', 'acknowledgement', 'acceptance', etc. constitutes the process of legitimation for a particular Bemba chief, and that legitimacy is not attributed automatically through matrilineal succession to political office". An individual's heredity determined his eligibility for a legitimate position of authority, but among other things he also needed the support of a sufficient number of commoners, military power and slaves.

[44] Throughout the 1800s the peoples of the region fell prey to raiders and slavers – the Arabs and Swahili from present-day Tanzania and Malawi, and the allies of the Portuguese on the coasts.

The Tswana succession was, in a way, more natural with the oldest son of the king succeeding him after his death. These successions happened within very strong family lines, where for instance one of the great chiefs, Khama III (1837-1923) attained world-wide prominence as a "zealous convert to Christianity, a fanatical prohibitionist of alcoholic liquor, and a strong supporter of British imperialism in central Southern Africa" (Schapera 1940: 56)[45]. These chiefs were the wealthiest people in the tribes, owning most of the cattle[46].

This differs from the Bemba chiefs who did not posses inheritable wealth. Accumulation of material wealth was not regarded as an indication of prestige or power amongst the Bemba. According to Simon (1970) the chief's status depended to a large extent upon how much control he had over his subjects' means of survival. Maday (accessed July 2004) describes how this situation can be a possible explanation for the absence of prominent families in the Bemba culture. No family was able to distinguish itself from the others through the accumulation of personal wealth. And the chief had no certainty that his son would become the next chief and therefore had little incentive to gather belongings beyond his basic needs for survival. After his death all his belongings could become the possession of the new, possibly unrelated, chief.

For the Batswana the identifiable strong chiefs were a great advantage. When faced with a common external threat (for example the possible handing over to South Africa) it was possible for these leaders to unite in their opposition. This gave them a much stronger basis to negotiate from. For the peoples of Zambia this was not possible. With the Bemba chiefs renowned primarily for being efficient slave traders, it did not create a basis for cooperation between the many tribes of Zambia. Furthermore, as will be discussed in section 6.3 in more detail, because they lived in small, scattered groups, most people were unaware of the arrival of the British colonialists before the process was already in an advanced state. The Bembas and the rest of the Zambian tribes were unable to work together to resist the British influence in their country.

The administrative structure of the Batswana society revolved around the chief, his councillors, the headmen, and the subjects. In theory the responsibility for the lives of his subjects rested with the chief, but in practice he depended heavily on his councillors and

[45] It was also Khama III, together with chiefs Bathoen and Sebele, who travelled to Britain in 1895 to convince the Queen not to hand over Bechuanaland to South Africa.

[46] Although no Batswana had private rights to game or other natural resources, the personal accumulation of cattle was unrestricted (Colclough and McCarthy 1980).

headmen. According to Mgadla (1998) the chief could be influenced by his headmen to alter his decisions, although it was in his power to make the final decision.

At the centre of the chief's administration was the traditional assembly or *kgotla* where national issues were discussed and debated and laws and resolutions were passed. According to Mgadla (1998: 4-5) "the *kgotla* was a public forum for the Batswana leaders and their subjects to announce laws and discuss matters affecting the village, and more importantly, the participants had the opportunity to air their views. This exercise could probably be regarded as some form of participatory democracy, in that an atmosphere existed where the people could exchange their views and could influence final decisions". Schapera (1940: 72) describes it as follows:

> all matters of tribal policy were dealt with finally before a general assembly of the adult men in the chief's *kgotla*. On important occasions the people of the districts are also summoned, and the tribe as a whole debates the question at issue. The decisions made are generally the same as those previously reached by the chief and his personal advisers, who as leaders of the tribe can sway public opinion; but it is not unknown for the tribal assembly to overrule the wishes of the chief. Since anybody may speak at these meetings it enables the chief to ascertain the feelings of the people generally, and provides the latter with an opportunity of stating their grievances: the chief and his advisers may be taken severely to task, for the people are seldom afraid to speak openly and frankly.

This interactive forum made it easier for the Batswana to communicate and keep their traditions alive during the time of British rule. The Bembas did not have a similar, representative forum. The Paramount chief of the Bembas, and some of the other biggest territorial chiefs, only had to rely on the direct support of a group of hereditary officials, the so-called *bakabilo*, who combined rituals with political and judicial functions. Together with the chief these officials formed a central tribal advisory council, but without a public assembly (Schapera 1940).

Although the *bakabilo* were advisors, their main function was to perform rituals. It was, for instance, their duty to perform the special rituals when a new chief was installed, they were in charge of the ceremonies at the sacred relic shrines and acted as regents at the death or absence of the chief. They were not royal, but nor were they commoners either. They were a body of hereditary councillors drawn from the eldest non-royal lineage heads, and attached to the courts of the most prominent chiefs (Simon 1970).

The *bakabilo* derived their effectiveness from the fact that they were neither royals nor commoners. "They are hereditary officials and therefore cannot be removed at will. They are immune from the chief's anger and exert a salutary influence over him by refusing to perform the ritual functions that are necessary to the chief's state" (Schapera 1940: 109-110). Whereas the Tswanas had direct discussions between the chiefs and commoners in their *kgotla* meetings, the Bemba chiefs only became aware of the unhappiness of the tribe with their rule through the non-performance of rituals by the *bakabilo*. It will be argued below that the *bakabilo* lost most of its functions and influence during colonial rule, whereas the *kgotla* meetings survived.

The historical events preceding and during colonial rule are discussed in the following section, where after the effect of colonial rule on tribal politics is discussed.

6.3 EVENTS LEADING TO COLONISATION

Except for slave traders, the first European interest in Africa came from the London Missionary Society (LMS), which arrived at the Cape Colony in 1799. One of the LMS's most famous missionaries-turned-explorers, David Livingstone, travelled parts of southern Africa between 1854 and 1873 in search of the origin of the Nile. It was especially his shocking descriptions of the slave trade that set off a wave of missionaries coming to Africa (Burdette 1988).

British missionaries generally supported colonisation for two reasons. The LMS missionaries were British citizens and they wanted their own country to rule the area, fearing that if the Boers should colonise it, the Dutch Reformed Church would replace the LMS. The missionaries also believed that the colonised people would be powerless to resist Christianity under British rule, because "Britain could change those African customs they considered heathen" (Tlou and Campbell 1984: 133).

But the real drive towards colonisation came in the 1880s when European powers became interested in Africa as a source of natural resources. European countries such as Britain, France and Germany became rich because of the industrial revolution that had taken place earlier. The manufacturers experienced large and growing requirements for raw materials, such as cotton, rubber, iron and tea, and this created an incentive for European traders and miners to explore non-European countries, including countries in Africa (Tlou and Campbell 1984). The imposition of European rule over most of Africa can therefore be seen as the result of two distinct but converging processes: growing rivalry among the major states of Europe as they became fully industrialised powers, and their increasing need for cheap raw materials[47].

European governments in general took active steps to protect the interest of their own traders and manufacturers against those of rival countries. Governments were not only concerned about defending existing interests in Africa; they also wished to reserve for themselves areas for possible future exploitation (Roberts 1976). The anxiety to secure both present and future needs was a major reason why so much of Africa and other parts of the tropical world were shared out among European governments in the late nineteenth century, in what is now commonly known as "the scramble for Africa".

By the time the scramble for Africa was in full force, Portuguese agents hoped to link together their colonies of Mozambique and Angola through the lands of the upper Zambezi. King Leopold of Belgium, who ruled the Congo, looked southward for more territory, and the Germans established a colony in Tanganyika (now Tanzania) and in 1884 annexed South-West Africa (now Namibia). These interests of the other European powers in the central African plateau threatened British control of the southern portion of the continent.

The British intended to preserve a route for Cape and British trade to central Africa along the road that had been opened up by the missionaries Moffat and Livingston. Cecil John Rhodes described this road as the "Suez Canal" to the north and it was extensively used by labour recruiters, labourers and traders. The economic importance of the road was increased by the discovery of diamonds at Kimberley in 1867, because the British mine owners recruited labour from everywhere in Southern Africa[48]. When gold was discovered at the Witwatersrand in 1884, the road became even more important for labour recruitment (Fawcus and Tilbury 2000, Tlou and Campbell 1984). However, the British use of the road was threatened, not only by Belgium and Germany, but also by the westward expansion of white adventurers from the Transvaal.

The Boers from the Transvaal took possession of wide areas of land on which they set up the small republics of Stellaland and Goosen. These republics were in the southern

[47] According to Roberts (1976: 150): " … African political organisation was unfitted for large-scale development of land and labour at the time of colonisation. If Africa's mineral and vegetable resources were to be exploited in full, capitalists had to be persuaded to invest money in Africa. Investors would only do so if they could be reasonably sure to appropriate the returns on their investment. And even the largest states in tropical Africa seemed too small, or too loosely governed, to provide adequate security for European lives and property. The objectives of the European powers seemed therefore incompatible with African political independence".

[48] As early as the 1870s, the Batswana had sought work in Kimberley.

part of the area occupied by the Batswana. It seemed likely that the Transvaal would absorb these republics and that would have posed a barrier to British trade with central Africa. All these strategic movements brought about competition by the different European powers to secure their positions in Africa (Burdette 1988).

In order to prevent a war between the rival countries, the European powers gathered at the Berlin Conference in 1884-85 where the African countries were partitioned. At the Conference the Europeans agreed to recognise each other's territorial claims based on effective control of the coast. The process was completed by 1914 and the resulting territorial borders were largely adopted at independence. The whole African continent was conquered, with only Liberia and Ethiopia retaining their independence. Throughout the whole process little or no consideration was shown for the African people's right to their own land.

At the time of the Berlin Conference the Liberal government in Britain could not pay for the extension of British power, so the challenge was picked up by the millionaire Cecil John Rhodes (Burdette 1988). Rhodes wanted to see the British flag fly right across Africa and he wanted to extend his control over Africa's mineral resources. Through the British South Africa Company (BSAC) Rhodes staked out claims of exclusive rights over central Africa for Britain (Roberts 1976).

By the end of 1891 the BSAC had gained recognition from other European powers of its right to occupy a specified area north of the Zambezi. They secured the agreement of other European powers through a series of international treaties that largely determined the present borders of Zambia. The occupation of Zambia was, however, unknown to most of the people living in the region. The Company's first officials and soldiers had mostly gained entry by talking to a small number of chiefs. And without the advantage of living in large cities around waterholes, like the Batswana had, communication between the Zambians was difficult.

Furthermore, the intrusion of the BSAC did not, at the time, seem to be an event of great importance to the people of Zambia. Often the BSAC had been welcomed as a potential source of protection against local, African enemies. "It took time for the scattered peoples of Northern Rhodesia to realise that they were now under different rule. It was only after the British started to collect taxes that the Zambian people realised that a new authority has been established in their area" (Roberts 1976: 170).

The annexation of Bechuanaland was completely different. The establishment of a protectorate was initiated by the Batswana themselves in order for Britain to protect them against the threats of their neighbours. Britain only agreed to this when it realised the strategic importance of the area for the preservation of its influence in Southern Africa. By 1880 an informal protectorate relationship had developed between the British government in Cape Town and the various Batswana chiefs, much unlike the situation just sketched for Northern Rhodesia (the present day Zambia).

In 1884 the British declared a protectorate over the southern parts of Batswana territory (British Bechuanaland) and in 1885 over the northern territories (Bechuanaland Protectorate) (Picard 1985). In 1895 the area south of the Limpopo, British Bechuanaland, came under the rule of Rhodes' British South African Company (BSAC). In practice this meant that British Bechuanaland was ruled from the Cape Colony. It was the British government's intention that Bechuanaland would eventually join the Cape Colony, because the cost of administering the whole area promised to be considerable. The Union of South Africa Act even provided for the eventual transfer of Bechuanaland to South Africa, but the Batswana strongly opposed the transfer[49]. The South African government periodically raised the transfer issue, but it was always firmly opposed by the indigenous people. This allowed Botswana to survive as an entity and not to be split up between different countries. But because its mineral wealth was still unknown, Britain left as much as possible of the administration to the local people.

With copper already being discovered during colonial rule, Zambia was of much greater importance to Britain than just strategically. The extent of Britain's control in Zambia was therefore much more intense.

6.4 COLONIAL RULE IN BOTSWANA AND ZAMBIA

The three main periods in the formation of modern Zambia were: mining company rule from 1891-1924; Colonial Office rule from 1924-1953; and Federation from 1953-1964. Each of these periods contributed a different element to the country's development. However, mining interests dominated political and economic decisions throughout the three periods. Even after independence the large mining companies remained a major political factor not to be ignored by the new government[50].

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[49] A visit of Chiefs Bathoen, Sebele and Khama to Britain and the discrediting of the BSAC after the Jameson Raid, resulted in the Bechuanaland Protectorate, north of the Limpopo, remaining under direct Imperial British control.

[50] The nationalisation of the copper mines will be discussed in Chapter 7.

Company rule refers to the rights the BSAC of Cecil John Rhodes received from the British government that were referred to in the previous section. The BSAC gained mining rights throughout Barotseland, which became a Company protectorate in 1891. This meant that the company was administering the area in the name of the British Crown. According to Hall (1976: 34) the Church of Scotland evangelists opposed this "infiltration from the white-supremacist south" with the following words: "A Chartered Company is not a government and never can be. To be ruled by such is to be ruled for commercial ends by absentee directors and shareholders, whose real interest are only served by tangible dividends". With the benefit of hindsight these words do seem very true. The Company had no intention to develop the country other than providing the infrastructure it needed for its operations and had no long-term perspective on how the country was to develop.

At first the Company mainly used Northern Rhodesia as a corridor for removing copper from Katanga by means of a railway which were completed in 1909. But the Company was in financial trouble due to high spending on the railway and on defence against German troops from East Africa. The income from the minerals in the territory did not cover these costs, therefore the Company started to look for ways to reduce its expenditure. One such possibility was the amalgamation with Southern Rhodesia, because that would have made administration cheaper and more efficient (Roberts 1976). Unfortunately for the Company, settlers in both Rhodesias opposed amalgamation and the Company ended up by handing over control over Northern Rhodesia to the Colonial Office in 1924.

Just before the transfer took place vast deposits of copper were discovered. This coincided with a large demand for copper internationally due to the expansion of electrical and automobile industries during and after the First World War. But in the end the transfer of power proved to be advantageous to the BSAC, because it handed over most of its responsibilities, but kept most advantages. Turok (1989: 18) explains it as follows:

> In handing control to Britain the Company remained true to its character – it retained monopoly mineral rights over the territory in perpetuity. Henceforward Company royalties were to be safeguarded by British Government rule, which would also ensure the existence of a reserve army of labour for industry throughout the region.

The extraction of copper in Northern Rhodesia was for the first time a profitable operation, but with an important prerequisite: a source of cheap labour was essential. The colonial administration supported and enforced the mechanisms already established by the BSAC for this purpose. For instance the imposition of taxes forced adult males to seek wage-employment in mines owned by the Company. Furthermore, there were restrictions on land use[51] and limits on the scope for earning cash outside of wage employment.

In a short time a migrant labour system emerged where male workers were paid less than what a family could survive on (Turok 1989). Although the rest of the income was supposed to be made up by agricultural income back home, agriculture was negatively affected due to the absence of all the able-bodied men. Roberts (1976) adds another consequence, and that is the slow disintegration of the traditional African way of life that started with the male population earning a living away from their families.

Hall (1976: 44) describes the conflicting opinions on what the people lost due to this new way of making a living. "On one side there is the portrayal of African life in pre-European days as happy, moral, courageous and free. On the other it is shown as vicious, fear-ridden and depraved". Hall suggests that the truth lies, probably, somewhere in between. "For some of the Zambian tribes the change was gradual, so they retained much of their ancient social structure, but for others, such as the Ngoni whose political formation was shattered by military conquest, or the Lamba whose tribal areas were swamped by white settlement, the change was overwhelming". Yet for all the tribes the new conditions quickly reduced the status of chiefs in the eyes of their people. Thus the chief was no longer the most powerful person in the tribe, and became subject to the administration.

As mentioned earlier, the Bemba chief did not accumulate a lot of personal belongings, and private property was subordinate to tribal ownership. The imposition of a hut tax by the Colonial office, therefore, had two consequences. Firstly, the chief could not pay the hut tax for his people because he had no cash income, and secondly, he lost his young men to cash employment on the mines. Even at the spiritual level, there were new pressures, because the missionaries were promoting Christianity to replace the traditional worship of the ancestors. The chief, who was previously seen as a person with supernatural powers, now "lost" even that power (Hall 1976).

In 1949 the introduction of the Native Authority system brought an even more dramatic change in the Bemba political structure. This system introduced educated councillors who assumed various clerical and semi-technical functions. From the chiefs' viewpoint the influence of this new element reduced the authority they had under Colonial rule because these councillors meant an increased involvement of the colonial government in traditional politics (Simon 1970). The councillors and messengers, "formerly fed by the chief while doing his work, were increasingly unwilling to serve the chief because the

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[51] This happened through the creation of reserves for Africans.

Colonial government discouraged tribute labour and supplied alternative means for these people to accumulate an income" (Whiteley 1951: 28).

Not only did this create a significant threat to the political autonomy of the chiefs, but for the *bakabilo* this was even more of a threat. "They were no longer the only privileged commoner group, nor were they the most influential. The new councillors moved into prestigious quarters, received the admiration of commoners in the capital, and displayed privileged behaviour in the presence of chiefs, etc." (Simon 1970 :27). The *bakabilo* responded by aligning themselves against the councillors, but eventually they too lost their power.

It was not only through the imposition of taxes and the installation of the Native Authority that the colonial administration changed the everyday life of Zambians, but also through a number of other restrictions. Because of their small numbers, the whites in the territory felt insecure and this led to the combined pressure of mining companies, colonial administration and settlers to sustain white privileges and prevent African advancement. Although they were few in number, the settlers continued to exert pressure on the British government for greater powers, which meant in practice greater control over the African population. This seemed justified because the smooth operation of the mines depended on skilled white labour.

Not only were political rights to Africans restricted, but also the extent to which they could participate in economic activity. They were restricted to unskilled labour and their earnings were far less than those earned by whites. In the 1930s the ratio of European to African earnings on the mines was around 30:1 (Turok 1989).

Furthermore, Africans were denied the right to settle the territory's best land. According to Roberts (1976) about 60 000 people were moved to reserves under Colonial rule, of which much was unsuited to cultivation and several reserves were soon overcrowded. As previously discussed, the Bemba had to move from time to time due to the poor soil quality, but because movement was now restricted, neither soil nor trees were given enough time to regenerate and it was not long before soil erosion and the destruction of woodland had further reduced the resources for African food production. According to Roberts (1976) much of the land next to the reserves remained quite uninhabited because the expected white farmers never arrived.

This stands in sharp contrast to what is generally understood under the theory of indirect rule, which was peculiarly British. According to Hall (1976: 51-52) the British philosophy was that "they would stay while they could, impart what it felt was good for the indigenous people and then retire gracefully – but keeping the trade going after the flag had been lowered". Implicit in this philosophy of "indirect rule" was that Africans would be guided towards running their own affairs. It was also cheaper administratively. In contrast to the British, the French saw it as their duty to strengthen the links with the metropolitan power and turn Africans into Frenchmen. The Portuguese and the Belgians had somewhat similar notions. Yet in Northern Rhodesia there were factors that made the implementation of indirect rule hazardous and difficult.

For Hall (1976) the most obvious was the presence of settlers, who were quite determined that when power was to be handed over to anyone, they would be the ones to receive it. Opposite them stood weak tribal organisations, offering little to which responsibility could be transferred to. And complicating the situation even further was the response of the few educated Africans who looked with disfavour on what was regarded as "a reversion to tribal rule"[52] (Hall 1976: 51-52).

The insecurity of the small number of settlers in Zambia also featured in the 1950s when they petitioned for a closer association with the white settler regime in Southern Rhodesia. Both Rhodesias joined Nyasaland in a Central African Federation on 23 October 1953. Roberts (1976: 176) takes the view that this suited settler interest and satisfied Britain that was anxious to be rid of "the massive problems of accommodating African pressure for political and economic advance"[53].

Unlike the satisfaction settlers derived from it, the drive towards the formation of the Federation stimulated Africans to make a counter-bid for political power. According to Roberts (1976), Africans in Northern Rhodesia feared any form of union with the south for the same reason that most Europeans welcomed it: union would strengthen European domination. The campaign for amalgamation gave the first stimulus to an African political awakening throughout the territory. Because the chiefs and councils were unable to organise political action on a large enough scale to challenge the Europeans, a political body, the Northern Rhodesia Congress (hereafter referred to as the Congress), was formed

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[52] This was unlike the situation in Botswana, especially with the strong tribal tradition, and that it was the most capable and strong tribal leaders that eventually broke away from the tribal tradition.

