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The impact of policy reversal on economic performance in Sub-Saharan Africa

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Abstract

The literature suggests that investment and economic growth respond very slowly to economic reform due to uncertainty about the permanence of reform. Despite clear theoretical underpinnings for the idea that policy reversal significantly impedes economic performance, there is limited empirical evidence on this topic. This paper derives empirical proxies for the probabilities of different types of policy reversal and investigates their impact on investment and growth in Sub-Saharan African countries. The results show that trade, fiscal, savings and financial policy reversals have been very damaging to investment and economic growth. The paper also finds that it is the prediction or expectation that reversal will occur that hurts performance. There is no evidence that exchange rate policy reversal has damaged performance.
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1. Introduction

Sub-Saharan African countries (SSA) have experienced poor economic growth and performance since the early 1980s, a period characterised by declining national incomes (GNP) per capita and a slowdown in gross domestic product (GDP) growth and decreasing investment[1] (Easterly, 2001a,b; Hillman, 2002[2]). The period between 1980 and 1996 was characterised by poor economic performances. In terms of investment, the average annual rates of private and gross fixed domestic investments as a percentage of GDP were 12.4 and 20.1 percentage points, which were similar to the rates in Latin America (LAM)[3] and South Asia (SA) but much lower than the 22.5 and 32.6

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[1] There has been an attempt by international organisations including the World Bank to help to increase the volume of gross domestic investment in Africa to 23% of GDP by the year 2000 (African Development Bank, 1997). The current volume is only 20% of GDP a year.

[2] Hillman (2002) provides a review of Easterly's (2001a) book providing explanations for the development failures experienced in poor countries in Africa and elsewhere in the developing world.

[3] The Latin America (LAM) averages are based on data from Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Mexico, Paraguay, Peru and Uruguay. The East Asian (EAS) averages are based on data from Indonesia, Korea (South), Malaysia, Singapore and Thailand. While the South Asian (SA) nations included are Bangladesh, India, Pakistan, Nepal and Sri Lanka.

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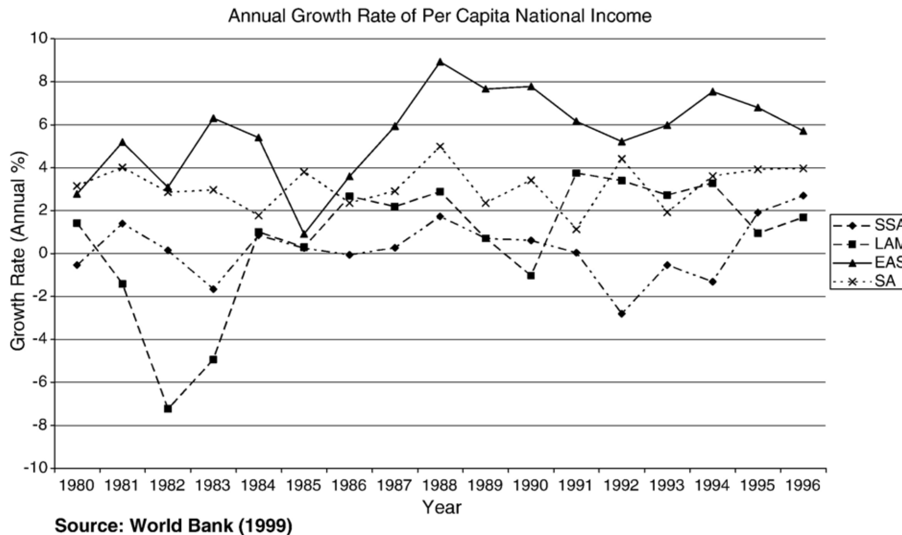

Fig. 1. Regional average growth rates of per capita income: 1980–1996.

percentage points in East Asia (EAS). This pattern of performance is manifested generally in other outcome indicators (World Bank, 1999). The average growth rate of GDP of 3% which translated into growth rate of per capita income of only 0.3% a year was worse than in any other region of the developing world (Yago, 2001; World Bank, 1999)[4] . These compare poorly with growth rates of GDP and per capita income of 7.5 and 5.6 percentage points, respectively in the EAS region. Although the rates of growth of GDP and per capita income were 2.7 and 0.9 percentage points in LAM, 5 and 3.1 percentage points in South Asia (SA), respectively, the contrast is made clear by the relative growth of per capita national income as depicted in Fig. 1 below. This implies that in 1996 the region was as poor as it was 15 years before.

Unsurprisingly, there has been a great deal of effort exerted in trying to explain this performance. While there is clearly a wide range of hypotheses that could be (and have been) tested to explain poor economic performance in SSA in the 1980s and 1990s, the focus of this paper is on the impact of economic policy reversal on investment and growth. In particular we develop the work of Rodrik (1991) who provides a theoretical basis on which policy reversal can be empirically tested.

This paper makes an empirical contribution by investigating the impact of policy reversal on investment and growth in SSA. Section 2 provides an overview of the various explanations of poor economic performance in SSA while Section 3 explains policy reversal in SSA countries. A model of investment and growth under reform reversal is presented in Section 4, while Section 5 discusses the empirical results of the impact of reform reversal on performance. Section 6 offers some conclusions.

2. Explaining economic performance in Sub-Saharan Africa

The principle focus of much empirical work in this area has been on economic policy and many studies have attributed poor economic performance to failure in domestic economic policies, including *inter alia*, lack of openness to international trade (Sachs and Warner, 1997), overvalued real exchange rates (Ghura and Grennes, 1993) and lack of financial deepening (Collier and Gunning, 1999). The link between bad policy design and policy reversal is discussed in Section 3 below. Macroeconomic as well as political instabilities have also been indicted (Collier and Gunning, 1999; Ghura and Hadjimichael, 1995; Fosu, 1992, 2001; Ghura and Grennes, 1993). Some studies, such as Easterly and Levine (1997), Sachs and Warner (1997), and Gallup et al. (1998) have focused on the vagaries of geography,

[4] This performance analysis is based only on data for the sample of 24 SSA countries that have been used in the study over the period 1980–1996.

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