[53] It is interesting to note that this was a change in British policy that was indicated in 1899 when the British High Commissioner to South Africa, Lord Milner, argued that the Zambezi was the natural frontier for a future British Africa in the southern part of the continent; the countries to the north should become a "black dependency". With the formation of the Federation this clearly aligned Northern Rhodesia closer to white southern Africa than to the "black dependencies" in East Africa (Roberts 1976: 195-196).

in 1948. They were, however, unable to successfully oppose the formation of the Federation.

After the failure to oppose the Federation it took the Congress a number of years to consolidate again and to form new strategies and objectives. By 1958 it once again had a network of branches over most of the country. One of the most important reasons for the revival of the Congress was the influx of new leaders as more young men emerged from secondary schools and obtained further education abroad. Some of these young men were committed to the idea of creating an independent African state. This aim, they believed, could only be achieved by refusing to compromise in any way with the Federal political system. In Roberts' words "they dedicate themselves to uniting Africans and any Europeans who cared to listen, in a sense of belonging to a new nation to be called Zambia" (Roberts 1976: 219-220). At first the influence of these young men remained limited, because the territory was still divided along tribal lines and this made it hard to unite an African front.

The first steps towards a united front were taken outside the framework of traditional institutions. This happened within the mining community. The reason is that a large proportion of Africans were drawn outside the sphere of their traditional tribal authority and made it easier for them to form new relationships and see themselves as separate from their tribes.

Kenneth Kaunda, who had been secretary-general of the Congress since 1953 broke away from the Congress in 1958 and formed a new party, the Zambia African National Congress (ZANC). His clearly expressed view that Zambia should be an independent nation caused the ZANC to be banned in 1959 and Kaunda to be sent to prison. This repression only hardened African resistance. A new party was formed, the United National Independence Party (UNIP) and when Kaunda was released form prison in January 1960, he took over the leadership of UNIP (Roberts 1976).

With rising African pressure against the Federation and many Southern Rhodesians supporting the idea of a fully independent Southern Rhodesia, the British government realised that the Federation could not be held together. Thus in 1961 the Colonial Office proposed a constitution for Northern Rhodesia that would make possible an African majority in the legislature. The pre-independence Constitution aimed at the following: liberation from undemocratic, imperial and colonial rule, abolition of race discrimination, freedom of the press, the raising of standards of living, equitable production and distribution of wealth, protection and help for traders and commerce (understood to be African), minimum wages for workers, social security, equal opportunities, facilitation of education, free health services, etc (Turok 1989)[54].

In the election of October 1962 the UNIP and the old Congress together won two-thirds of the total vote. The Federation was doomed and it was finally disbanded at the end of 1963. Early in 1964 another election was held, based on universal adult suffrage. This gave the UNIP a decisive majority. Kaunda became Prime Minister of an all-UNIP government with full control of internal affairs, except defence. Constitutionally the way was then clear to full independence and this was arranged for October of the same year (Roberts 1976).

With the benefit of hindsight two events at independence can be isolated as indications of things that were still to come in independent Zambia. The first one happened the day before Independence Day when the chairman of the British South Africa Company agreed to surrender its mineral royalties in return for token payments by the British government and the incoming Zambian government. The second event was the fact that no white heads of state attended the Independence celebrations[55]. These two events were indicative of Zambia's drive to get rid of the European influence in the country and to align itself closer to the independent black north.

As previously mentioned the colonisation of Bechuanaland was mainly for strategic reasons and the mineral wealth was discovered only after independence. This is an important difference between Botswana and Zambia, because the colonial government had different designs of the two countries.

After the establishment of the Bechuanaland Protectorate a dual administrative system was agreed on between the Imperial Government and the chiefs. All lawmaking authority was placed in the hands of the High Commissioner, while African affairs were left to the chiefs as long as they did not fundamentally contradict imperial rule. A skeleton European administration supervised, rather than administered African affairs (Samatar

[54] It is interesting to note that the post-Independence Constitutions of the UNIP showed a shift of emphasis: the achievement of African democratic socialism became "point number one" and it was claimed that "the mutual aid society way of life is peculiarly African both in origin and pattern – it borders on the one hand on capitalism and on the other on communism" [quoted in Turok 1989: 25].

[55] In a discussion with Prof Neil Parsons (Department of History, University of Botswana) the author became aware of the fact that Queen Elisabeth of the United Kingdom, who was the head of state of British colonies in Africa at that stage, did not attend, but had sent a local representative from each country.

1999). The British administration could intervene in the *morafe's*[56] affairs and overrule the chief, but the administration did not exercise this power frequently. This lack of intervention was due to the fact that Britain tried to minimise administration costs in the protectorate.

While colonial rule brought all Batswana *morafes* under one authority, it also maintained an explicit form of division between them. The protectorate was divided into administrative units and these units' defining feature was the "tribe". The chief was the principal native administrator and judge of the unit, and the chief's representatives acted as junior judges. According to Samatar (1999) the consequence of this was that the morafe's traditional administration was adapted to the colonial one, while still maintaining the traditional authority as a basis for the running of everyday affairs. The chiefs made use of small tribal administrations of secretaries, clerks and teachers who were dependent on and accountable to them. This differs greatly from the Zambian situation where these people were paid by the colonial government, and the chiefs thus lost their power over them.

The scope of rule by Batswana chiefs changed with the promulgation of the 1934 proclamation. Up to 1934 the chiefs ruled themselves pretty much as before, but with the passing of a new law in 1934, British administrative officials could suspend, fine and depose uncooperative or troublesome chiefs (Mgadla 1998). The legality of these proclamations was challenged by Tshekedi Khama, the paramount chief of the Ngwato, speaking as representative of the other chiefs. He argued that the implementation of the proclamations would alter the treaty between the chiefs and His Majesty, which was the very foundation of the Protectorate. The proclamations were challenged in a special court in 1936, but the judge ruled against the chiefs. The proclamations became law, but afterwards the administration realised that the chiefs could subvert its intentions and the proclamations were therefore reformed in 1943. To make sure they had the cooperation of the chiefs, the chiefs were consulted and closely involved in this reformation (Samatar 1999). Again this increased the importance of the chiefs in the eyes of their people, and their persistent and successful defence against the British influence enhanced their prestige.

An important change brought about by the British intervention in tribal politics was to make it a more authoritative system. Before British intervention the chief's power was limited by tribal laws, which, for example, meant that if a chief committed an offence against one of his subjects, the victim could get some prominent person to intervene. Schapera (1940: 80-81) describes it as follows:

[56] community

often enough the victim had no real remedy except to leave the tribe and transfer his allegiance to some other chief. If the chief flagrantly misruled the tribe the leading headmen would withdraw their support and publicly attack him at tribal gatherings. The imposition of European rule deprived the people of the principal remedies they formerly possessed against oppression and abuse. The administration has intervened in local disputes, but since the official policy was to rule as much as possible through the chief, the Administration tended in most cases to uphold his authority. Freed from fear of the sanctions formerly restraining him, he became more arbitrary in action and jealous of any challenge to his authority.

Important changes happened within the Tswana society, even without the interference of the British government. The chiefs were able to successfully challenge most of the British influence, but they were not immune to the changes taking place within the Tswana society. The first change came when Khama III abolished his ownership rights over the cattle traditionally kept by the tribe. According to Samatar (1999: 52) "the decline in patronage, the growth of private property, and the commoditisation of what was heretofore collective property melted away traditional bonds". Another landmark change started with conflict between Tshekedi Khama and his nephew Seretse Khama in the Ngwato reserve in the late 1940s and early 1950s, which brought into focus the decline of another tradition, that of the hereditary chieftainship[57].

The absence of a direct colonial influence made it possible for the Batswana to gradually move to a system of private property ownership and a system where the rulers are chosen by the people and not by birthright. This is unlike Zambia where these changes were forced onto the society without the necessary time to adapt to the changes. Moreover, in Botswana the changes were brought about and communicated to the people,

[57] Seretse Khama was the son and heir of Sekgoma II, and was four years old when his father died. Seretse's uncle, Tshekedi Khama ruled as regent while Seretse grew up, and later went to Oxford University in England. It was during his stay in England that he met and eventually married an English woman, Ruth Williamson, on 29 September 1948. This had serious consequences for the whole Protectorate. Not only was it uncommon for a ruler to marry outside the Batswana group - even Africans who did not belong to the Batswana group was not usually acceptable - but "a European woman was totally out of the question" (Tlou and Campbell 1984: 213-214). Furthermore, the white people of Southern Rhodesia and South Africa strongly opposed the marriage. The British government did not want to offend these countries, because they did a lot of business with rich South Africa and did not want to anger the white governments there. This led to the banning of Seretse and Ruth from the protectorate (Morton, Murray and Ramsey 1989).

by their trusted chiefs. Seretse Khama, the Paramount chief of the biggest tribe, for instance, initiated the end of the chieftainship in Botswana.

The conflict between Tshekedi and Seretse Khama was settled in 1956 when both agreed to renounce their *bogosi*[58]. On his return in 1956 Seretse declared his intention to form a political party. Together with Quett Masire, he recruited local notables and created a strong network of support throughout the Protectorate. This drive eventually led to an independent Botswana.

At independence the chiefs lost most of their power. Instead, a House of Chiefs, similar to the House of Lords in Britain, was created to give the chiefs a forum through which they could still voice their opinions. According to Samatar (1999) a final indication of the passing of the era of chiefs was Bathoen's resignation from the chieftainship and the House of Chiefs to run for parliament in 1969. He defeated the then Vice President of the Botswana, Quettt Masire. His victory underscored both the strength of chieftainship and its weakness.

> Only the most educated, experienced and activist of them all had the courage and conviction to completely reject the symbolic role of the chief in Botswana. The other chiefs were unwilling, and perhaps unable to challenge the government and risk losing their remaining authority (Samatar 1999: 56-57).

As mentioned at the start of the chapter, the economy was poorly developed at independence. According to Picard (1985) the uncertainty over the issue of transfer is a partial explanation for the lack of British commitment to the educational, social and physical infrastructural development of the territory. Another reason was Britain's own financial difficulties resulting from the First World War. Britain did not have the means, or the commitment to develop its protectorate and left a country with extremely backward economic and social conditions. But the advantage of the Protectorate structure, however, was that through its creation Britain enabled a substantial part of Bechuanaland to survive as a separate entity and to become the independent nation state of Botswana. Fawcus and Tilbury (2000: 19) conclude that

> there can be little doubt that, had the protectorate not been declared, Bechuanaland would soon have been divided up between the land-hungry Boer Republic of the Transvaal on the east, and Germany, seeking an African empire and having already seized the substantial territory now known as Namibia on the west.

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[58] The title, power, authority and institution of the chief (Morton, et al. 1989).

Without the Protectorate, no Botswana would have existed today.

At independence, politics in Botswana was in the hands of capable people who had previously shown that they could act together in the best interests of the country. These leaders have also had practical experience in governing a country, through learning administrative skills from the colonial authorities. Since 1962 each nonofficial Executive Council member was paired, as a trainee, to work closely with one of the Protectorate's administrative secretaries. This step left Botswana with people experienced in the administration of their country and a good working relationship with Britain.

The difference in the relationship between the two countries and Britain is reflected in some of their policy decisions after independence. The following chapter will shed some light on these issues, and especially on how strong the link is between colonisation and post-independent policies.

6.5 CONCLUSION

Botswana and Zambia had different experiences during colonial rule. The British had a more cooperative attitude towards Botswana than that demonstrated towards Zambia. There are two reasons for this. The most obvious one is that a British company extracted copper during colonial times, and therefore the administration of Zambia was important for Britain. With almost no skilled labour in Zambia, the British made heavy use of skilled expatriate labour.

And secondly, the British administration not only had to secure cheap labour for the copper mines, but it also had to secure the position of the small settler community that were responsible for the extraction. To secure cheap labour, exploitive policies, for example the hut tax, was introduced. And to secure the position of the settlers, they introduced employment practices that discriminated against the local workers.

Since Botswana's mineral wealth was unknown until independence, the country was treated with as little intervention as possible to keep costs down. Furthermore, the British rulers also made use of local people in administrative positions in order to reduce their costs in the protectorate as far as possible.

But, these are not the only differences between Zambia and Botswana. The two countries had different tribal structures before European intrusion. And these different structures are important for the analysis of post-colonial policies. Firstly, the leaders of the Batswana tribes had experience of the capitalist tradition of private property through their ownership of cattle, whereas the Zambians were indifferent to the accumulation of private wealth. It was shown that the Bemba chief had no incentive to generate private wealth, because he had no certainty that his son would be the next chief.

Secondly, the large tribes that settled around water forced the Batswana to develop a system of cooperation and consultation. This formed a solid base for the democratic system they inherited at independence. This is unlike the people of Zambia who were always on the move in search of virgin lands for their crops. There was no history of cooperation, rather a history marked with slavery by the biggest tribe.

To provide a thorough understanding of how the abovementioned can be linked to the divergent growth paths witnessed, these two countries are analysed in the following two chapters according to two important institutional features. Chapter 7 discusses the lowering of transaction costs and the protection of property rights, whilst Chapter 8 focuses on the constraints on government.

CHAPTER 7
TRANSACTION COSTS AND THE PROTECTION OF PROPERTY RIGHTS IN BOTSWANA AND ZAMBIA

7.1 INTRODUCTION

The minimisation of transaction costs and the protection of property rights are two of the essential requirements for sustained economic growth. The purpose of this chapter is two-fold. Firstly, it discusses comparable examples (of transaction costs and property rights) from the two countries' post-colonial rule in order to determine whether historical evidence underscores the empirical findings. And secondly, it determines to what extent these examples can be linked to the type of colonisation the two countries were subjected to. In other words: the issue is whether colonisation can be blamed for higher transaction costs and insecure property rights in Zambia, relative to the experience in Botswana.

On the latter issue Pettman (1974: 34-35) describes three factors that had, directly or indirectly, an influence on the perceptions of Zambia's leaders. All three can be linked to Zambia's experience with extractive colonisation and will be incorporated in the discussion below.

1. The first one is anti-colonialism, where Zambia's memories of colonial humiliation created a "tendency to interpret an advance of colonial forces in one place as a threat to all of Africa". He sees this as the reason why Zambia's leaders felt obliged to support the nationalist movements against Portugal and South Africa despite the obvious dangers of retaliation.
2. Related to this are the anti-white feelings that prevailed in independent Zambia. He claims that "the bitter heritage of pre-independence race relations in Zambia is aggravated by the continued existence of a large white minority within the country, of whom many made no attempt to identify politically with Zambia".
3. The last factor is a fear of neo-colonialism. The Zambian government felt uneasy with the extent of foreign ownership in the country. Although Zambia gained political independence, there was still uncertainty about the influence the British had through their economic power. The economic vulnerability was compounded by a transport and supply network which tied it to the white-ruled south.

The fear of losing their independence was a major determinant of Zambia's foreign and domestic policies. The application of these policies seemingly did not take the opportunity costs inflicted on the economy into account.

Section 2 focuses on transaction costs and section 3 on property rights. Section 4 concludes the chapter.

7.2 TRANSACTION COSTS

In section 4.3.1 a distinction is made between economic transaction costs and political transaction costs. Economic transaction costs consist of the costs of using the market and costs related to personnel management, public relations, and lobbying. It also includes all costs related to the management of labour and the costs of intra-firm transportation. An important part of economic transaction costs is the cost of uncertainty in the market, the so-called unobservable costs. And it is often these unobservable costs that restrain trade, like for instance in SSA where the bad state of the transport and communications infrastructure create difficulties for the trading partners. Another unobservable cost present in SSA is the bad neighbourhood. It is this cost, imposed upon countries by the neighbourhood where they are situated, that is discussed first.

The Neighbourhood

Being landlocked must, theoretically, have restricted the economic growth of both Zambia and Botswana. Both countries depend on neighbouring countries for access to a shipping port. However, due to a number of exogenously enforced and endogenously determined policies since independence, they ended up in totally different positions with regard to international trade. And it was especially the unobservable transaction costs that are caused by trade instability that influenced transaction costs to such an extent that it is necessary for this section to focus specifically on incidents that contributed to an increase in these unobservable costs.

Botswana and Zambia both depended on their southern neighbours for trade routes at the time of independence. But for different reasons, which can partly be traced back to their different experiences under British rule, they reacted differently to these vulnerable positions. At independence Botswana was highly dependent on the South African economy, both as a market, a transport route to Europe for its beef exports, but also for income via its membership of the Southern African Customs Union (SACU). It became a member of SACU in 1910 when it, due to its status as a British protectorate, became one of the founding members together with the Union of South Africa, Basotholand and Swaziland (as these regions were then known). SACU was formed to facilitate trade amongst these integrated economies.

Although Botswana wanted to lessen its dependence on South Africa after independence, it realised that it would be an unwise decision to end its membership of SACU. One reason was that one of the earliest sources of revenue for the post-colonial Botswana government was income derived from SACU. Botswana even went one step further and asked for new negotiations after independence in order to secure a better share of the customs revenue. A new, more favourable agreement was reached in 1969. The additional revenues received from the customs union partly enabled Botswana to balance its budget for the first time in 1972/73 (Tlou and Campbell 1984). The other objective of the renegotiations was to retain access for Botswana's exports to the South African market[59].

This positive attitude towards trade with South Africa must be seen against the background of Botswana's opposition towards the apartheid policy of the South African government. In its relationship with South Africa, Botswana decided to take a middle-of-the-road strategy. Coetzee (1986: 68-69) explains it as follows: "Botswana's foreign policy towards South Africa was two-fold. On the one hand it stood critical towards the policy of apartheid, but its economy depended on the Republic. It criticised the apartheid policy, but also tried to secure peace in the region". It did, however, try to lessen its dependence on South Africa through the creation of the Southern African Development Co-ordination Conference (SADCC).

The SADCC was formed by a group of nine African States consisting of Angola, Botswana, Mozambique, Tanzania, Lesotho, Malawi, Swaziland, Zimbabwe and Zambia. These countries previously formed a regional group, called the Front Line States[60], which cooperated in the liberation struggle. As early as 1977 the Front Line States decided to cooperate in economic development as well, and this gave birth to SADCC. The Botswana Government did most of the planning for the establishment of SADCC and was one of the founder members at its formation in 1979. The aim of SADCC was to encourage regional development and to reduce members' economic dependence on South Africa (Tlou and

[59] It was expected that enterprises would establish themselves in Botswana and sell their products in the Customs Union Area as a whole. Unfortunately this hope has not realised, apart from beef and karakul pelt exports. Botswana is a high cost area compared with the rest of the Customs Union Area, especially South Africa itself. South Africa has cheaper electricity and water, a developed transportation system, an industrial labour force, and easier availability of skilled manpower, and benefits from economies of scale (Mogae 1983).

[60] The group was formed in 1974.

Campbell 1984)[61].

Even before the formation of SADCC, Botswana had tried in a limited way to reduce dependence on South Africa, and to some extent on Rhodesia. With regard to Rhodesia, Botswana decided to take over the railway line inside Botswana that was administered by Rhodesia, and to reduce its dependence on South Africa, an international airport was built near Gaborone. A telephone system, which linked Botswana to the outside world without passing through South Africa, was established, and in 1976 Botswana introduced its own currency (the Pula) (Tlou and Campbell 1984).

Through these carefully planned actions Botswana succeeded in securing a stable environment for its international trade and internal environment. This Botswana accomplished without losing sight of its greater dependence on its southern neighbour. But taking its vulnerable geographical position into account, it made sure it minimised the unobservable costs related to the international trade environment by securing a workable relationship with South Africa.

Zambia was more forceful in its striving to lessen dependence on its southern neighbours and through that action indirectly inflated economic transaction costs. Some reasons were exogenously induced, such as the closing of the border between Zambia and southern Rhodesia by the Rhodesian government, but also partly to reasons that can be traced back to its colonial experience, as was mentioned in the introduction to this chapter.

At independence Zambia's main lines of access to the sea ran through Southern Rhodesia (today Zimbabwe) to South Africa. It was especially this link that soon after independence turned into a source of grave embarrassment. Not only did Rhodesia become unfriendly, but it also became an actively hostile neighbour. In November 1965 Ian Smith took over the Rhodesian government and rebelled against British rule by unilaterally declaring Rhodesia independent (UDI) from Britain. Not only did this complicate trade through Rhodesian territory, but Rhodesia's deteriorating relationship with the outside world also affected Zambia. For instance, when the United Nations applied sanctions to Rhodesia, the closure of the oil pipeline from Beira to Rhodesia was detrimental to the Zambian economy because the country immediately had to find alternative ways to import oil (Roberts 1976).

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[61] It was only after 1992 that South Africa became a member of SADCC (now called the Southern African Development Community) and made it possible for these two countries to work together towards economic development for the region.

In January 1973 Smith closed the border between Zambia and Rhodesia. With the closure of the border Zambia lost its principal southern supply and export route. The Zambian government reacted to this incident by upholding the closure even after Smith's government softened their stance (Burdette 1988). The closure of the border can be linked to President Kaunda's commitment to end colonial rule. Right from independence Zambia took a leading part in efforts to extend the frontiers of African political and military powers south of the Zambezi. According to Roberts (1976: 229) "the independent government lost no time in giving support to African guerrilla movements in Portuguese Africa and Rhodesia". As a result Zambia found itself in the front line of conflict between black and white Africa.

Acting upon a commitment to end colonial rule, President Kaunda permitted liberation fighters to use Zambia as a sanctuary on the condition that no military actions would be permitted within or launched from Zambia. In 1970 Kaunda signed the Mogadishu Accord, accepting the need for some violence to overthrow the racist regimes in the region. According to Burdette (1988: 137) this new policy "brought Zambia more in line with Tanzania but lessened the credibility of its claims of non-interference in the eyes of Pretoria, Salisbury and Lisbon".

Zambia's decision to provide sanctuaries for guerrillas and to join in the international boycott against Smith's Rhodesia disrupted trade patterns with Rhodesia, but also resulted in military conflict. Wars of liberation erupted to the east and west of the country, as Angolan and Mozambican nationalists began the long struggle to overthrow repressive Portuguese colonial regimes. By the mid-1970s the South African military was invading western Zambia, pursuing Namibian freedom fighters, and partisans in the civil war in Angola moved in and out of Zambia (Burdette 1988).

Already after Rhodesia's UDI, Zambia started to explore other transport options. The country's plans to create alternative transport routes culminated in the construction and improvement of two key roads, the Great North Road, which runs from central Zambia to Tanzania's seaport capital Dar es Salaam, and the Great East Road, which runs east from Lusaka to Chipata and then to Salima in Malawi. From there goods could be railed to the Mozambican port of Beira (Burdette 1988). The new routes, and the source of its financing, were signs of new alliances Kaunda formed. Kaunda sided more with northern black African leaders, than southern white leaders. Not only did it show a closer alliance with Tanzania, but it also signified an alliance with the communist regime of China.

The financing of the railroad was not without its problems. Several western governments and aid agencies were approached but to no avail. This was probably because it was not seen as a profitable venture. In 1968 the People's Republic of China agreed to supply an interest free loan for the purpose, as well as manpower, equipment and initially the supervisory personnel. But it was only in 1970 that the Chinese began to build the 1600 kilometre railroad (Burdette 1988). In the mean time, Zambia had no secure transport route, adding to the unobservable costs created by uncertainty.

The whole drive to divert the trade routes created inefficiencies that became harder to finance as income received from copper started to decline. For example between 1975-80 two of the three major railroads for the country were either blocked or inefficient. The third route (the Tanzania-Zambia Railroad to Dar-es-Salaam) failed to live up to its planners' expectations because it was not able to carry the total mass of the imports and exports. Therefore, Zambia's dependency on the southern transport system continued.

It would be unfair to attribute all the costs of these conflicts to decisions made by the Zambian government. It was, however, possible for them not to have sided with the liberation movements. Their decision to support the liberation movements directly influenced their economic progress due to the extra costs it imposed on the Zambian economy. Botswana did not provide sanctuary for guerrillas and retained its economic links with South Africa through a process of negotiation. In comparison the country's reaction to white-ruled Southern Africa was markedly different from that of Zambia. Zambia not only tried to end its dependence on its southern neighbours, but was also much more openly sympathetic to the post-colonial struggles in these neighbouring countries.

By focussing more on the prosperity of their own country, the Botswana government made an effort not to estrange itself from its more prosperous southern neighbour, and by doing so kept transaction costs as low as possible. For Zambia its colonial experience made it more committed in its resistance to any form of domination from white southern Africa, even if that meant higher economic transaction costs to the Zambian economy through the instability it created in the trading environment.

Labour issues

The examples in this section focus specifically on how the Zambian and Botswana governments respectively reacted to a shortage of skilled labour. The way they reacted to the shortage influenced economic transaction costs in the countries.

For managers to be able to minimise transaction costs, they have to be able to make the right choices, in other words they have to be suitably skilled. At independence both

Botswana and Zambia had a shortage of skilled labour and were reliant on expatriate labour to supply the skilled labour. However, the countries reacted differently to this shortage.

The examples below show that unskilled Zambians took over from skilled expatriates after independence. It is not possible to draw statistical correlations between the replacement of expatriates and the subsequent economic stagnation, but it can be assumed that the replacement of qualified and experienced personnel by those less qualified and experienced must have detrimentally influenced decision making in the economy. And as will be shown below, Botswana had a much more cooperative relationship with the British citizens residing in the country, both before and after independence.

The reality post-colonial Zambia had to deal with had much to do with the treatment they received during British rule. As discussed in Chapter 6, the need for cheap labour in colonial Zambia culminated in a situation where rural societies were destabilised through the imposition of a hut tax. This was supported by a system that safeguarded European employment by blocking opportunities for Zambians in the mining industry.

To make matters worse, the colonial administration also opposed the emergence of an informal sector economy. According to Turok (1989: 33) "prior to independence Africans were actually prohibited in major urban trading areas and those who were commercially active were either very poor shopkeepers or hawkers". This process was sustained by the establishment of political control and was achieved first by direct company rule and then by the colonial administration. This created the institutional framework where those with political power created rules that benefited them at the expense of those without power. Although it does not excuse the making of poor policies after independence, the institutions created during colonial times can explain the decisions made in post-colonial times.

Until independence, expatriates, many from South Africa, were mostly employed as skilled personnel while local Africans were employed as unskilled labour. According to Turok (1989) the mining companies assumed that settlers and expatriates would continue to manage the economy for a long time after independence, but the Zambian post-colonial government was determined to install Africans in positions of responsibility notwithstanding their lack of experience or expertise. Therefore, following independence, the status of all the non-Zambian mineworkers was changed to that of expatriate. These expatriates could only be employed if no qualified Zambian could be found, and then only on a renewable two-year contract. To further discourage the employment of expatriates, employers had to pay a selective employment tax of 15 percent on the wages and salaries paid to non-Zambians. The effect of the replacement policies was that expatriate employment in the copper industry dropped from 16 percent of the total number employed in 1964, and 19 percent in 1971, to 3.5 percent in 1983.

The extent of the impact of the decision to replace skilled expatriates with Zambian citizens, becomes apparent only if it is taken into account that the mining industry fully depended on expatriates at the technical and managerial levels at that stage (Obidegwu and Nziramasanga 1981). According to Obidegwu and Nziramasanga (1981) the policy of replacement led to inefficiencies in all aspects of mine operations: planning, maintenance, and production.

Although the harmful effect on transaction costs cannot be quantified, it must have been considerable due to the replacement of skilled personnel with people inexperienced in the operations of the mining industry. Proof of the lack of the ability to contain costs is the fact that the policy was reversed in April 1982 and efforts were made to attract expatriates once again to skilled positions in Zambia. Under the revised policy, expatriates received compensation comparable to international standards along with a tax-free expatriation allowance (Gulhati 1989, Obidegwu and Nziramasanga 1981). To change a policy of substituting locals for expatriates to a policy designed to attract expatriates again, shows that there must have been serious draw-backs in the initial policy. A policy reversal of that nature brought about the direct costs of incentives to attract skilled expatriates and implied an admission of the indirect costs of the bad decisions that were made by unskilled Zambians.

The example above shows how economic transaction costs in the Zambian economy were increased due to inefficiencies created in the economic environment. This was not only due to an unwillingness of Zambians to work together with the expatriates, but also due to the employment of Zambians for political reasons rather than for efficiency purposes. Furthermore, the Zambianisation of the labour market proved detrimental to the economy, not only due to the high costs it created, but also due to the fact that people without the necessary experience had to deal with problematic economic issues, such as a volatile copper price. It is then not surprising that Aron's (1999: 20-21) conclusion regarding the copper price reads as follows: "the decline in Zambia's economic fortunes between the positive and negative shocks was drastic, and the boom was not managed so as to smooth the transition into recessionary circumstances". Decisions regarding the labour market were taken by an independent post-colonial government, greatly influenced by their colonial experience.

The situation in Botswana proved to be different, starting off with the same basic constraint of an excess supply of unskilled workers and a serious shortage of skilled labour.

The policy response to these shortages was largely in the form of heavy investment in training by the public sector, including a similar investment in training by the state-owned enterprises. The remaining shortages were met by employing expatriates on term contracts. This is similar to the situation just sketched for Zambia in terms of ending up with expatriate workers on term contracts. However, the way they independently got to that point, differs.

It is mentioned in Chapter 6 that the British government wanted to minimise its costs in Botswana, and it was therefore to their advantage to secure a situation of cooperation with Botswana citizens. Furthermore, to smooth the transition at independence Botswana citizens were paired with British expatriates in the civil service for a considerable time before independence. Also the relationship between Botswana citizens and outsiders before independence needs to be considered.

Botswana has had a long tradition of using friendly outsiders to help cope with unfriendly ones. For example the three principal tribal chiefs took the lead in proposing protectorate status for Bechuanaland, but they had help from the London Missionary Society in convincing the British government (Stedman 1993). These institutions of cooperation were also present in independent Botswana, when the government for instance made use of external consultants in dealing with foreign banks and companies. In the negotiations between the Botswana government and the mining companies after independence, the Botswana government strengthened its position by the use of skilled advisers on its negotiating team. According to Stedman (1993) a culture to learn from others, both about their successes and failures, was present in Botswana and helped them to cope with post-colonial skilled-labour shortages.

Political transaction costs

The civil service in Zambia was politicised through the patronage system. The Zambian example discussed in the previous section can be traced back to their colonial experience. The following example, however, cannot be ascribed to their colonial history. It explains a situation where political transaction costs were created by a tremendous growth in the civil service.

The move to expand the civil service created extra costs, not only through the direct costs brought about by these extra workers, but also costs brought about by unskilled workers making the wrong decisions. The unit cost of production was raised due to the extra, unproductive, workers that had to be supported. Gann (1986: 186) describes the situation as follows:

> State managers earned high salaries and lived well. Their projects routinely received favours for credits, supplies and state contracts, but nevertheless incurred heavy losses because of inefficiency, high overheads and lack of adaptability in marketing. A commission of inquiry into the parastatals appointed in 1980 revealed a sad tale of heavy debts, forged cheques, misappropriated funds, inefficient management, and a number of other irregularities.

The reason for the lack of performance in the civil service can be traced back to the lack of skills in the country. At independence only 4 percent Africans occupied senior civil service posts, compared to Ghana's 60 percent. Most local Africans were unskilled. Zambia had no university at independence and there was a shortage of training facilities for civil servants. At that stage there were only about 100 university graduates and 1500 high school graduates (Gulhati 1989). But this did not deter the post-colonial government from expanding the civil service.

During 1964-74 the civil service increased six-fold and became almost fully Zambianised. And furthermore, the new governing elite made heavy use of government patronage for personal advancement, but this lowered the standards of the civil service very sharply. A survey concluded that 38 percent of those in supervisory posts lacked sufficient qualifications, and that such deficiency was even greater at higher levels of management. In 1969 67 percent of mid-level civil servants did not even have secondary school qualifications (Gulhati 1989).

The result was that efficiency in many public services began to decline. In 1970 Kaunda himself complained that since independence Zambia has been forced to cope with both a sharp drop in labour productivity and a serious increase in wages and prices. Absenteeism in industry, drunkenness and nepotism increased rapidly, and investment suffered. This lack of efficiency that increased transaction costs was supportable only because of the high income generated by the copper mines. The problems only became apparent when the income from the mining activities started to falter.

Not only were people employed in jobs for which they did not have a sufficient level of skills, but they were also at the mercy of the President because appointments were made at his discretion. In a move to incorporate all tribes in the government, Kaunda made sure to provide employment opportunities to all tribes in the government administration. In theory this seems to be a sensible move, but in practice it created more friction than anticipated.

The struggle for independence had produced powerful politicians with their own regional and class power bases and their own distinct notions of what the new government should do. In 1964 Kaunda appointed his trusted friends and colleagues at senior level, but after ethnic hostility erupted in February 1967 in a by-election campaign and particularly in the intra-UNIP elections in August 1967, Kaunda developed a new form of "ethnic balancing". Each ethnic-linguistic group was to be granted a certain number of high-level positions based in part on the numerical, political or bargaining strength of a particular group within the ruling party. But according to Burdette (1988: 72-73) the root of the problem was not an ethnic dispute but one of "factions within the newly formed upper class trying to get access to power and prestige". Ethnic balancing did not end the struggles.

It only created a civil service that was not politically neutral, with political appointees reflecting competing political interests that became enmeshed in personal and sectional disputes. According to Burdette (1988) it sometimes brought the administration to a standstill. To deal with such bureaucratic paralysis and ministerial infighting, Kaunda and his advisers devised a strategy that involved frequent changes at the senior levels of the party, the bureaucracy and the parastatal bodies. This tactic of reshuffling involved both officeholders' being shifted from one post to another, and restructuring of the jobs. A reshuffle could happen at any time and without prior warning, and was simply announced at a presidential press conference. Burdette (1988: 69) provides the following examples:

> In the first republic this meant that many ministries and departments went through a bewildering change of identity and personnel. For example, between September 1964 and June 1971 there were eighteen major shifts of ministries. The national economic planning body, potentially key to the transformation of the economy, was shifted from the Ministry of Finance to the Office of the President in 1965, put under the guidance of the vice president until early 1969, after August 1969 reabsorbed in Finance and Development, then rehoused in the Ministry of Development Planning and National Guidance in late 1971 and then back to Finance.

One of the worst features of this system of frequently replacing top-level people was that office holders hardly felt it worthwhile to master any specific skills related to the job before they were shifted to a new position. Furthermore, since their positions could change "at the whim of the President, officials tend to play safe and do nothing rather incur the wrath of the President by taking what may be an unwanted initiative" (Turok 1989: 150-151). It can be deduced that this motive to break up tribal cliques within departments exacerbated inefficiency, and therefore also increased political transaction costs through the uncertainties and inefficiencies that were created.

Although the governments of both these countries were much involved in the economies, they differed radically in their approach to employment in the civil service. Not only did the Botswana government take time to learn the ropes from their European colonisers and made use of skilled foreigners, while the Zambian government tried to get rid of them as soon as possible, but the incentives for the civil servants also differed considerably. In Zambia civil servants were employed because they were, for instance, representative of a specific tribe, and could be replaced again at any moment. The uncertainty this created must have made most of them ineffective in their positions.

In Botswana the situation was somewhat different, especially on two grounds. Firstly, while employed, civil servants could still earn an income from their cattle herds. Harvey and Lewis (1990) highlight the fact that there was no ban on civil servants owning cattle. Secondly, they could retire at 45 with pension.

These two facts led them either to enter the private sector after retirement, or to return to their cattle herds. The advantage of such a system was two-fold. Firstly, it gave young civil servants the opportunity to get promoted after the retirement of the older ones, and secondly, while in service of the state, the civil servants had the incentive to promote the private and the agricultural sectors. An additional benefit was that senior government officials regularly travelled to the rural parts, which made them aware of conditions in these areas.

Furthermore, for Harvey and Lewis (1990) the most distinguishing feature of the Botswana civil service, was the extent to which attention was paid to put able people into key positions and keeping them there for extended periods. And because the country was open and democratic, it did not lose talented people to political exile or other international organisations.

Civil servants were also willing to learn from the experience of other countries. For more than a decade after independence, it was common for visiting consultants or academics to present evening seminars attended by Ministers, Permanent Secretaries, and other senior officials. In addition, meetings of Cabinet frequently involved presentations by visiting experts, who were encouraged to share the comparative experience of other countries both in Africa and other parts of the developing world. "Despite relatively limited budgets, small delegations involving Ministers and senior officials visited successful development projects in a number of countries. Travel to countries farther north in Africa which have been making better and worse choices of economic policy, for some years before Botswana achieved its budgetary independence, provided a variety of lesson for Botswana citizens" (Harvey and Lewis 1990: 61).

In chapter 3 it is mentioned that the Botswana government was good at planning ahead. It is shown that the National Development Plans offered a detailed outline of what the government set out to achieve in a five-year period. The certainty that these plans created in the economy probably lowered political transaction costs as well. All government departments knew what to expect. These plans set priorities, and once achieved the departments could move on to other projects. According to Stedman (1993: 19) "Fundamental to setting those priorities was the practice of looking ahead to anticipate problems that would be likely to arise in the future, and preparing ahead of time to deal with them". For example, as soon as Botswana achieved budgetary independence, it established reserve funds to see it through difficult times.

> Since then it has built up reserves in good years and run them down in bad, enabling its development efforts to proceed almost uninterrupted for nearly twenty-five years. Perhaps the best illustration of anticipation in the policy process involved drought. The government started to think about drought relief measures during the wettest part of the weather cycle. By the time the next sustained drought hit Botswana in the 1980s measures were in place to run a major drought relief programme (Stedman 1993: 19).

The example just mentioned was probably also due to the fact that civil servants were still part-time cattle owners. They had the incentive, therefore, to ensure a smooth-functioning agricultural sector.

It can be concluded that the Zambian civil servants had little incentive to do their work properly. They were employed not so much for their skills, than for appeasing the tribe they represented. With few other forms of profitable employment to fall back on, they were hesitant to annoy the president (who could replace them at any moment). In contrast, the situation sketched for Botswana shows civil servants with an incentive to support the private as well as the agricultural sectors. Colonisation cannot be blamed for this difference. The difference in colonisation could, however, be held responsible for the extent to which local civil servants got along with expatriates, and to what extent they were willing to learn from them.

7.3 THE PROTECTION OF PROPERTY RIGHTS

The different colonial experiences of Zambia and Botswana also have explanatory power for their attitudes towards property rights after independence. Botswana, which was subjected to "benign neglect", eventually had more secure property rights than Zambia that was subjected to extractive colonisation. The difference in their property rights protection is graphically shown in Chapter 5. But, as discussed in Chapter 4, colonisation does not inevitably lead to stagnation.

The discussion so far has centred on the fact that post-colonial policies can, in many instances, be explained by colonial experiences. In this section another dimension will be taken into consideration: the link between post-colonial policies and the situation that existed in pre-colonial times. The reason for this is to establish whether colonialism is indeed the sole explanation for post-colonial behaviour.

Examples of confiscation

Political independence for Zambia did not bring about economic independence. For the newly independent country to feel secure in its independence, it had to become fully independent from the previous colonial power. But this was problematic given that the copper industry was essentially in the hands of foreign businesses, and this relationship was particularly strained due to the extractive nature of their colonisation.

The Zambian public regarded the companies as insensitive to the needs of the country, since these companies made no other investments during colonisation, other than those necessary to extract the minerals[62]. The relationship was also strained by the mining industry's strong support of the Federation that preceded independence[63]. Furthermore, many foreign companies operating in Zambia were subsidiaries of multinationals also operating in Ian Smith's Rhodesia and therefore seen as unsympathetic to the wish of Africans to rule themselves.

From the companies' side, they expected their rights to be protected. As Stiglitz (2000: 15) remarks "…when the colonial powers granted independence to their former colonies they forgot the abrogation of (implicit) property rights that they perpetrated in the first place and strongly urged that the newly independent countries respect property rights (including those of white settlers)"[64]. The companies did not really trust the new

[62] Only £136 000 was given in development grants between 1930 and 1940, in return for the £24 million in taxes. This created a country, for example, that was dependent on Southern Rhodesia and South Africa for most of its infrastructural needs (Roberts 1976).

[63] The formation and breaking up of the Federation is discussed in Chapter 6.

[64] A discussion on the violation of the indigenous population's property rights falls outside the scope of this dissertation.

government and rather than invest in the Zambian operations, paid out most of their profits as dividends to their foreign owners.

The post-independence situation, therefore, started with mutual suspicion between the Zambian government and the colonial power. This made it difficult for the two parties to find a solution that was mutually beneficial.

Disillusionment with foreign private investment led to a wave of nationalisations, starting in 1968. In a speech in April 1968 at Mulungushi, Kaunda complained about the excessive expatriation of profits after independence. He proposed new reforms which would direct available capital to development and ensure that Zambians "individually and corporately share in the commercial and industrial life of the country" (Kaunda in Turok 1989: 42). Kaunda stated that new measures of state intervention were necessary because Zambians lacked the capital and skills to be economically active on their own. "Only the government of the people can participate on their behalf and ensure that the nation has control of the vital resources in the country, and also provides avenues for the acquisition of skills pertaining to economic development and participation" (Kaunda in Turok 1989: 42). The public sector was therefore assigned a leading role in development in independent Zambia.

The Mulungushi Reforms permitted the government to acquire 51 percent shares in private retail, transport, and manufacturing firms through a parastatal, the Industrial Development Corporation (INDECO). The government bought out 24 large private companies that were mainly involved in production and distribution throughout the country. But soon the government realised that manufacturing accounted for only 6 percent of the GDP; if they wanted "a real hold on the economy it had to come to grips with the mining industry" (Turok 1989).

Until 1969 the Zambian government adopted a laissez-faire policy towards the mining industry and disclaimed any intention of nationalising it. Nevertheless, according to Roberts (1976) the argument for some form of nationalisation became stronger over time. Since the country depended so heavily on the copper industry, the government was likely sooner or later to increase not only its share in profits, but also in shaping mining policy.

The private companies had long foreseen that the government would wish to become involved in the ownership of the industry. They did, however, not expect the full nationalisation of the mines. They acknowledged the suggestion of the 1964 United Nations mission that the government take a large minority shareholding in exchange for abolishing royalties altogether and for undertaking to limit taxes and not to nationalise the mines (Cunningham 1981).

However, this was to no avail as President Kaunda set about nationalising the copper industry in 1969. The first step was a referendum that gave the government the right to change the clause in the constitution that had previously prevented them from acquiring private property by compulsory order. The outcome of this referendum encouraged Kaunda to announce major changes in the sharing of Zambia's copper wealth. Secondly, government appropriated all mining rights in the country. The Mines and Mineral Act of 1969 provided for the reversion of all mineral rights to the President on behalf of the State (Pettman 1974). And thirdly, the Matero Reforms of 1969 resulted in the government purchasing 51 percent shares in the mining companies, Anglo American Corporation and Roan Selection Trust, leading to partial nationalisation of the copper industry. The government had no wish, at first, to run the mines itself and undertook to pay the companies for continuing management and services (Obidegwu and Nziramasanga 1981, Roberts 1976).

Although the government paid for taking over ownership of the mines, it did this without any prior consultation with the mining companies' executives. This could be attributed to strong political pressures within the country at the time, believing that the foreign-owned mining companies were one of the last vestiges of colonialism, and that one of the controlling interests, the Anglo-American Corporation, was a South African company. According to Cunningham (1981: 270-271):

> The president would probably have run into considerable political difficulties if the nationalisation had appeared to result from some gentleman's agreement with the private owners. The political situation demanded that nationalisation appear to the Zambian voter as a unilateral action taken by a proud and sovereign nation to break the bonds of colonialism and foreign capitalism.

Yet, in spite of all the internal pressure, President Kaunda did negotiate a deal that was accepted by his own people and also, reluctantly, by the private owners - a considerable achievement if one takes into account the differences in expectations they had at independence. According to Cunningham (1981: 269) "it is to the government's and especially the president's considerable credit that the terms agreed with the private owners, while not exactly generous, were nevertheless not outright confiscatory". Cunningham (1981) proposes that of the various nationalisations of mining properties in Africa and in Latin America during the 1960s and early 1970s, the Zambian case was perhaps the most advantageous to the private shareholders. The government arranged to pay for its share out of its dividends over a number of years.

The take-over had its advantages and disadvantages from the point of view of the mining companies. To the industry it seemed clear that the new partnership was a transitional arrangement to help Zambia avoid a costly disruption of its mining operations, therefore their primary interest remained the maximisation of short-run profits and high-dividend payments. The companies realised that high level investments would decrease dividends, since the majority owner, the government, would favour financing investment out of profits. Therefore, the companies decreased their investments and rather paid out the profits as dividends. One of the most important South African mining magnates, HF Oppenheimer remarked that the only real advantage of the partnership with the Zambian government for the mining companies, was that the compensation payments provided the companies with liquid funds that enabled them to broaden their field of operations elsewhere (Gann 1986).

When discussing the lessons of the Zambian mining industry for other developing countries, Cunningham (1981: 293) concluded "it would be difficult to hold up the partial nationalisation and subsequent expulsion from management control of Rhodesian Selection Trust and Zambian Anglo-American as examples to follow".

At Zambia's independence, the industry was run by two high quality and internationally respected organisations that used retained profits to expand production and capacity continually and profitably. Alternatively the objective of the Zambian government was different. It removed the bulk of operating profits to help fulfil its own objectives of promoting "the rapid development of mineral resources in order to increase employment opportunities, Government revenues, foreign exchange earnings and the development of rural areas" (Burdette 1988: 103).

During the "last stage" of Zambianisation announced in November 1970, the government appropriated a 51 percent share in the private banks and in five foreign companies. The involvement of the government now went well beyond the copper industry. It took over the building societies, and the closed down of all insurance companies—except the one owned by the state. The four foreign owned commercial banks had been under attack for applying conventional commercial standards, thus discriminating against Zambians borrowers trying to establish their own businesses, so that only 20 to 25 percent of total credit went to the Zambian sector of the economy. To overcome this politically inequitable situation a state-owned National Commercial Bank was established in October 1969 to provide extended credit facilities for Zambians (Pettman 1974).

To strengthen its perceived control over the mining industry, the government also decided to terminate all contracts for services with foreign mining companies in 1973. It also decided to redeem all bonds, despite the penalty of US$55 million. At that stage the government had to borrow US$150 million on the Eurodollar market to finance these transactions, which all took place under the euphoria that the income from the copper industry would remain at pre-nationalisation levels.

Expectations that the mines under government control would provide more revenues to the state proved misplaced. Not only did the cash flow position of the mines deteriorate, but the real copper price also fell. Profits were not as high as expected, and must have had serious consequences for financing these loans. "Nationalisation [of] the mines had not alleviated the fiscal problem, rather the money spent absorbed much of the nation's reserves just as it entered a period of serious fiscal crisis" (Burdette 1988: 103). The government was left indebted. The result was that, except for a feeling of pride, the nationalisation offered small potential short-term gains for the Zambian government.

In conclusion, it can be said that the extractive nature of the mining companies before independence allowed little income to trickle down to the Zambian economy as such. This, of course, provides no excuse for the outright nationalisation of the copper mines, because by taxing the mines the Zambian government could have received an income to use on development projects in the country. If the government had accepted the suggestion by the United Nations and had fixed taxes at a nominal rate of 50 percent, for example, it probably would have been the best long-term solution for both the industry and the country. The companies would have remained in control of the management of their properties, which was a very important consideration for obtaining loan finance, and taxes would have been at a level that international investors would have found attractive (Cunningham 1981).

The question is: Why did the Zambian government act in such a fashion? Firstly, the government acted on pressure from its constituency to rid the country of European influences. Although this can be understood in terms of their colonial experience, it was also short-sighted because it did not take future advantages and disadvantages fully into account. It is unlikely that government was just scared that it would lose its majority at the ballot box if it did not respond to pressure from the constituency, because it was in any case willing to change the constitution to ensure a one-party state. It therefore seems as if more was at stake than just responding to the will of the majority of the population.

Furthermore, if the pre-colonial history of Zambia is taken into account, the vitality of property rights protection was not an institutionalised practice. Chapter 6 shows that the Bemba was not accustomed to gathering and protecting private property. To nationalise the mining industry was, therefore, not so much in conflict with an institutionalised tradition of the leaders, and the situation during colonisation certainly did not support its creation.

The situation described above contrasts with the experience in Botswana. The main difference was that, although government earned a high income from the diamond mines, it did not try to run the whole industry by itself. It must, however, be acknowledged that the situation for Botswana was much easier right from the outset because no international mining company operated there on a large scale before independence.

Prior to independence, mineral rights belonged to the local tribes and were administered by tribal authorities. One of the earliest tasks of the post-independence government was to vest mineral rights clearly in the national government, so that the benefits of any developments would accrue to the national government. In 1967 Parliament passed the Mines and Minerals Act to govern prospecting and mining development and the Mineral Rights in Tribal Territories Act that vested mineral rights in the national government. According to Harvey and Lewis (1990) the fact that the President, Sir Seretse Khama, was the traditional leader of the Bamangwato tribe, where both the copper-nickel concessions and the principal diamond prospecting activity occurred, made an otherwise difficult issue more manageable.

Since the mineral discoveries were made after independence, the government accepted the fact that it had no capacity – financial, administrative, or technical – to carry out any substantial mineral prospecting or development on its own. Government realised that it needed the skills of foreign companies to successfully exploit the mineral resources (Harvey and Lewis 1990). For example, when De Beers discovered a diamond pipe at Orapa shortly after independence, the government negotiated a deal with the company that secured a working relationship. The shortage of skilled manpower gave rise to a decision that both the mine, the town and infrastructure at Orapa would be developed entirely by a new mining company, Debswana, that was formed to exploit the pipe. Debswana was owned 85 percent by De Beers and 15 percent by the Government of Botswana, with De Beers providing 100 percent of the capital necessary for exploitation (Harvey and Lewis 1990).

The willingness of the Botswana government to negotiate with foreign companies can be traced back to the attitude of negotiation that was present in the country, before, but also during, British rule. This stands in stark contrast to the Kaunda government that tried to lessen the influence of foreign companies, rather than work towards a close relationship with them. This is illustrative of the difference between extractive colonisation in Northern Rhodesia and the more co-operative situation that was present in the Bechuanaland protectorate.

Although the Botswana government did not contribute substantially to capital projects, it played an important role in mining development. In compensation for ceding mineral rights, the government obtained share capital. The benefits of shareholding were more than just financial, since directors were appointed to serve on the boards of the principal mining companies[65] (Harvey and Lewis 1990).

Like Zambia, the Botswana government also extended its involvement in the economy further than the mining industry, but with the difference that no public enterprise has come into being in Botswana as the result of nationalisation (Jefferis 1998). All public enterprises were established from scratch, by acts of parliament. This was possible because of Botswana's level of underdevelopment at independence. At independence there was no economic base except for the meat industry. Therefore the government saw itself responsible for the scope of economic development that was to take place. According to Jefferis (1998: 321)

> The avoidance of nationalisation reflects two characteristics of Botswana. Firstly, the ruling Botswana Democratic Party did not share the radical nationalist or socialist background of their counterparts in other countries, and opted for a pragmatic rather than ideologically driven approach to economic and social development. Secondly, Botswana achieved independence later than most other African countries, and when developing its own strategies, was able to observe (and avoid) some of the mistakes made and problems encountered elsewhere.

One important difference between the Zambian and Botswana strategies was that, although both governments tried to maximise revenues from mineral production, Botswana did this through negotiating the best possible agreements with the companies, whereas the Zambian government changed policy unilaterally. This must have created a high level of uncertainty, and therefore high transaction costs, in the Zambian economy. For Botswana

[65] In their negotiations with foreign companies the Botswana government made it clear that, although they expected privately-owned mining developments to be geared to the development needs of the entire nation, and that the government would take considerable interest in how mines were developed, they accepted the need for international companies to earn a financial rate of return comparable to what they could earn in alternative projects in other countries (Harvey and Lewis 1990).

Harvey and Lewis (1990: 116) state that "by the 1980s the Botswana government had a track record of agreements which was known internationally in the mining industry". An example was when the Botswana government decided to increase its share in diamond production, it did so through a change in the contract with De Beers that was allowed for in the negotiations of the Orapa mine just after independence[66].

The level of shareholding seems to be much the same as the shareholding in Zambia, but the paths that were taken to get to this point differ dramatically in the two countries. Whereas Zambia did it through the outright confiscation of property, Botswana followed a path of negotiation. It is possible to argue that colonialism explains these differences in attitudes, but it must also be taken into consideration that the situation regarding land and land ownership differed before colonial rule took hold in these countries. The situation for Zambia has already been sketched, and in Chapter 6 it is shown that the Batswana had, through their cattle industry, an institutionalised appreciation for the gathering and protection of private property.

The cattle owners in Botswana had a tradition of property protection, although maybe different from what is common today in an industrial country. It was more in the nature of control rights, which Rodrik claims to be very important, than rights that could be bought and sold. But, what is important, is the fact that people had the right to a specific piece of land and could claim the yield from that land[67].

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[66] The initial Orapa agreement included a clause which provided that, would conditions change so that one party was severely disadvantaged, the parties would meet to work out how to correct things. After production started at Orapa, the value of world diamond sales soared as part of the general commodity boom of the early 1970s. De Beers increased its prices, and the profitability of the Orapa mine far exceeded what the government, at least, had expected in 1969. The government sought to invoke this provision. New agreements were signed in July 1975, which saw government's shareholding increased to 50 percent (Harvey and Lewis 1990).

[67] The principal issue for Batswana in their survival was the provision of water for their cattle. The ability to finance a borehole for water provided control over land for grazing purposes, whereas surface water sources were communal (Harvey and Lewis 1990). Traditionally the chief or his representatives had control over boreholes and could allocate land accordingly. Tribesmen given land were not required to pay anything for the use of the land. At the same time, if individuals consistently disregarded complaints of their neighbours about their activities, such as tree-cutting or grazing too many cattle at one place, the ward-head or overseer could require them to move to a new area. "Taking land away from an individual for lack of compliance with the decisions of tribal authorities was, however far from common" (Hitchcock 1985: 92).

It can be concluded that the Batswana had respect for the general principle of private property before colonisation and they possessed a culture of negotiation. These traditions made it a lot easier for them to negotiate deals with the British, whether it was to protect them, or to establish deals with the mining companies.

Examples of infringement

One of government's roles is to intervene in the case of market failures. This type of intervention should, however, be monitored carefully because it sets the rules of the economic game and hence the incentives faced by the actors. Also, intervention can become so extensive that it violates property rights (such as a regulatory taking[68]). The problem with regulation is that governments tend not to take all the consequences of their actions into consideration.

Regulation is an example of a popular response to market failures by political agents. Some regulations may be justifiable in that they enhance knowledge-creating capacity, e.g. by subsidising research at universities. But regulation may also hinder potential competitors, increase the compliance costs for market participants, and limit the freedom of contract (Kasper and Streit 1998). Kasper & Streit (1998) also discuss the use of a tariff to stimulate production by local industries, as an example. They acknowledge the problem that this redistributes wealth from many dispersed and unorganised buyers to the few organised domestic producers.

Furthermore, if regulation is the result of lobbying rather than the result of an attempt to increase efficiency, scarce resources are not put to the most beneficial use and the result is poor growth and development[69]. By definition regulation should increase competition and assist in building knowledge capacity, not hamper economic growth. If a government makes decisions that are to the advantage of a small, well-voiced section of the population, and to the disadvantage of the majority, it has failed in its role as protector of property rights.

Infringement can be extremely subtle. One example from Zambia is where people's personal security was threatened. Kaunda saw groups opposing his rule as a threat to security and this threat therefore justified the use of violence against them. When Kaunda

[68] An example of a regulatory taking was discussed in article written by du Plessis and du Plessis (2005), where they show how the overuse of regulations infringe on the property rights of steel producers.

[69] In addition if governments spend too much time on regulating the market, they may fail to deliver market-supporting activities.

faced the outbreak of fighting between Lumpa followers and the police in July 1964, he used force to squash the uprising. He had frequently vowed that he would use whatever force was necessary against revolting fellow Zambians. For example he told the secession leaders in Barotse Province: "Today I warn, tomorrow I crush", and repeated these warnings to others who used tribalism and threatened to split Zambia (quoted in Pettman 1974: 39).

Other examples of infringement are less severe. At least six important tax and institutional changes were enacted between 1964 and the early 1970s, aimed at taxing windfall revenue and gaining more control over the mining sector. For example, after the referendum of 1969, the Zambian government changed the royalty and tax system in such a manner that the total tax on mining profits was 73 percent. Such a high tax rate comes close to expropriation and provided little incentive for expansion in the mining sector (Aron 1999).

The Zambian government started to regulate retail trade after the Mulungushi reforms of April 1968. It decided to confine areas of retail trade in which non-Zambians could participate to the centres of large towns. According to Pettman (1974) these restrictions affected some 830 retail shops. By August 1969 restrictions were extended to the wholesale trade. In November 1970 Kaunda removed the existing protection of expatriate trading in special areas, but gave all expatriate traders until January 1972 to become Zambian citizens or sell their businesses to Zambian citizens.

The regulation of agricultural prices provides another example of infringement that distorted the market. Turok (1989: 195) describes the situation as follows.

> In the late 1970s Namboard, acting on government instructions, paid farmers a rather low price for their maze. This caused farmers to move out of maize leading to a serious shortage the next year. In 1980 maize had to be imported at very high prices and was then sold at subsidised prices to consumers, the government having to meet a large bill.

One problem often encountered with regulation is that one form of regulation that distorts the market, creates the necessity for another form of regulation. In an attempt to regulate the price of basic foodstuffs in the country, the agricultural sector was distorted to such an extent that these foodstuffs had to be imported. Due to the high prices of these imports, government again felt obliged to intervene through regulation. Turok (1989: 198) describes the situation:

In 1975 Zambia imported almost 100 percent of its wheat, 85 percent of vegetable oils, and 60 percent of its cotton for processing. Due to the policy of subsidising food imports, wheat flour was sold by the milling company at 40 percent below the landed cost plus packing materials, while vegetable oil was sold at 15 percent below. The cost of this kind of subsidisation has been huge. While the masses obviously benefited from them, there is nevertheless good reason to question them because they reflect on wrong policies in agriculture and because they reveal a too ready expenditure of public funds when alternative policies might make this unnecessary.

In Zambia the increasing interventionism of the state did not arouse undue alarm in the early years, partly because it was widely recognised that much needed to be done to make up for the previous gross neglect, partly because state intervention was an accepted principle in the period, and partly because it did not seem to threaten existing interests (Turok 1989).

Again, the situation in Botswana proved to be much different. The main reason was Botswana's membership of SACU, which provided no autonomy in setting trade regulations. In Chapter 5 the graphs depicting relative trade restrictions, restrictions on the allocation of credit, and business restrictions, show how the situation in Zambia and Botswana differed. Zambia's relative level of these restrictions is much higher than those shown for Botswana.

One form of regulation that was popular with the Botswana government, since the middle of the 1970s, is financial market regulations (see for instance Figure 39 which shows the relative level of interest rate regulation). Government's strategy regarding the financial market was set out in a White paper where the regulation of interest rates were acknowledged "with a view to satisfying domestic business and general economic requirements" (Leith 2002: 54-55). According to Leith the approach was to change the regulated rates in response to changing circumstances, and that it was done successfully for a number of years. But in the first half of the 1980s, the economic circumstances began to change so rapidly that it was very difficult for the government to make the necessary adjustments in time[70]. Again, this shows the inefficiencies created by government

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[70] Leith (2002: 54-55) provides an example: "Substantial balance of payments surpluses, largely due to a major new diamond mine, were not fully sterilized by offsetting increases in Government balances. A significant liquidity overhang emerged. Although the regulated commercial bank lending rates were very low in real terms, the banks faced limited lending outlets which were not expanding nearly fast enough to absorb the growing deposits. A classic tug-of-war between the regulated and regulator ensued as commercial banks turned away deposits, and frequently required depositors to hold some portion of their funds in non-interest bearing current accounts. Changes in regulated commercial bank (CB) interest rates were slow

regulation. The prime lending rate of commercial banks was eventually deregulated in 1986. The improvement in Botswana's relative position for "Sound Money" coincides with this deregulation.

The examples of regulation discussed above are extreme forms of regulation, but each of them had an important influence on the respective economies. It is not suggested in this dissertation that there should be no regulation in countries. Regulation is used throughout the world to ameliorate the effect of market failures, and for that reason it also alters the wealth distribution in developed countries. It is not regulation *per se* that creates a problem, but the extent of the regulation. Regulation should increase competition, and not lessen it through the infringement on the property rights of the role-players.

7.4 CONCLUSION

In this chapter it is shown that the Zambian government became much more involved in the economy, and over a much wider spectrum, than the Botswana government. Furthermore, Botswana created an atmosphere in which international investors felt comfortable to invest, whereas the nationalisation of the copper mines in Zambia created uncertainty over the protection of property rights.

It is shown that these different approaches could be attributed to their respective forms of colonial rule. Zambia was subjected to extractive colonial rule where little protection was granted to the rights of the indigenous population, whereas Botswana's resources were unknown to Britain and no foreign companies operated on a large scale within the country before independence. But it is also suggested that the policy patterns after independence could be traced back to pre-colonial institutions. The biggest tribe in Zambia, and the one to which Kaunda belonged, had no history of gathering and protecting private property. The cattle owners of Botswana, of which the biggest ones became the ruling elite after independence, had a tradition of gathering and respecting private property. Therefore, although colonial rule in Zambia was extractive, it cannot be accepted straight away that the situation would have been the opposite if no colonialism had taken place.

In the protection of property rights, history is one element. To secure property rights it is also necessary that the ruler must be subjected to restraints in using coercive force and that there should be limits on its powers to prevent arbitrary seizure of assets

and inadequate, with the prime lending rate remaining below the rate of inflation for extended periods".

(North 1991). These formal limits will differ for each country because the supporting informal institutions will differ. Different institutions are appropriate under different circumstances and the way in which each country 'decides' on how to restrain their leaders, will also differ.

With this in mind, the role of the state in the success or failure of a country is highlighted once again. The success or failure of a country depends on the decisions that the government makes, because these decisions directly or indirectly affect the security of property rights and transaction costs in the economy. According to North (1990: 58-59), "there is an immense difference in the degree to which there can be relied upon contract enforcement between developed countries and Third World countries". Why do the nature of governments differ between Third World and developed countries? If governments know that the lowering of transaction costs and the protection of property rights are important for economic prosperity, why are there still such differences in how governments succeed in doing this? This, and also how the two countries differed in this regard, is the focus of Chapter 8.

CHAPTER 8
POLITICAL INSTITUTIONS AND THE RULE OF LAW

8.1 INTRODUCTION

Governments play a central role in institutional change because they define and enforce economic institutions. An essential part of development policy, therefore, is to determine how to create polities that will generate and enforce efficient economic institutions. Section 2 will elaborate on the link between political institutions and economic development.

The state must not be too powerful in the absence of countervailing powers, but it must also be kept in mind that if it is too weak and easily overthrown it may be unable to deliver the social and economic goods that groups expect, or to maintain order in the face of conflicting group demands. Acemoglu (2003: 3) found that "countries with greater constraints on politicians and elites and more protection against expropriation by these powerful groups, have substantially higher income per capita (i.e. higher long-run growth rates)", achieve greater investment rates, extend more credit to the private sector relative to GDP, and have more highly developed stock markets. For a country to prosper over the long term, governments, therefore, need to be constrained in their decision-making. Two forms of constraints will be discussed in this chapter—namely, democracy and the rule of law.

Although Britain left Botswana and Zambia with basically the same constitution, and therefore the same formal constraints, their response to these constraints were totally different. It will be discussed in section 3 how Zambia moved to more centralised decision-making, while Botswana adhered to the principles of democratic decision-making. Although there is no conclusive evidence that democracies fare better economically than autocracies, the advantages of a democracy as a restraint on government decisions, will be highlighted.

Section 4 considers the question of why the governments took these different paths of economic development. Why did they respond so differently to the inherited formal constraints? Was the centralisation of power in Zambia a reaction to their colonial experience and in accordance with the fashionable ideology of the day? Or were there also other reasons? North (1995: 25) suggests that "it is hard – maybe even impossible - to find a government that consists of wealth-maximising actors who are unconstrained by other considerations". These "other considerations" will be discussed in section 4. Section 5 concludes the chapter.

8.2 POLITICAL INSTITUTIONS AND ECONOMIC DEVELOPMENT

What role do political institutions play in the process of economic development? It can be argued that malfunctioning political institutions severely harm economic performance through a reduction in both incentives and opportunities to invest and innovate, because governments are important role players in the economic environment. Not only do they provide security and property rights, they also implement economic policies and provide infrastructure and economic services. Through their policymaking they create an environment that either makes a country attractive for international investment or not.

Politics are often the main reason for explaining Africa's poor economic performance. The World Bank, for instance, have stated in the "Berg Report" that economic growth in Africa had been undermined by "domestic policy inadequacies" (World Bank 1979: 1.6). And again in a Policy Research Bulletin that "at the core of Africa's economic crisis, lay poor public policies and the lack of 'political will' to correct them" (World Bank 1994: 99).

Reasons why governments play such an important role in economic growth have already been discussed in other parts of this dissertation. The reasons have all focussed on the fact that the expansion of markets necessitate more specialised producers, and for these to come into effect impersonal contract enforcement becomes essential. In the absence of effective impersonal contracting, the gains from "defection" are big enough to forestall the development of complex exchange. A capital market, for instance, necessitates the security of property rights over time and will simply not evolve where political rulers can arbitrarily seize assets or radically alter their value. And according to North (1991: 100-101) "establishing a credible commitment to secure property rights over time requires either a ruler who exercises forbearance and restraint in using coercive force, or the shackling of the rulers' power to prevent arbitrary seizure of assets". These constraints are discussed in the following section.

Why do governments choose policies that are detrimental to society? Acemoglu (2002: 2) argues that "there are strong empirical and theoretical grounds for believing that inefficient policies and institutions are chosen … because they serve the interest of politicians or social groups holding political power, at the expense of the society at large". The reason why groups may use their resources (this can either be their time or monetary) to influence government in their decision-making, is because economic policies can alter the power base in an economy.

Political rules lead to economic rules, but powerful groups in society influence these rules, and in turn economic rules influence the powerful groups in society, which will again influence the political decision-making. Causality therefore runs both ways: political institutions influence economic institutions and economic institutions influence political institutions. For example, property rights and hence individual contracts are specified and enforced by political decision-making, but the structure of economic interest will also influence the political structure. North (1990: 48) describes it as follows:

> In equilibrium, a given structure of property rights (and their enforcement) will be consistent with a particular set of political rules (and their enforcement). Changes in one will induce changes in the other.

With this interrelatedness of influence in mind, it can be concluded that political institutions will be stable only if they are supported by organisations with an interest in their perpetuation. This highlights the importance of social conflict, the leadership in the country, and the prevailing informal institutions, as will be discussed in section 4.

8.3 CONSTRAINTS ON POLITICIANS

8.3.1 Democracy vs. centralised decision-making

Over time a large number of policy devices have been invented and implemented to enhance the likelihood that public policy meets the aspirations of the majority of citizens. One of these policy devices is the establishment of a democracy. Lipset (1959a: 71) defines democracy as a

> political system that supplies regular constitutional opportunities for changing the governing officials, and a social mechanism that permits the largest possible part of the population to influence major decisions by choosing among contenders for political office.

Democratic governments are typically seen as a more politically efficient choice than an autocracy. North (1990: 109), for instance, explains the move towards democracy as "a move towards greater political efficiency". Different reasons are discussed in the literature as to why democracy may result in better economic performance.

- A democracy compels a nation to hold regular, free and competitive (multiparty) elections (Alesina and Perotti 1994). With the openness and certainty this creates, transaction costs are lower. It was already established that the minimisation of transaction costs in the economic market plays an important role in the process of economic growth and development. It is important that, not only in the economic market, but also in the political market, there should be a drive to minimise transaction costs.

The lower the transaction costs, the more willing the voters will be to cast their votes. And one way to lower transaction costs, is to lower information costs. This will be lower if there is open debate among opposition parties. If an incumbent's opponents are able to bring his or her deficiencies before constituents, it will not only reduce information costs for the voter, but also reduce agency problems.

- There are more civil and economic liberties available to the population under a democracy than under an autocracy. With no absolute power in the hands of a ruler, the infringement on personal property rights are less likely. This contributes to the protection of property rights. De Long and Shleifer (1992) illustrate this point when they show the incompatibility of despotism and development. According to them absolutist states are characterised by the subjection of the legal framework to the prince's will: subjects do not have rights, they have privileges, which endure only as long as the prince wishes. "His incentive to extract resources is restricted only in that he has an interest in keeping the people prosperous enough for him to extract more resources in the future, and is augmented by the possibility of using taxes from his current domain to conquer other lands" (De Long and Shleifer 1992: 10).

  North (1981) ascribes economic growth in the west to the increasing security offered to property rights and freedom to endeavour to make profits. Such security is probably stronger in the absence of a powerful individual autocrat or 'absolutist prince.' Under an absolute ruler the legal framework and property rights can be altered from time to time to produce short-term revenue.

- Under democracy, the range of feasible economic policies is likely to be limited to the median voter's preferences. This situation is more likely to produce moderate results.
- Political participation allow for greater voice to all the citizens, without the need for conflict or civil strife (Rodrik 1997). This will secure a more stable society.
- Democracies are less able to withhold economic rewards from the losers in political competition. The losers still have an outside chance to benefit in a democracy. This increases the incentives for social groups to partake in positive cooperative behaviour (Rodrik 1997). The more the sources of power,

status and wealth are concentrated in the state, the more the political struggle tends to approach a zero-sum game in which the defeated lose all. This, in the end, makes it harder for the ruling party to abstain from its hold on power.

- The greater the importance of the central state as a source of prestige and advantage, the less likely it is that those in power – or the forces of opposition – will accept rules of the game that institutionalise party conflict and could result in the turnover of those in office (Lipset 1994).
- In a more centralised society, more hinges on the ability of fewer individuals. Economic crises are a threat to democracies as well as to dictatorships, but in a less centralised society the problem is addressed by a larger number of preceptors, which is more likely to span a wider range of characteristics. "Diversification here not only reduces risk in a standard, static sense, but also as a deeper longer-term advantage in an environment that is changing and is essentially unpredictable"[71] (Sah 1991: 72).
- Under an autocracy, consultation and supervision are absent. Decision-makers in the executive are also deprived of feedback that can be crucial both for the technical quality of policies and for the political support necessary to sustain them. Economic reforms are thus likely to be unstable and subject to reversal[72] (Haggard and Kaufman 1995).
- In the case of a crisis a democracy is more likely to survive, because "under democracy it is easier to change a government without changing the regime" (Przeworski and Limongi 1993: 62).
- Another reason why democracies will find it easier to survive, is because the rulers derive legitimacy from more than their economic performance.
- Democracy makes government accountable for its decisions. Accountability means that "those who exercise power on a continuing basis are required to answer or account for their conduct to others who are entitled to judge it" (Sklar 1989 (reprinted 2002): 69). Elections at regular intervals serve that purpose. In Chapter 4 it is shown that no one can force a government to keep its commitments. And if a government is not accountable, the ability to credibly commit to decisions, is weakened.

[71] The centralisation of power in the person of Kaunda is discussed in section 8.4. With a declining income from the copper mines, economic solutions had to come from only a few people (and they were inexperienced in handling such crisis).

[72] This was the case in Zambia during the economic crisis of the 1970s and 80s.

- The competition between political parties is an important advantage of a democracy. Monitoring takes place not only within but also across political parties. Competitive political parties are in a good position to monitor any shirking. And because they can gain great advantages by providing evidence of the opposition's shirking, they provide a good monitoring device (Wittman 1989).
- Democratic institutions provide a check on governmental power and so limit the potential of public officials to accumulate personal wealth by misusing their positions of power. The one-party rule, which has been common in Africa, makes it easier for rulers to make decisions that confiscate wealth rather than add to it, because there is little cost (e.g. the cost of losing the next election) involved. Ndulu and O'Connell (1999: 45) find that the economic downturn in SSA corresponds to a period of "consolidation of authoritarian rule".
- Democracy also has the advantage that it makes succession more predictable and stable. When the autocrat dies or is deposed of, there are no formal institutions that can be relied upon to select or install a new dictator peacefully. Democracies provide the structure for an orderly succession of leaders. Thus, in Olson's words: "virtually the only societies in the world today in which there can be much confidence about what the government will be like a decade or two into the future are democracies" (Olson 1991: 153).
- Related is the advantage of a longer time horizon: Under an autocracy the ruling party cannot credibly commit that the regime itself will last. This creates the problem of decisions influenced by a short time horizon. When an autocratic government, like for instance the Kaunda government, is insecure, or for any other reason has a short time horizon, it has no incentive to encourage the long-run investment that will increase the output of the domain in the long run. Przeworski and Limongi (1993: 53) put it strongly: "An insecure autocrat, in particular, is likely to plunder the society". Of course the short time horizons of elected politicians also cause severe problems, but it is only in democracies where a predictable environment for long-run investment in capital goods and in research and development is secured, because there is more certainty that the regime will last.
- Democracy also has the ability to deal effectively with ethnic diversity. Collier (1998: 5) finds that ethnic make-up affects rates of growth only in nations that lack democracy. This might be explained by the fact that "democracy has the potential both to discipline governments into delivering reasonable economic policies and provide a framework in which groups can negotiate mutually beneficial outcomes". It also provides institutions in which disputes between

ethnic groups can be taken care of. Collier suggests that the low rates of growth in the nations of Africa may come not from their ethnic diversity, as is often predicted, but rather from their lack of democratic forms of governance.

With all the abovementioned advantages in mind, it is probably not an accident that most of the richest countries in the world are democracies. The correlation between democracy and high income is sometimes alleged to be due to a taste for democracy in high-income societies, which reduces democracy to a luxury only affordable by rich countries. This assumption started with work done by Lerner (1958) and Lipset (1959b), which proposed that nations with a higher income have a greater chance to sustain democracy and that prosperity stimulates democracy. Recently Barro (1999) confirmed the Lipset hypothesis as a strong empirical regularity. He showed that increases in various measures of the standard of living forecast a gradual rise in democracy.

Barro (1999) took this analysis further and explained that failing democracies may be the result of democracies that arise without prior economic development. He shows that democracies that are, for instance, imposed by former colonial powers or international organisations, tend not to last. Barro's regression analysis predicts that, as with the African experience of the 1960s, democracy that gets installed well ahead of economic development will not last[73].

Barro (1999: 158) concludes that the net effect of democracy on growth is uncertain. He explains it as follows:

> An expansion of political freedom – more democracy – has opposing effects on economic growth. On the positive side, democratic institutions provide a check on governmental power and thereby limit the potential of public officials to amass personal wealth and to carry out unpopular policies. But on the negative side, more democracy encourages poor-to-rich redistribution of income and may enhance the power of interest groups.

This brings the discussion to the inherent problems of democracy. North (1990: 51) equates political markets with economic markets, stating that "…[efficient] markets are scarce enough in the economic world and even scarcer in the political world". The following are general problems associated with democracy:

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[73] This, of course, does not correspond to the observations in Zambia and Botswana. Zambia's per capita income at independence was much higher than that in Botswana, but democracy lasted in Botswana and not in Zambia.

- One of the advantages of a democracy that was discussed, is the fact that it provides more secure property rights. This can also have a negative side if the state specifies a set of property rights that maximises the revenue of the group in power, regardless of its impact on the wealth of the society as a whole (North 1981, 1997).
- Similarly, if an effective opposition does not exist, one loses a lot of the stated advantages of a democracy. Under such conditions, the authority of officials in power will steadily increase, and popular influence on policy will be at a minimum.
- There is also an incentive problem. For voters to make the optimal choice at the ballot box, they have to be informed. But generally, voters have little incentive to become informed. This, of course, leaves room for political agent opportunism. With voters not informed, political agents have the opportunity to shirk, take bribes, etc., without the treat of being voted out in the next election. But it must be admitted that candidates develop reputations. If they have not kept their campaign promises in the past, they are less likely to be re-elected or elected to a higher office in the future (Lipset 1959a).

These disadvantages contribute to why North (1990) stresses the importance of having rules that eliminate the failure of political organisations. To be able to benefit from a democracy, it is important to ensure that competition gets rid of growth retarding agents.

The economic rise of dictatorships, such as the South Asian tigers, has led to arguments that economic growth is facilitated by authoritarianism, not democracy. Arguments have been that "the masses would be ungovernable under democracy because the social and welfare demands of the working class and the poor would impede economic advances" (Lipset, Seong and Torres 1993).

Evidence (see for instance Barro 1999) show that in the post-war era, electoral democracies have not grown faster than dictatorships. And in a review of 21 quantitative studies investigating the relationship between regime type and economic growth, Przeworski and Limongi (1993: 60) explained that "eight studies found in favour of democracy, eight in favour of authoritarianism and five discovered no difference".

But on closer account one finds that, by not only concentrating on the authoritarian regimes that has realised high economic growth rates, but by taking all authoritarian regimes into consideration, a different picture unfolds. In the vast majority of developing countries political authority has actually been highly centralised, and that with a handful of exceptions, their performance has been poor (Sah 1991). For instance dictatorships in

African and Latin America did not realise the same outcome as the successful dictatorships in Southeast Asia.

Olson (1991: 154) discusses an important historical event that also shows the general supremacy of democracies. He shows that "after World War II economic development and technological advance spread mainly from democracies to other countries, rather than the reverse".

Both Rodrik (1997) and Alesina and Perotti (1994) accept the fact that there does not seem to be a positive functional relationship between democracy and long-run growth, and then debate the statement whether democracy is "the safer choice". Rodrik finds that under a democracy the expected long-run growth rates cluster more closely around the mean than under autocratic rule. There is less variation of outcome. Rodrik (1997: 3) demonstrates that democracies perform better than authoritarian regimes in a number of respects and his results show that: "a risk-averse individual not blessed with a lot of capital – an individual that is like most of us – is considerably better off living in a democracy". Alesina and Perotti (1994: 353) agree with Rodrik by concluding that "democracies have done much better than the worst dictatorships but not as well as some of the most successful dictatorships".

Botswana displays an unparalleled record of political stability in SSA. Free and fair elections have been held at five-year intervals since the pre-independence election of March 1965. In each of these elections the ruling Botswana Democratic Party (BDP) won with large majorities, causing the country to be named "a de facto one party state through the ballot box" (Tsie 1996: 600). The situation created stability and the impression that the constituency are satisfied with the work done by the BDP, but on the negative side it has created a situation where democracy has not been "tested". For a democracy to be seen as a truly mature system, it must be tested by a peaceful regime change. This has not happened in Botswana and it is hard to predict whether the BDP will hand power to an opposition.

The Botswana government, in principle, accepts the idea that political rights ought to be respected. It has, however, been hesitant to apply them too extensively in practice. Not only has much been written in the literature on the discrimination against the Basarwa[74],

[74] A report released by the United Nations Committee on the Elimination of Racial Discrimination condemns Botswana's treatment of the 'Bushmen' as racist. The report, released in August 2002, criticises Botswana's eviction of the Bushmen (who are known in Botswana as Basarwa) from their ancestral land in the Central Kalahari Game Reserve. Prof Kenneth Good from the

but generally the BDP has also made political participation difficult. Holm (1988: 193) describes it as follows:

> Complete democratic rights are only enjoyed by a small group that is educated and privately employed. The freedom to run for office is, in theory, very great. Anyone who can raise the necessary deposit may contest a seat. There are, however, several important restrictions. Most significantly, no government employee can run for office. This includes civil servants, teachers, and employees of parastatals. They cannot even take a leave of absence during the campaign. Since this group constitutes two-thirds of the wage- and salary-earning public, this means that most who are financially able to run for office cannot do so without resigning from government, hence bearing not only the costs of the campaign, but also the risk of a career change. For the society as a whole, this restriction effectively excludes most of those who are informed and articulate on policy questions.

The democracy in Botswana also has other weaknesses. Until the mid-1980s, only government media, both radio and the daily newspaper, existed. There are also limitations in the electoral system. Botswana operates a single member constituency system. Under this "winner-takes-all" electoral system only one candidate makes it to the National Assembly. This system benefits established and politically experienced parties that enjoy the advantage of incumbency.

Despite being one of the oldest democracies in SSA, voters in Botswana are still relatively ill-informed about their civic rights and responsibilities and their political rights (Molomo and Somolekae).

The mentioned problems lead to the political marginalisation of a significant proportion of the population, rather than a deepening of democracy. It can therefore be concluded that Botswana resembles a democracy, but there is cause for concern.

Zambia received the same constitution as Botswana at independence. The multi-party system was abrogated in 1972 and replaced by a one-party state. Elections were still held, but the only candidates that were allowed to partake were those approved by UNIP. This lasted until 1990 when the multi-party system was introduced again. Power was transferred to the Movement for Multiparty Democracy (MMD) after the general elections in November 1991. Therefore, for most of the period under discussion, Zambia was a de facto one-party state.

University of Botswana has also contributed to this subject (Good 2003).

With the exception of the trade union movement, which was already a well-established group by the 1970s, no other means of organised opposition to government was allowed. The government of President Kaunda, therefore, had to deal with the problems created by a fading economy, the hostilities created by the trade union movement, and any other form of opposition that they encountered during that period, without having any of the advantages of democracy that was mentioned at the beginning of the section. It would be reasonable to speculate that UNIP would have lost control at a general election (or at least much of it) during the 1970s and 80s, were other parties free to participate, due to the difficulties experienced in the economy. Therefore, the move to one-party rule can be seen as a means for UNIP to cling to power. Possible reasons for this will be discussed later.

8.3.2 The rule of law

The second constraint on government comes from the rule of law. For economic growth to be sustainable, property rights need to be protected, not only from rival private parties, but also from government. This protection not only provides order in the economy, polity and society, but also creates a form of predictability that lowers transaction costs. If government has unlimited power, it may easily infringe on the property rights of private citizens.

Constraints to the power appear to De Long and Shleifer (1992) to be the most important determinants of what Adam Smith calls "security of property". And the importance of an effective rule of law is shown by Alesina and Perotti (1994) in their discussion of the success of the four dragons in Southeast Asia. These countries are undemocratic, but grant a fair amount of individual, and especially economic, rights to their citizens. Long-run economic growth, therefore, entails the development of the rule of law for the protection of civil and political freedoms. The rule of law means the establishment of the rules of "due process" and an independent judiciary (Lipset 1994). In practice this means that the rule of law consists of formal rules, which are enforced by an independent judiciary, and informal rules that influence the way society responds to the formal rules.

There is no prospect of a laissez faire government under the rule of law, but rather that government's actions must be consistent with the rule of law. The rule of law prevents, or at least greatly hinders, the exercise of arbitrary power by the state that would undermine the credibility of the many formal institutions. The arbitrary infringement of property rights by government, for example, would be unlawful and beyond the scope of legitimate government activity. And if government does not adhere to the principles of the rule of law, and power is used arbitrarily, it would increase transaction costs because the citizenry will not know how to behave; any such action would produce unforeseen risk.

Berkowitz, Pistor and Richard (2001) tried to establish whether countries that experience lawlessness, also experience lower levels of investment because the cost for individuals to protect themselves, that is the transaction costs, may be too high. They found a strong association between economic development and legality in their sample of countries. They recognise that rich countries could afford better institutions, but suggest that it is more likely that good legal institutions are a precondition for long-term economic growth and development. Good institutions help countries to become rich. They are not alone in this analysis for there are other scholars that emphasise the crucial role of legal institutions for sustained economic growth (see for instance Knack and Keefer 1995, North 1981, 1990).

From the literature three, broadly defined, principles for the rule of law can be identified: there must be clear limits to the power of government at all levels; the law should be known and certain; the law should be supported by the prevailing informal institutions.

Clear limits to the power of government at all levels

In Chapter 4 it is mentioned that the state as third party is the most efficient enforcer of formal rules, but that does not exclude the actions of politicians and officials from scrutiny under the law. Kasper & Streit (1998), amongst others, discuss the development of a constitution, which subjects the rulers, elected politicians and officials to general constraining rules, as a popular device to limit the powers of government.

One of the important constitutional devices is to separate the powers of government among the legislative (rule making), the executive (rule-bound implementation) and the judiciary (adjudication of conflicts), and to lay down a system of checks and balances among the holders of these three types of authority over collective action.

A legislature operating under a written constitution remains sovereign, but it cannot be supreme. It is sovereign in the sense that parliament is the sole legislative authority and it alone has the power to make, amend or alter laws for the peace, order and good government of the country (Otlhogile 1998). But it is not above the authority of the courts.

Although the separation of powers is most of the times protected by the constitution, an independent judiciary (often a constitutional or supreme court) guards over the constitution in turn. This explains the importance of an independent judiciary. If the state controls the judiciary, it produces a system that focuses more on the power of the state and less on the private rights of individual citizens. According to Beck and Levine (2003) cross-country differences in the independence of the judiciary are critical for explaining, for example, cross-country differences in financial development.

Botswana inherited a formal constitution at independence, which provided the president with extensive powers. These powers were kept in check by the independent judiciary, as the following example (which shows a clear separation between the legislature and the judiciary) illustrates:

> In 1984 parliament amended the citizenship laws to bar Batswana women married to non-Batswana husbands from passing Botswana citizenship to their children, regardless of whether or not they were born in Botswana. By 1991 women were against the law on the grounds that it discriminated between male and female. When the matter was brought to trial, the courts ruled that, although the legislature is supreme within its sphere of law-making, those powers must be exercised in accordance with the constitution. In this way, the courts declared the citizens of Botswana – male and female – equal before the law (Otlhogile 1998: 157).

Although Zambia operated under basically the same constitution, the relationship between the executive powers and the judiciary was totally different. The executive did not accept the authority of the judiciary, especially not where racial issues were at stake, as an example from 1969 illustrates.

The High Court, the judicial constraint on the Zambian government's power, became the centre of a major political crisis in June 1969 when a white judge squashed the sentence levied against two Portuguese soldiers by a black judge. Kaunda condemned this as a political judgement, while the chief judge defended the ruling saying in a letter: "If the Courts of Zambia were to impose excessive sentences… simply because the offenders were associated with a foreign regime, then we would be following the example of aggression set by the Portuguese Courts" (quoted in Pettman 1974: 34-35). The publication of the Chief Justice's letter triggered off a violent reaction, including the storming of the High Court by members of Zambia Youth Service. Among the placards carried were "White Men Cannot be Zambians" and "Kaunda is the only unchallengeable authority in Zambia" (Pettman 1974: 34-35). The crisis resulted in a number of resignations, including the white judge who started the controversy, and the gradual Zambianisation of the Court after changes in the law allowed Zambians to be appointed judges after having served five years as magistrates (Pettman 1974).

The example illustrates the conflict that was present between the executive and the judicial authorities. There was resentment against the independence of the court and the restraint it placed on government– especially in the case of an all-white judiciary.

The law should be known and certain

It is necessary to ensure that all citizens are formally protected from the arbitrary use of force by fellow citizens and the government. According to Kasper and Streit (1998: 120): "where human interactions are determined by the violence potential of thuggish people or groups, ordinary people experience injustice". This also means that citizens must be able to predict with reasonable certainty the consequences of their actions. To be effective this needs to be done in a low-cost, non-violent way, but to such an extent that individual freedom is limited so as to avoid destructive conflicts.

An independent judiciary and impartial tribunals that follow the rule of due process and deliver judgement whenever laws are violated, allow individuals to anticipate the response to their actions. If rules are broken, sanctions are applied in a predictable manner and all people are treated equally before the law.

This is important because the effectiveness of the enforcement shapes the whole character of the game. According to North (1990: 4) "some teams are successful as a consequence of constantly violating rules and thereby intimidating the opposing team. Whether that strategy pays off obviously depends on the effectiveness of monitoring and severity of punishment".

The examples of Botswana and Zambia raised in the previous section, show a difference that is also applicable to this section. If government interferes with decisions made by the judiciary, uncertainty is created regarding future decisions. No one is able to predict what will happen in the future, because the decisions will be affected by the judgement of government. Therefore, judicial decisions become politically tainted.

The law should be supported by the prevailing informal institutions

Laws must be such that they do not, on the whole, clash with the informal institutions of the community and their fundamental values, so that people are able and willing to obey the law. The deterrent value of the penalties depends not only on the ability and willingness of the authority to enforce the relevant regulations, but also on the level of acceptance, by the citizenry, of the judgements rendered by the country's institutions.

The rule of law requires a generally law-abiding civil society where formal judicial sanctions are supplemented by spontaneous enforcement, such as social disapproval, shaming and exclusion. It is necessary for the sustained rule of law in a community that an attitude of legality is fostered and that citizens subject themselves willingly to the laws of the land. This will also reduce the transaction costs of law-enforcement.

Developing norms of behaviour that will support and legitimise new rules is a lengthy process, and in the absence of such reinforcing mechanisms, polities will tend to be unstable. Unfortunately, it often happened that with independence the departing colonial power left the colony with formal rules to guide the rule of law that were not supported by the prevailing informal institutions in the colony. Djankov, et al. (2003) refer to this as the inefficient transplantation of institutions through conquest and colonisation. Many countries have inherited their legal systems, but the institutions, which in the origin country respected the rule of law, may not, once transplanted, remain efficient due to the absence of supporting informal institutions. The fact that a transplant country (in)voluntarily receives a formal legal order, does not imply these transplanted formal legal rules are compatible with its initial conditions.

Scholars have long noted that the quality of law on the books does not ensure their actual enforcement. In their paper, Berkowitz, Pistor and Richard (2001) highlight the importance of supporting informal institutions, rather than the quality of the law on the books. They explain that the transplantation of formal legal systems from European countries to their colonies has shaped the legal order in most of these countries, but that it often happened that the imported law did not match demand in the new country. If the law is not adapted to local conditions, or if the population within the transplant was not familiar with the law, then it can be expected that initial demand for applying these laws will be weak (Berkowitz, et al. 2001). Furthermore, the judges, lawyers, politicians and other legal intermediaries that are responsible for developing the law must be convinced of its appropriateness for their country.

Even though the transplant effect is strongly path dependent, the institutions can indeed be modified. A few countries, like Hong Kong, Taiwan, Singapore, Spain and Portugal, received better legality ratings than the Berkowitz-model predicted. An explanation being that most of them have made considerable investments in reforming their legal systems.

Berkowitz, Pistor and Richard (2001) state that countries that developed a formal legal order on their own should develop more effective legal institutions than counties that received a complete package from a colonial power. There could however be situations where the transplanted law is relatively compatible with the original needs and this could offset the fact that the laws were transplanted. This was true for Botswana.

Botswana and Zambia inherited a written variation of the Westminster model of government from Britain at independence. Both countries are therefore perfect examples of countries subjected to the transplant effect. The constitution was not established by the people at a referendum or a constituent assembly elected specifically for that purpose, but by the colonial power.

The British left their former colonies with constitutions as the framework of powers, procedures and rights that are vested in the government. Most written constitutions provide for the separation of the functions of government organs, but the one these countries received does not. The constitutions vested all executive powers with the president who was the head of the state and government. It leaves the president with the power to be commander-in-chief of the armed forces; the president appoints all ministers, assistant ministers, and permanent secretaries; may exercise the prerogative of mercy; and appoints a vice-president (Parson 1984).

Although Zambia started out with the same constitution as was presented to Botswana, there was internal pressure to change it to something perceived as "more suitable" to the needs of post-colonial Zambia. In June 1969 a constitutional referendum did away with the requirement for referendums to amend the previously entrenched clauses within the Zambian Constitution. This step ensured that as long as a single party such as UNIP controlled the National Assembly, it could change the constitution without first getting the approval of the nation (Pettman 1974). The government made use of this amendment to change the constitution to instate the one-party democracy that was referred to in the previous section.

The effective power both within the Party and the state was vested in the President of UNIP, who was simultaneously the President and Head of State/chief executive (Ollawa 1979). The new constitution made it clear that the party was to be supreme over government as the phrase 'the party and its government' implies. The main purpose of the cabinet was to implement policies, rather than policy formation (Burdette 1988).

In practice this meant the concentration of power in the President of UNIP and also served to subordinate all other organs of the state such as the Cabinet and the legislature to himself. Ollawa (1979: 261-262) describes it as follows:

> This strong constitutional and power position of the President within Zambia's one-party system thus enables him in actual fact to determine personally the broad outline of major national policies or to make many important decisions. This view is enhanced by the realisation of the fact that many policies and decisions promulgated by the Party are usually made by the President himself and presented by him to the Party's highest policy-making body, namely the National Council.

President Kaunda not only consolidated all political power, but also silenced the judiciary as oversight agency. During the Second Republic the important constraints on the government (opposition parties and the judiciary) were silenced. This seems to be a plausible explanation for the unresponsiveness of the Zambian government to the changing needs in the Zambian economy, while raising transaction costs and thwarting the protection of property rights.

Reasons for the change of the constitution are difficult to identify. It could have been in response to colonisation and the drive to get rid of European influence, since it was fashionable at that stage in Africa to move to more authoritarian rule, or it could be due to the personality of President Kaunda. And, related to this, why did the informal institutions allow such a move? The following section discusses possible reasons for the centralisation of power.

The situation in Botswana was from the onset of independence, and even before that, different. According to the judgement of Colclough and McCarthy (1980) both Khama and Masire were personally deeply committed to the constitutional rule of law. For instance, in colonial times the characteristic response of traditional leaders to dissatisfaction with the administration was not to provoke dissatisfaction in public, but to take legal action. Seretse's uncle, Tshekedi Khama, also initiated several legal actions against the British administration[75].

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[75] Tswana political culture does not support extremist organisations. Both the BNF and the BPP started out with radical socialist and antiracial platforms. Both soon concluded that such politics would not gain them popular support. Even opposition to South Africa has been handled in a very low-key fashion. The traditional Tswana values of public discussion, community consensus, non-violence, and moderation are critical elements of a democratic political culture (Holm 1988).

Since independence the same attitude has prevailed. As Adamolekun and Morgan (1999: 590) concludes: "The few minor changes to the constitution that were made have been approached with considerable reluctance and caution, while the constitution itself has rarely been flouted. This gave Botswana the reputation of a country in which the rule of law, assured by an independent court system, is predictable".

8.4 POSSIBLE REASONS FOR THE CENTRALISATION OF POWER IN ZAMBIA

8.4.1 Colonialism

British colonial rule had a great impact on the character of central government in both Botswana and Zambia. Political accountability to parliament by public officials had been adopted from the British style of administration. Botswana stayed on this path, whereas Zambia did not. It is possible to relate this to the different forms of colonisation, with Botswana's experience of participatory colonisation and Zambia's of the extractive form. According to Acemoglu and Johnson (2003a: 86) "there is a great possibility that extractive colonisation leads to extractive institutions, where the majority of the population faces a high risk of expropriation by the government, the ruling elite, or other agents". Extractive institutions are therefore characterised by few checks on the power of ruling elites and little protection for private property, as was the case in Zambia.

Many of the decisions the post-colonial Zambian government made can be related to the extractive nature of the colonisation they were subjected to. Colonisation creates path dependency and in Zambia many policies can be explained by the drive to rid the country of any further European influences. This is illustrated in the previous chapter's discussion of transaction costs and the infringement of property rights through nationalisation.

Another example where colonial rule can be more directly linked to post-colonial decisions, is the choice of the person that came to power after independence. In Zambia the traditional structure of Chiefs was broken down and Kenneth Kaunda came to power without the same legitimacy Khama had. Kaunda was the strong, charismatic leader of the resistance struggle, but this was ineffectual to bring about unity in a much-divided society after independence. Reasons for the social conflict are discussed below.

Botswana had a different experience during colonial rule, with much less British influence, not as much discriminatory policy, and fewer European companies, to deal with. It cleared the way for greater cooperation between the post-colonial government and these companies and expatriate workers. With no extractive colonialism the traditional structure of the people of Botswana remained very much intact and the "rightful heir" came to power after independence, although not as a monarch, but as part of a democratic system.

Was Zambia therefore destined for failure because of extractive colonialism? That they had to deal with problems due to this type of colonialism cannot be ignored, but "path dependency is not a story of inevitability". If the Kaunda-government were convinced of the advantages of a democracy, it would not have turned in the opposite direction as their routine reaction to the colonial power. Since the post-colonial Zambian government did change the formal institutions left by Britain (e.g. the constitution), the country was therefore not merely an inevitable victim of the decisions of the colonisers. Furthermore, it was not as much the extractive institutions created during colonisation that were transplanted into post-colonial Zambia, but rather a reaction towards the very existence of extractive institutions during colonial rule (i.e. reactive institutions came about). These "reactions" were taken by autonomous leaders, which were not mere victims of colonialism.

The next question is to what extent these reactions were tainted by social conflict and to what extent the social conflict was due to colonialism.

8.4.2 Social conflict

Social conflict may take on a variety of forms. It can either be violent, like a war over control of land, or it may be in the form of industrial conflicts (strikes and lockouts) or even legal conflicts (lawsuits) (Hirschleifer 1987). In Chapter 4 a distinction is made between *de jure* and *de facto* political power and how conflict between them can be detrimental to the economy due to the resulting inefficient policy choices.

Conflict gives rise to a wide variety of efficient and inefficient institutions, and if the inefficient institutions are in the majority, the country will not grow. Social conflict is, therefore, costly for the economy and bad for growth. It is harmful both because it diverts resources away from economically productive activities and because it discourages such activities through the uncertainty it generates. But where does social conflict come from?

Economists generally find the reason for social conflict in the problem of scarcity. All living things compete for their means of existence. Acemoglu (2002) explains that whatever decisions are made, there will always be winners and losers (especially in the short term). For example, income or profits may go up for some individuals or groups as a consequence of a given policy, while it may fall for others. Even if the net social outcome of a policy decision is positive, the losing groups will be aware of their loss (Goldsmith 1998). To reach Pareto optimality, some form of agreement has to be reached between the winning and losing parties in order to force the winners to compensate the losers. For this to be successful and enforceable, some form of contract or formal promise needs to exist.

This is easier said than done, because the process of contracting seems to be an intricate one. Sened (1997) ponders the question of how parties can reach an agreement while mutual suspicion exits between them. Even without suspicion it is difficult for a group, where each individual has their own objective, to reach a conclusion that satisfies all contracting parties. "Human history is richer with examples of how mutual suspicion prevents players from improving their conditions than with examples of how mutual confidence makes individuals co-operate to reach mutually beneficial institutional changes" (Sened 1997: 74-75).

Furthermore, as is explained in Chapter 4, this even becomes more difficult if one of the contracting parties is the state. With the state as the ultimate enforcer of contracts, no commitment between the state and the other contracting parties is possible and powerful groups in society may find it easy to influence the decisions.

In Chapter 7 two examples from the Zambian history are discussed in which transaction costs were raised and property rights infringed because of mutual suspicion. Mutual suspicion existed between the mining companies and the post-colonial Zambian government. It is shown that this conflict was part of the decision that led to the nationalisation of the copper mines and that the nationalisation created no long-term advantages for the Zambian economy. This stands in contrast with the situation in Botswana where cooperation was the order of the day. In Chapter 7 these reactions are linked to the two countries' colonial experience, but in this section two other sources of social conflict in the Zambian economy that cannot be attributed to the colonial process, are discussed.

It is not possible to relate these conflicts, which are the conflict within government itself and also the conflict between government and the trade union movement, to colonial rule, but rather to the increasing centralisation of power that has come about in Zambia since independence. These types of conflict, their origin, and the reaction to them, are discussed and contrasted with how the Botswana government averted possible conflict with the chiefs who lost their power at independence.

In the years immediately after independence, infighting in the Zambian government was at the order of the day. It is possible to attribute this infighting to colonial rule, because violence was institutionalised, especially at the end of colonial rule. The use of violence was, however, not confined to violence against the colonial administration, but it was also extended to any opposing group. In practice this meant that anyone or group opposing UNIP leaders before independence, were subjected to violence. This has set a pattern for post-independence conflict, because the leaders who used violence before independence held senior posts in local and central government after independence. The result was inter-party and inter-tribal fights during elections (Roberts 1976).

Before independence the fighting was focused on the removal of the colonial administration, but after independence when that motivation had faded away, infighting was still the order of the day. Why did it happen that way? Were the informal institutions formed during colonisation to blame, or were there other reasons (not related to colonisation)?

Ollawa (1979) suggests that the different tribes only worked together for the removal of the colonialists, but that there was never real unity as such. It was a compromised solution to oppose colonisers, but that disappeared at independence. The motto, 'One Zambia-one nation', used during the fight for independence, masked tribal conflict. Wills (1985) even goes as far as saying that the division between tribes was more threatening than that between races.

Furthermore, it must be kept in mind that the nationalist movement in Zambia involved only a small minority of the African population. For instance, although a good number of the early radical elements within the nationalist movements, most of whom later teamed up with UNIP, were of Lozi origin, it is doubtful if "most members of the Lozi aristocracy, especially the traditionalists, ever regarded the new Zambian state as something more than a vague abstract on the basis of which they could defend their regional interest or autonomy" (Ollawa 1979: 233). Although UNIP was successful in mobilising the different tribes at the end of colonisation, and won a clear majority in the first general election under universal adult suffrage, large sections of the community over which it was to exercise political control, were alienated from it. The absence of sustainable unity left Kaunda with a complicated task of forming a transitional government (Ollawa 1979).

It can be suggested that the large number of tribes was the result of the drawing of the borders of African countries at the Berlin conference, but the tribal character of Zambian politics was not always seen as detrimental to Zambian politics by Kaunda's UNIP. The differentiation of tribes provided an opportunity for UNIP-leaders to secure their positions in by-elections. UNIP leaders tended to seek support in those regions where they were best known and understood and stressed their tribal relation. It is mainly for this reason that political competition in Zambia has taken on a "tribal" character (Roberts 1976).

Kaunda tried to end this by a drive to artificially include almost all tribes in the government. He deliberately composed the UNIP government of leaders from almost all parts of the country. This did not help, but rather intensified the tribal issues in the country. For example, the first post-independence elections for the members of the Central Committee were held at the Mulungushi Conference in August 1967. Posts in this committee were crucial because those who held them "wielded tremendous power and influence over the decision-making process that allocated scarce resources to regions, communities and individuals in Zambia" (Hamalengwa 1992: 137). Thus stiff competition arose in UNIP over the posts in the Central Committee, almost causing UNIP to collapse. Lobbying for support was mainly along tribal and regional lines, and resulted in victory for Bemba and Tonga candidates, and the destruction of the previously existing delicate balance between the different factions within UNIP. The continuing power struggle caused such bitterness that Kaunda resigned briefly in February 1968 (Pettman 1974).

Meanwhile, factional competition within UNIP continued, leading to the departure of leaders from UNIP, causing more inter-party conflict[76]. For example in 1969 those politicians who had been edged out in 1967 began to form coalitions to fight the next round of elections that were to be held in 1970. And even more important, the vice-president Simon Kapwepwe resigned his post in 1970 and formed the United Progressive Party (UPP), a formidable opposition party to Kaunda's UNIP. Kapwepwe, whose constituency was based on the Copperbelt and in the Northern Province, quickly gathered support from some key members from UNIP, the Copperbelt, Northern Province and elsewhere. Members were defecting from UNIP and there was a likely coalition with the ANC-Zambia (Hamalengwa 1992).

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[76] Edwards and Tabellini (1991) have argued that political instability weakens a government, making it difficult if not impossible, for the government to develop and implement the economic policy reforms necessary for long-term economic growth. Because of political weakness resulting from political instability, governments are likely to implement policies that encourage rent-seeking activities as a means of survival. Gyimah-Brempong & Traynor (1999) found that political instability affects economic growth both directly and indirectly through reduced investment in the current period as well as inter-temporally. Good policies are useless unless they are effectively implemented, and effective implementation of policies may not be possible without political stability.

UNIP reacted to the conflict by banning the UPP just before the elections. The reaction of the UPP leaders was to strengthen the power of the ANC by supporting them in the election. The result was that the ANC-Zambia gained some seats due to the increased membership. To UNIP this indicated that the ANC-Zambia was not going to suffer a natural death, as had been hoped[77].

It was within this political context that Kaunda saw the one-party system as a viable option. He saw the constitutional structure inherited at independence and based on the multiparty model as a "failure", because it created competition he was probably not ready or able to deal with. At that stage, no wider political system had developed in Zambia that could contain the conflict. Rather than facing the different parties involved in the bargaining process to determine their bargaining positions and political power, the Second Zambian Republic was established in 1972 and the UNIP became the only legal political party.

It is possible to attribute the unstable situation to the colonial history of the country. The presence of the colonial authorities did disturb the power balance in the country. At independence a government came into being that had no existing, previously developed political and governmental system in place. As Pettman (1974: 34) describes it: "they had to establish their own legitimacy, win popular support for themselves as the government, as opposed to their previous status as nationalist leaders against the government, and extend effective control of government over the whole territory". Not only were unity in government and the nation underdeveloped, but almost nonexistent. And the way Kaunda reacted to the problem only intensified the lack of stability.

It is difficult to say what other options were available to Kaunda, but the choice of a one-party system proved not to be the solution he was looking for. The one-party system did not eliminate all opposition, and with all the constitutional ways by which the population could express dissatisfaction gone, Kaunda was left to become an insecure autocrat. Prominent members of his own party, leading scholars and activists openly challenged his domination of Zambian politics and his ability to continue in power. Within this sphere of insecurity, Kaunda saw any criticism as a threat to his one-party rule. To secure his position he instructed the security forces to "fish out and detain any person or persons found to be in sympathy with the idea of multiparty politics" (Jhonvbere 1996: 64-65). A state of emergency enabled the security forces to detain those opposing Kaunda.

[77] Kaunda was under the impression the one-party system would be imposed through the ballot box, and not through imposition. However the resistance proved so resilient – and UNIP was so badly fragmented by the power struggle among its leaders – that rather than declining in strength, the UPP and ANC seemed to be gaining support (Tordoff and Scott 1974).

Although these were drastic efforts, it did not deter those supporting a multi-party system. Many of the prominent UNIP members who had been dismissed, demoted, disgraced or discriminated against (Jhonvbere refers to them as 'fragmented party members') began to get together to discuss how to alter the country's political balances.

In his "Logic of Collective Action" Mancur Olson (1965) describes how difficult it is for groups to form. For the 'fragmented party members' it was difficult to coordinate and to focus their opposition. But the trade union movement was a group already formed and it had a defined purpose. With all opposition parties banned, they were the only formally arranged group through which Zambians could voice their disapproval with their ruling government. This was especially true of the Mineworkers Union of Zambia (MUZ) that was active on the Copperbelt. Gulhati (1989: 25) finds it ironic that "although Zambia received most of its income from the activities in the Copperbelt, the Copperbelt was also a source of social conflict in Zambia".

The relationship between the Kaunda government and the trade unions, and especially the MUZ, had already started in colonial Zambia. Together they struggled for independence against the colonial power. After independence UNIP expected the trade unions to promote national unity by working together for the development of the whole nation, rather than promoting the interest of their members only. An umbrella trade union organisation, ZaCTU, was created by UNIP for this purpose.

Although the trade union was more committed to promote the interests of its members, relations between the government and the leadership of the trade union were still positive at the time. This is illustrated by the fact that many trade union leaders left their unions to work actively within UNIP. The process of absorbing trade union leaders into UNIP was intensified in 1968-71. One reason was that UNIP wanted to attract mature and responsible leadership into the party, but another was that Kaunda wanted to ensure close cooperation between UNIP and ZaCTU (Nordlund 1996).

This process had an unintended consequence, in the sense that it continued to such an extent that soon only union leaders who were not particularly loyal to UNIP, remained in ZaCTU. This led to a deterioration of UNIP's legitimacy in ZaCTU. With ZaCTU not as loyal to UNIP any more, it began to see itself as an autonomous force that could match UNIP in terms of organisation, membership and bargaining power (Nordlund 1996).

The reaction to the institution of the Local Administration Act (LLA) serves as an example of the mounting conflict between UNIP and ZaCTU. The LLA was an act that would have incorporated the mining townships with local authorities. Although not intended to be, the act was seen as weakening the position of the labour movement, making it more vulnerable to UNIP demands for industrial peace and development. The labour movement's opposition was intensified when no consultation about the bill was allowed before it was brought before Parliament in 1980. According to Norlund (1996: 72):

> Noticing the determination of the Party to enforce the new system, ZaCTU soon felt that the implications of the new legislation could affect the running of all unions and that the issue therefore should be regarded as a policy matter for the whole union movement. The extent to which the trade union movement felt seriously threatened by the new piece of legislation can be illustrated by the statement of the ZaCTU chairman Frederick Chiluba at an Executive Committee meeting of the ZaCTU in December 1980, where he called the LLA 'the real test of the labour movement in the post-independence era'.

It seems ironic that in his drive to contain social conflict, first by appointing union leaders in government, then by abolishing all opposition parties, and then by increasing control over the trade union movement, Kaunda each time created even more conflict. By suppressing social conflict, without giving it a voice to object, Kaunda's position became increasingly more fragile and insecure.

The discontent in the Zambian labour market culminated in wage demands and other forms of conflict. The strike days in 1980 more than doubled from that in 1979, and the trade union movement's resistance to adjustment programmes after copper mining faltered, added to the declining economic situation that started in the mid-1970s (Nordlund 1996).

This situation of suppression can be contrasted to the way the Botswana government reacted to a situation that had the possibility to disrupt its young democracy at independence. The following example from Botswana shows how democracy provides a safer route to deal with social conflict than autocracy.

As discussed in Chapter 6, the chiefs lost most of their power at independence. This was the beginning of a new power struggle between the traditional authority and the younger, more educated leaders of the BDP. For Colclough and McCarthy (1980) this conflict overshadowed the conflict between different parties (especially because the BDP easily asserted its dominant position).

Legislation removed the powers of traditional leaders or chiefs and vested them either within the central government or local government authorities. Since they lost their traditional power as chiefs, they were accommodated in the new democratic structure by their incorporation in the House of Chiefs, but only in an advisory position.

The chiefs were not altogether happy with their new position, and felt that their role was reduced to the role of legitimising the new political structure. A number of chiefs were a source of continual difficulty for the government. Because the chiefs saw themselves as advocates of the village community, they did, for example, not hesitate to flounder development projects which they saw as only beneficial to one segment of the community, e.g. cattle owners (Holm 1988).

But, importantly, these errant chiefs were not suppressed. Each modern, democratic institution that was brought into existence to replace a chiefly function incorporated the chief as an ex-officio member or even chairman. In spite of everything chiefs were paid a stipend for the exercise of the traditional functions that they still retained (Colclough and McCarthy 1980). Chiefs were also not held back from competing in the democratic process. But it was only Bathoen who took the chance, and succeeded, by giving up his income received as chief and even ousted the then vice president, Masire[78]. The advantage of such a system was that only the best-educated and capable chiefs were incorporated in the government of the country.

It can be concluded that the chiefs were the losers in terms of their position in society, but they were compensated financially as well as with a position in the House of Chiefs. Although they lost their power, society as a whole benefited in terms of the containment of social conflict. This is in stark contrast with the situation in Zambia where the reaction to opposition was met by suppression and where the incorporation of all the tribes in the government led to more inter-party and intra-party conflict. The containment of conflict in these two countries seems to coincide with the difference between democracy and autocracy, these being distinctive features of the governance of the two countries.

Another explanation for the durability of more intense conflict in Zambia than in Botswana is the fact that conflict tends to be higher in divided societies. The leaders in post-colonial Zambia chose the autocratic route, rather than accepting that democracy offers mechanisms to overcome economic discrimination of ethnic groups and to ensure that the rights of ethnic or other constituent groups are respected (Hameso 2002). Democracy

[78] Masire was brought back into the National Assembly by using the constitutional provision which permits the National Assembly to co-opt four additional members to its numbers (Colclough and McCarthy 1980).

enables the citizenry to see the polity as including all societal elements, not only those in power. That way the electorate becomes part on the legitimating structure.

It can be concluded that Botswana successfully dealt with social conflict through the democratic process, unlike the situation that pertained in Zambia. Zambia suppressed conflict, but through that created even more conflict. Conflict should be resolved in a structured manner through consultation and cooperation, not through taking away people's right to voice their dissatisfaction. The question that needs to be resolved is why the different governments reacted so differently to the probable sources of conflict. The following section focuses on the incumbent post-colonial leaders and where their different attitudes possibly originated.

8.4.3 Leadership

In section 8.3.1 it is suggested that although economic performance does not directly correlate with democracy, performance under democracy is indeed much less diversified than under an autocracy. Both democracy and autocracy display disadvantages. For example, democratic leaders have to secure their own re-election and are therefore tempted to make policy decisions that will facilitate their re-election and not necessarily those that are to the long-term advantage of the country. Alternatively, autocrats are in a position to exploit the country directly to their own benefit (Olson 1991). In the previous section it is suggested that the more democratic state of Botswana benefited from democracy in terms of dealing with social conflict.

This does not suggest, however, that centralised states cannot perform well, as the examples of China, Singapore and South Korea would suggest. It is, however, safe to conclude that more centralised societies will have more volatile performances. And the reason being that in a centralised society a lot more depends on the person in charge of that centralised state, than in a decentralised democracy. An autocracy can either be in the hands of someone like Lee Kwan Yu of Singapore or the late Chung Hee Park of South Korea, who are regarded as having made substantial contributions to their societies. But an autocrat can also be of the opposite persuasion like Idi Amin of Uganda (Sah 1991). Since Zambia turned into an autocracy, it is important to explore the leadership in both Botswana and Zambia as an explanation for their different growth performances. How did Khama and Kaunda end up as presidents and why did they embark on the different paths of policy-making, which in the end led to such different economic outcomes?

With both countries starting out as democracies, the first question will be why Botswana stayed a democracy but Zambia did not. The answer lies in the legitimacy of democracy in the different countries. Political stability in democratic systems cannot rely on force and the alternative to force is legitimacy. Theories of democracy stress that democratic stability requires a widespread belief among elites and masses in the legitimacy of the democratic system. The next question that will be addressed is whether the President and the ruling party had legitimacy in the eyes of the population. In other words did they have the "title to rule"?

In the process of clarifying legitimacy in the two countries, much emphasis will be on the prevalence of supporting informal institutions. As explained below, the informal institutions in Botswana supported democracy, whereas the same cannot be said for Zambia. Exploring this process will provide possible reasons for the instability in the democratic process in Zambia, relative to the experience in Botswana. But before the discussion focuses on Zambia and Botswana, theoretical issues regarding legitimacy will be touched on.

Legitimacy of the democratic process

By definition, authoritarian regimes are less legitimate than democratic ones; they rely on force rather than legitimate power[79]. Theoretically a constitution can provide a basis for legitimacy by limiting the state's power, and by providing free political and economic rights. But, unfortunately, for a system to be legitimate in practice, more is necessary. In order to achieve a situation of support for the constitution, it is necessary to have supporting informal institutions, a well-performing regime, and enough time for both to develop.

Diamond, Linz and Lipset (1990: 16) identify several informal institutions that play an important role in a stable democracy: "belief in the legitimacy of democracy; tolerance for opposing parties, beliefs and preferences; a willingness to compromise with political opponents, and, underlying this, pragmatism and flexibility; some minimum of trust in the

[79] Such regimes are inherently more unstable and likely to collapse in the face of a crisis. However, a brittle, unpopular system need not collapse – Zimbabwe seems to be an excellent example of such a system. Repressive police authority, a powerful army, and a willingness by rulers to use brute force may maintain a regime's power almost indefinitely. The breakdown of such a system may require a major catalytic event, a defeat in war, a drastic economic decline, or a break in the unity of the government elite (Lipset 1994).

political environment, and cooperation, particularly among political competitors; moderation in political positions and partisan identifications; civility of political discourse; and political efficacy and participation". For the democratic process to be legitimate, there has to be the belief that "it is the best form of government (or the least evil), [and] that in spite of shortcomings and failures, the existing political institutions are better than any other that might be established, and that the democratic regime is morally entitled to demand obedience – to tax and draft, to make laws and enforce them" (Diamond, et al. 1990: 9). If a political system is not characterised by a value system allowing the peaceful "play" of power, democracy becomes chaotic.

Democratic legitimacy (gained both economically and politically) stems from a perception that the system is stable and secure, and from the performance of the democratic regime, it becomes so both economically and politically. The performance of the regime is measured by the extent to which the system fulfils the basic functions of government as interpreted by the majority of the population, and by such powerful groups as big business and the armed forces. The more successful a regime has been in providing what people want, the greater and more deeply rooted tends to be its legitimacy.

For both the informal institutions and the stable regime to become supportive of democracy, time is necessary. Norms do not change rapidly and for procedures to become effective, it has to go through change to adapt to local circumstances. It also takes time for most political parties to recognise the existence of rights of the opposition and to react constructively to their criticism. Lipset (1994: 4) shows that "almost all the heads of young democracies, from Johan Adams and Thomas Jefferson to Indira Gandhi, attempted to suppress their opponents". It takes time for policymakers to extend the rule of law and to recognise the independence of the courts.

It is no wonder that almost everywhere the institutionalisation of democracy has occurred, the process has been a gradual one in which opposition and individual rights have emerged in the give and take of politics. As a result democratic systems have tended to develop gradually, at first with suffrage, limited by and linked to property and/or literacy. Elites yielded slowly in admitting the masses to the franchise and in tolerating and institutionalising opposition rights. Lipset (1994: 4) makes another interesting point by saying that

> Democracy never developed anywhere by plan, except when it was imposed by a democratic conqueror, as in post-World War 2 Germany and Japan. From the United States to Northern Europe, freedom, suffrage and the rule of law grew in a piecemeal, not in a planned fashion.

At independence, Africa's formal political institutions were young. Most countries lacked a tradition of mass political participation. Political constitutions granted at independence were modelled on their European counterparts—the British colonies were given parliamentary systems and the French colonies republican systems with stronger executive positions. In theory the stage was set for political liberties and political contribution by many, but these sought-after beneficial aspects did not last. By 1975 nearly all the African regimes had replaced democratic rule with authoritarian structures (Ndulu and O'Connell 1999). Zambia is such an example. In Zambia, Kaunda saw the democratic process as a failure because it could not deal with political and social conflict, but alternatively it seems as if the lack of legitimacy might explain much of the conflict.

After the downfall of the Soviet Union, democracy, again, spread to many African states, and the ex-Soviet nations were also under international pressure to become or remain democratic. But examples like Haiti, shows that these newly democratic regimes also experience a high probability of failure. For Lipset and his co-authors (1993) one way these countries can survive long enough to create legitimacy, is through high economic growth and development.

Regimes that lack deep legitimacy depend more on current performance and are therefore vulnerable to collapse in periods of economic and social difficulty. This explains the vulnerability of new democracies because they will have had no time to secure legitimacy and are therefore especially vulnerable to economic instabilities. Diamond and his co-authors (1990: 10) describe it as follows:

> Because of the combination of widespread poverty and the strains imposed by modernisation, regimes that begin with low legitimacy also find it difficult to perform effectively and regimes that lack effectiveness, especially in economic growth, find it difficult to build legitimacy

Legitimacy of the president and the ruling party

Another form of gaining legitimacy, especially in the case of a democracy that has had no time to mature, is through the legitimacy of the president and the ruling party in the eyes of the population. A leader gains legitimacy when he (or she) is believed to be endowed with great personal worth, either from God, as in the case of a religious prophet or simply from the display of extraordinary talents –the so-called "charismatic leader" (Lipset 1994). The "cult of personality" surrounding many leaders is an illustration of this.

Legitimacy in Botswana and Zambia

For Botswana legitimacy of the political system was established and strengthened in more than one way. Botswana has had a history of popular participation in political decision-making through the *kgotla*, which resembled a democracy closely enough to serve that purpose. Botswana has also had able traditional leaders for at least a century before reaching independence. The successful resistance of the chiefs to the incorporation into South Africa (discussed in Chapter 6) serves as an example of this. And these chiefs ruled through the *kgotla*, where there was an opportunity to express one's view and a need to achieve a degree of consensus. Openness and consultation were, therefore, always part of the political structure in Botswana[80].

The advantage of the *kgotla* that is stressed by Harvey and Lewis (1990) is that through it, the system of consultation and feedback was already established at independence. The perceived openness such a system creates probably added much support for the legitimacy of the newly established democratic government. The ruling party made use of this system already in place to discuss all new policies with the local community in the *kgotla* before any [local] implementation.

One can argue that the countervailing power, which the *kgotla* represented against that of the chief, was weakened during the colonial period. The British administration, not understanding the subtleties of this traditional structure, regarded the chief as the sole representative of the tribe and on occasion supported him against the will of his own people. By the end of the colonial period many of the chiefs, including Tshekedi Khama and Bathoen II, were accustomed to behave in a very autocratic way (Colclough and McCarthy 1980). But this was not how the system traditionally functioned, and it was relatively easy to revert to the more democratic version after independence[81]. This was, of course, strengthened by President Khama's strong support for a democratic system.

[80] This tradition was strengthened after independence, where in addition to Parliament and elected local governments, there have been frequent presidential commissions on national issues. Their membership was often broadly based; they held public hearings and issued public reports that were debated in Parliament. Public education has been a major function of these commissions, as has been consensus-building (Stedman 1993).

[81] The *kgotla* did undergo important changes after independence. For example, after independence women were beginning to attend *kgotla* meetings and while not participating as fully as the men, women were increasingly able to speak out and make themselves heard (Odell 1985).

It can therefore be argued that the democratic system itself had legitimacy in the eyes of the Batswana. And, although poor at independence, the economic prospects of the country soon after changed for the better. This strengthened the system adopted at independence. The next question is whether the leaders had legitimacy.

Samatar (1999: 77) discusses five reasons why the chiefs had legitimacy in the eyes of their subordinates at independence.

1. the traditional Botswana elite retained a significant degree of autonomy by resisting British colonial rule and Pretoria's attempts to incorporate Bechuanaland into South Africa
2. the traditional leadership maintained its hegemony over the masses during the period of colonial transformation
3. the destructive behaviour of South African leaders, and the enslavement and dispossession of their people, ingrained in the Botswana leaders a strong sense of themselves and their role as guardians of their society
4. the traditional, political and economic elite were almost one and the same, unlike other African societies
5. the dominant class was unchallenged by any other indigenous group.

Traditionally, the chiefs had wide executive and judicial powers over their tribesmen. But they were not, or were not supposed to be, absolute dictators. A Setswana proverb has it that a chief is a chief only by the will of the tribe, implying that the tribe could, if necessary, remove the chief. In practice this implied that the chief had to govern with the consent of the *kgotla*. Professor Isaac Schapera described it as follows after he did his research during the 1930s and 1940s on the Tswana (quoted in Odell 1985: 64):

> All matters of public policy are dealt with finally at an assembly open to all the men of the tribe… Such assemblies are held very frequently, at times almost weekly… Since anybody present is entitled to speak, the tribal assemblies provide a ready means of ascertaining public opinion… The discussions are characterised by considerable freedom of speech, and if the occasion seems to call for it, the chief or his advisors may be severely criticised… Such assemblies are frequently used by the government as a means of informing the tribes about new legislation and other developments or of inquiring into local disputes…

Seretse Khama's legitimacy was strengthened through his association with the long tradition of capable rulers in Botswana. It is no wonder that Harvey and Lewis (1990: 9) explain Botswana's successful growth record as partly due to an "unusually high quality of leadership. As the paramount chief he embedded both his right to rule and the institutions of his state into the pre-existing Tswana system, and conferring upon the new state a high degree of historical legitimacy". His legitimacy as national leader was therefore rooted both in the traditional ruling system and in the Westminster parliamentary system transplanted by the colonial power (Adamolekun and Morgan 1999).

Harvey and Lewis (1990: 9) describe both Seretse Khama and his right-hand man, Quett Masire, as "remarkable men". To them Khama's political skills, his vision and his stature as a person added immeasurably to the ability of his party. He has set the tone of government with "common sense, good humour, honesty and a desire to learn lessons from other countries". He has also set the tone for depersonalised political power[82].

Until his death in 1980, Khama occupied a central political position. His status as a traditional leader extended beyond a narrow regional or ethnic base. Parsons (1984: 50) describes him as follows:

> He materialised the ideological connection between the governing elite and the mass peasantariat base. He was also the focal point of the otherwise uneasy coalition of senior bureaucrats and the socio-economic group that governed through the BDP. Seretse Khama moved easily between these apparently contradictory groups.

The abovementioned conditions made it possible for the post-colonial leadership to build effective institutions to lead the transformation and growth of the economy. Good governmental management further strengthened legitimacy. Hope and Somolekae (1998: 13) provide an account of this:

> Government was able to create a reasonably honest and competent bureaucracy that enjoys the reputation of having an outstanding record of ability to formulate and efficiently execute national development projects. Botswana has a relatively open and accountable government and is outstanding in creating and maintaining effective structures of control, including independent audits.

[82] Khama also openly supported a capitalist development. He opposed communism and jokingly characterised himself as a capitalist. Khama "often used to joke about being a capitalist among socialists, wryly commenting at one meeting that, although he was a capitalist, he was the only member of the front line team to come to a meeting in a hired rather than private plane" (quoted in Samatar 1999: 83).

From the onset at independence the situation in Zambia was different. Zambia had no history of popular participation in political decision-making. This situation was made even worse with the combination of different tribes in one government. The instability in the functioning of the political process was seen as due to the fighting amongst the tribes, while political representatives who wanted to further their own political aspirations contributed to it. Furthermore, although the economy prospered at independence, that soon changed and increased the already-present instability.

Kaunda received legitimacy from being a leader in the resistance that led to independence. It was reinforced by his appearance as an individual "above tribe", made possible by the fact that his parents originally came from Malawi. He was a schoolmaster, but had no extensive overseas education in Western universities, although he did spend six months in Britain studying the organisation of the Labour Party. His political education was gained largely as a provincial party organiser (Pettman 1974).

Although a leader in resistance, Kaunda only had sustained legitimacy over a much smaller percentage of the population. And his legitimacy had little time to develop before the economy started to falter. The point was already made that the establishment of a stable legitimacy takes time to develop. Having a charismatic leader or rational-legal legitimacy will be beneficial, but sustained stability takes time to develop. In Botswana time was provided both by the fact that the paramount chief of 80 percent of the population came to power after independence, and the economy went into a growth phase at that stage. In most of the northern European and British Commonwealth nations, a continuing monarchy provided 'traditional legitimacy' while it gave time for democratic institutions to develop. Botswana enjoyed the same advantage, where the paramount chief came to power at the onset of democracy after independence.

There was no leader with historical legitimacy in Zambia. The struggle for independence was led by leaders who had some privileges either through education or family backgrounds that propelled them to political prominence. These people, called a 'petty-bourgeois' by Jhonvbere (1996: 48), were able to join the people of Zambia in their fight against the colonial powers, and became part of the 'bureaucratic bourgeoisie' after independence. Unfortunately, these characteristics did not restrain them from political opportunism, and they, soon after independence, lost the legitimacy they gained during the struggle. According to Pettman (1974: 34-35) "these authorities were not fitted for the demands of nation building and development and their difficulties were compounded by shortages of manpower and funds, and by severe security problems, political discontent and lack of popular support". The government did not exist as part of an established political system like the *kgotla.* And in its search for legitimacy, the focus turned to a political structure (they thought) could deal with all these problems.

Within this search for a suitable political structure, Kaunda played a prominent role. The efforts to discover and develop a political system, more in accordance with Zambia's own needs, were only partly reflected in constitutional amendments and other changes to the formal arrangements of government. The dominant personality and powerful position of Kaunda, coupled with the relative absence of competing national figures for the post of the Party's presidency, enabled him to implement his own ideological orientations in the country. Kaunda was a firm supporter of, what he called, humanism, or else socialism.

According to Pettman (1974), Kaunda's powers in office and his party were reinforced by his particular style of leadership. He was suspicious of colleagues, disliked delegation and consultation, and preferred a highly personalised rule. The move towards autocracy was already apparent in the late 1960s when he announced major administrative reforms and the nationalisation of the copper industry without either consulting or informing his Cabinet colleagues.

Kaunda dissolved the Central Committee of UNIP and personally assumed all responsibility for party affairs. At one stage he held six portfolios, including defence, foreign affairs, and government participation in industry. In late 1970 and early 1971 he off-loaded several of his portfolios, claiming that "his decision in previous years had fully established the direction in which he wishes the government to move, and suggested that others could not have pursued that direction at that stage" (Pettman 1974: 34-35).

At the same time he strengthened his position as leader of UNIP under the new constitution which was adopted in 1973. The new constitution asserted the supremacy of the Party over the government and Parliament. And with the President as the head of the Party and the State, he commanded enormous power in both capacities[83].

Kaunda has always acknowledged that survival, not principle, is the key to politics. His conception of his own key position as the unifying focus for national unity led him to regard his continuance in office as essential for the good of the nation. "If the President is

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[83] For instance, according to the Mwanakatwe Commission, Under Article 132 (1) of the Constitution of Zambia the power to appoint persons to any office in the public service is vested in His Excellency the President. And, as discussed in Chapter 7, Kaunda used these powers extensively. A large number of top politicians, administrators and managers owned their appointments directly to the President in this vast patronage system. According to Turok (1989) Kaunda even appointed managers in parastatals where he did not have similar powers.

to direct the people's loyalty to the state over a period of time, he must first be in undisputed possession of it" (quoted in Pettman 1974: 34-35).

It can be concluded that post-colonial Zambia started with no institutions supportive of a democratic state, and an incumbent President who concentrated power in himself. This can be attributed to the legacy of colonial rule: it was lacking hegemony, credibility, stability, and legitimacy. But the decisions that led towards Presidentialism and authoritarian rule was made by Kaunda himself, and was helped by the absence of the necessary informal institutions to enable the elite to oppose the increasingly dominant position of the president. This made it easier for the state to become a direct instrument of oppression and exploitation.

8.5 CONCLUSION

This chapter shows that two constraints necessary to ensure that governments stay responsive to the needs of the majority of the population, i.e. the democratic process and the rule of law, were both inherited at independence by Botswana and Zambia. These constraints proved to be effective and enduring in Botswana, ensuring high-quality institutions supportive of economic growth and development. Zambia faltered on both these constraints, ending with a society divided by social conflict and a stagnating economy. Why did Botswana stay on the path left by the colonial power, and Zambia not?

One possibility is that Zambia wanted to be rid of everything related to their colonial power due to the extractive nature of their colonisers. But, alternatively, if the ruling elite in Zambia was convinced of the advantages of democracy and judicial independence, nothing (except maybe pride) forced them to change their constitution.

It is suggested in the chapter that the answer can be found in the countries' history, apart from their colonial experiences, and the prevailing informal institutions. It is explained that democracy is a safer choice to reduce transaction costs and protect property rights, but that informal institutions must support it. Informal institutions in Botswana that supported democracy and a free judiciary, came from patterns established by open discussion in the *kgotla*. Also the tradition of solving conflict through a judicial process, rather than protest, was firmly established before independence. Although not resembling a mature democracy, the Botswana political system has all the checks and balances in place that (in theory) will remove the ruling party if the majority of the population would seek that.

In Zambia democracy, open discussion and a free judiciary were seen as in opposition to the government. Supportive informal institutions did not exist at independence and this brought the formal institutions left by the colonial power into conflict with the ruling elite.

But the consolidation of democratic rule also depends not only on a system regarded as legitimate, but also on a leader with legitimacy in the eyes of the constituency. The paramount chief of the biggest tribe that came to power in Botswana established his legitimacy from the onset. Khama's legitimacy was supported by a growing economy, which gave democracy enough time to create its own legitimacy.

Kaunda did not have the same kind or level of legitimacy. At independence the country experienced social conflict, not so much between the local people and the departing colonisers, as between different parties and different tribes. Kaunda dealt with the conflict by closing down the routes of opposition and discussion. This only intensified the conflict and his insecurity. The whole process of conflict and insecurity was intensified by the stagnating economy. And with increasing insecurity, Kaunda reverted even more to authoritarian rule and the suppression of opposition. By enforcing authority, Kaunda lost the legitimacy he was actually trying to secure.

CHAPTER 9
CONCLUSION

Cross-country empirical research provides useful information regarding reasons for growth differences. All these reasons—ranging from geography, to years of schooling, to direct investment—exhibit a strong correlation with economic growth. But they do not fully explain the experience of individual countries in the sample; neither do they explain what lies behind these correlations. To broaden the understanding of reasons for growth differences, case study research proves a useful tool.

For the case study method to be applicable for a comparison between countries, the countries should show a number of similarities to make it easier to identify the actual differences that were instrumental in their divergent growth performance. Botswana and Zambia display a number of similarities that make them suitable for a comparative case study. Among these the most applicable similarities are the fact that both were subject to colonial rule, they are landlocked neighbours in Sub-Saharan Africa, both are richly endowed with minerals and are also mineral dependent in their exports. But within these similarities enough differences are present to shed light on the divergent growth paths they exhibit.

The most obvious difference that may be instrumental in their divergent growth experiences is the nature of their dominant minerals. Zambia primarily exports copper and Botswana diamonds. Often in the literature a declining real copper price is presented as an explanation for Zambia's economic decline. However, there is no direct correlation between the copper price and Zambia's economic growth. The present analysis therefore incorporates policy choices made by the Zambian government in reaction to a declining income from copper mining.

Botswana is a clear example of a country able to manage its mineral resources in such a manner that the country has been able to enjoy long-term economic growth. The potentially negative effect of the resource curse was overcome through prudent spending and a good working relationship with the foreign companies extracting its minerals. In Zambia this was not the case. The post-colonial government was unwilling (or unable) to curb public spending in the face of declining income from its copper industry. With an unpromising relationship between Zambia and its colonial power, the Zambian authorities made decisions such as the substitution of experienced expatriate workers with inexperienced Zambians. And it was these inexperienced workers who had to deal with the crisis created by the declining copper income.

These are interesting differences, and by exploring them, more light falls on the reasons for these two countries' growth differences. But these differences should be explored against an acceptable theoretical background. In an overview of historical explanations for growth differences, it is shown that these traditional theories cannot fully explain growth differences in general—they all lack a deeper understanding of the incentives people are subjected to. The New Institutional Economics are currently perceived as one of the most important explanations for growth differences. And an analysis of the institutional empirical data for the two countries does indeed reveal a worse performance of the Zambian economy relative to that of Botswana. Different institutions, therefore, can explain the divergent growth paths of these two countries.

In general countries have different combinations of formal and informal institutions–where some institutions are supportive of growth and others not. For a country to grow the growth-enhancing type of institution should be in the majority. There is no prescription as to which institutions should be present to enhance growth, but for a country to grow, institutions should bring about the minimisation of transaction costs and protect property rights.

Botswana, for example, has experienced higher levels of property right protection. This is especially well illustrated in work done on "contract intensive money". Countries where property rights are perceived to be protected, will display higher levels of contract intensive money than countries where governments are perceived to infringe on property rights. The data shows that Botswana's property rights are perceived to be well protected, relative to those of Zambia.

These two mentioned factors—the lowering of transaction costs and the protection of property rights—do not seem so difficult to adhere to, but many countries still find it impossible to acquire and sustain high growth rates. These countries have institutions that do not support growth. A variety of reasons exist for the survival of bad institutions. Research done on the relationship between colonisation and economic growth suggests a negative correlation between extractive colonisation and post-colonial economic growth.

Being a protectorate was to the advantage of Botswana since it helped the country to survive as a unit and prevented it from being incorporated into South Africa or divided up into smaller pieces among its neighbours. But what was even more of an advantage is the fact that diamonds were only discovered in Botswana after its independence. The British had no real incentive to extend their influence in that country and in order to reduce their expenditures in Botswana, established a co-operative relationship with the chiefs. The relationship between the Batswana and the British was therefore one of cooperation and not exploitation.

With copper production already under way in 1924 Zambia was not so fortunate. Because there was much to gain from the mining industry, the British had a clear presence in the country without protecting the property rights of the local people—to give one example of the colonial stance. This was essentially extractive colonisation and it did not establish a basis for cooperation.

It is, however, suggested that there must be more previously unanalysed factors impacting on the theory, because path dependency does not automatically lead to stagnation. As it was possible for the colonial powers to change the formal institutions in the colonies, the post-colonial governments have similarly had the opportunity to change the path created by the colonial rule. Colonisation is not deterministic.

What colonisation did influence, and which cannot be changed over a short period, are the informal institutions. Colonisation created a "memory" (whether positive like the cooperation between Botswana and Britain, or negative like the exploitative relationship between Zambia and Britain) and many of the post-colonial policies can be understood in this context. With a drive to rid them of everything resembling colonialism or imperialism, Zambia not only increased transaction costs, but also infringed on property rights. For example, transaction costs were raised through the diversion of trade routes from the south to the north. And in order to "complete" their political independence while simultaneously gaining economic independence, Zambia nationalised industries formerly run by European companies.

The Botswana government has also been active in the economy, but this involvement happened through consultation and cooperation. The process they followed created an atmosphere of certainty – and this assurance lowered transaction costs.

Although colonisation provides an understanding of post-colonial policies, it cannot provide an excuse for all poor post-colonial policies. As an independent government Zambia has chosen to implement drastic turn-around post-colonial policies. One policy-change that proved detrimental to the Zambian economy was the move from democracy to autocracy. The empirical institutional measures show a bad score for Zambia, relative to Botswana, for this reason. Zambia has faltered on both restraints that are meant to ensure that government stays responsive to the majority of the people in the country: democracy, and the adherence to the rule of law. Although some reasons are given as to why these policy changes can be related to colonial rule, other reasons not linked to a colonial past are also provided.

The theoretical discussion shows these 'other reasons' to be an inability to commit by politicians, and the prevalence of social conflict. Due to the fact that the government is unable to commit to policy-decisions (because of its function as the ultimate enforcer of contracts), the ameliorating constraints that were previously mentioned were indeed necessary.

Social conflict proved detrimental to the Zambian economy. There was social conflict between local Zambians and foreigners, but also among the Zambians themselves. Kaunda tried to deal with the latter by forcing representatives of different tribes into one government, and later to disband all parties except UNIP. The move to a one-party state only aggravated the existing conflict because by now the routes to express opposition were closed.

Botswana dealt with a possible source of social conflict, i.e. the chiefs, by giving them a voice of opposition in the House of Chiefs. Chiefs also had the right to stand for election to Parliament. Again the feature of cooperation and consultation of Botswana society supported the growth-enhancing institutions and thus creating an atmosphere of stability and certainty.

To fully understand post-colonial policy choices, the pre-colonial and colonial situations in the two countries needed to be explored. The dispersed pre-colonial tribes in Zambia created an easy opportunity for the British South African Company to enter the area and to start mining without having to deal with unified resistance. The fact that one of the biggest tribes, the Bemba, had a history of slave trading did not enhance the prospects of national cooperation.

In Botswana the chiefs were better able to cooperate with one another and to resist external influences. The scarcity of water has forced the Batswana cattlemen to live together and deal with one another in harmony in the vicinity of water sources. In pre-colonial Zambia the majority of people made a living from the land that required them to move regularly to fresh land when the fertility of the soil deteriorated. Consequently they never built big cities and therefore created no institutions to regulate cooperation, such as the *kgotla* of Botswana.

The *kgotla* provided the Batswana with an acceptance of the tradition of democracy that created the necessary supportive institutions for those democratic institutions the

British left on departure. There was no such history, and therefore no democracy supporting informal institutions, in Zambia.

At independence both Botswana and Zambia received basically the same constitution from Britain. This constitution provided for democratic rule, an independent judiciary, and strong powers for the executive. For Botswana it was easy to continue within these parameters, because supporting informal institutions were present. Not only were they well versed in the traditions of democracy because of their *kgotla* system, but their first president was also accepted as a legitimate ruler because of his position as the paramount chief of the biggest tribe. These factors created an atmosphere of social and political stability, which was further enhanced by the post-colonial economic prosperity.

The Zambians had no schooling in democratic rule when the British left. By using tribal differences to secure their own positions in parliament politicians created political instability. Kaunda's solution to instability was to incorporate the opposing tribes into his government. This created even more tension and paved the way for patronage employment. Kaunda did not see consultation and cooperation as a solution to the political conflict and instead declared a one-party state in which he had wide-ranging powers. With no opposition allowed, the trade union movement was the only organised group in Zambia to oppose government. Kaunda met the resistance from the trade unions with force and more curtailment of their freedom. Again consultation and cooperation were not an option: the president chose suppression instead.

Although Kaunda was a charismatic leader, he did not enjoy legitimacy throughout Zambia. And a faltering economy did nothing to improve the situation. As Kaunda gained personal power, opposition to his rule increased. With no legal way to voice this opposition, social conflict was inevitable. This placed not only politics, but also the economy in a downward spiral. To counter the social conflict Kaunda made random adjustments to economic policies, leading to higher transaction costs and less secure property rights. When the income from copper mining faltered, the un-coordinated adjustments (especially those regarding spending) increased the instability.

A typical pattern in Africa, and observed in Zambia, is that the educated, urban-resident population takes over the government. This has serious consequences for politics in general. Being insulated from the mass of the rural population and having only limited legitimacy, governments are acutely exposed to pressures from their own narrow base of supporters. This often results in an increase in public sector employment with wages rewarded to fraternal groups rather than being based on skills. Those policies implemented favour redistribution rather than accumulation. This was evident in Zambia where

Zambians without the necessary skills were appointed in the public sector and the leaders of the trade union movement were given government posts to ensure cooperation between the unions and government.

Furthermore, if the state's economic power is not counterbalanced by private means for economic accumulation and creating opportunity, upward social mobility and the accumulation of personal wealth depend on getting and maintaining control of, or at least having access to, the machinery of the state (Diamond, et al. 1990). In Zambia this raised the premium on political power to the point where the ruling party was not willing to consider the prospect of defeat. The result was a zero-sum game where control of the unstable political environment and economy was in the hands of the president. The president was, therefore, totally unable to enjoy any of the benefits of a democracy.

This contrasts starkly with the situation in Botswana, where the elite not only had the political power, but also enough economic power to provide them with little incentive to exploit the state and ruin the economy. Much of Botswana's successful policy choices can be attributed to the fact that the ruling elite came from a strong capitalist, agricultural background. The class that inherited political power at independence is one that was already involved in cattle production and wealth accumulation before independence. This dominant class of accumulators became conscious of the fact that its interest would be better served by private capitalist accumulation rather than state capitalism because the state itself was in dire financial problems at independence and could not be the sole means of accumulation. Consequently, this class did not necessarily see the state as a source of self-enrichment. The fact that many of the country's leading politicians and bureaucrats have extended or acquired business interests while holding, or upon vacating, public office has given them a strong commitment to maintain a strong, open economy.

Extractive colonialism in Zambia was detrimental to the post colonial situation due to the drive it created to get rid of everything resembling European influence and imperialism, i.e. there was a drive to get rid of the memory these created. But, not all post independent policies can be ascribed to colonial rule.

It is therefore true that much of the growth differences between Botswana and Zambia can be explained by their colonial rule. But, with the onset of colonial rule, Zambia did not have the institutions to secure a prosperous democratic society and they certainly did not gain these during extractive colonisation. It is unclear what would have happened without colonial rule. The different tribes were probably too small to create economically prosperous units, but maybe if they were left to create institutions of cooperation over time, they would have been able to make the transition to a modern democratic entity.

But by reviewing the surveyed facts it is clear that much of Zambia's decline can be attributed to post-colonial policy making, to a centralising drive by the ruler, and an unwillingness to face opposition. As for Botswana: good, prudent policies by the ruling elite have established an economy that realised the highest average economic growth in the world since independence.

The beneficial growth-supporting parameters set by the New Institutional theory, i.e. the lowering of transaction costs and the protection of property rights, provided a good structure to analyse growth differences between Zambia and Botswana. It is not the intention to present this analysis as the one and only explanation for the growth differences between the two countries, but it does answer questions other theories could not fully explain. It must therefore be seen as an addition to other explanatory frameworks and not the final word on this issue.

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