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J. Clark Leith

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Department of Economics
Social Science Centre
University of Western Ontario
London, Ontario, Canada
N6A 5C2
econref@ssl.uwo.ca
The Design of Policy Frameworks and the Role of the Policy Advisor

by J. Clark Leith
Department of Economics
University of Western Ontario

e-mail address:
<leith@julian.uwo.ca>

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"[I]t is very important indeed that economists, inside government and out, get things right. When we are wrong, we do a lot of harm. When we are right -- and have the clarity to prevail against special interests and the quacks -- we make an extraordinary contribution to the amelioration of poverty and the progress of humanity." 

Mancur Olson (1996)

Introduction
Economists, despite their reputation for having two hands, are usually able to agree on whether or not a policy yields a ‘net benefit to society’. This remarkable agreement is generally based on the application of some well defined criterion. The most common is certainly the ‘potential Pareto improvement’ criterion: where a change is judged on the basis of whether or not it is possible for the gainers to have gained enough to be able to fully compensate the losers and still be better off. Based on this, policy economists have a long list of welfare improving initiatives, ranging from trade policy to tax policy to environmental policy.

Politicians, in contrast, look at policy changes in terms of whether or not a proposed change strengthens or weakens their position with the electorate. The difference between what the economist sees as the social objective function and what the politician sees as the objectives of policy, creates a serious dilemma for the economist who takes on a policy advisory role: should the policy advice constitute best practice economics, or should it try to satisfy the politician’s objectives?

Most economists opt for the former because one’s professional reputation depends crucially on acceptance by colleagues – be it in an academic, government, or private sector setting, but especially in the academic setting. Yet such a strategy almost inevitably invites the politician to

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* The author served in policy advisory positions with the government of Botswana, and the central bank of Botswana. The discussion of the Botswana case draws heavily on that experience, but views expressed are solely those of the author. He wishes to thank Fergus Chambers, Peter Freeman, Jan Isaksen, Keith Jefferis, and Jay Salkin for helpful comments on an earlier draft. The usual caveats about responsibility of the author apply with special force in this case.

1 For example, there is wide agreement on the appropriate functions of the state. Few contemporary economists would disagree with the list of such functions put forward by the World Bank (1997, p. 27).
dismiss the advisor and the advice as irrelevant, with the result that sound economic policies are not followed.

This was the dilemma which Doug Hartle faced throughout much of his professional career – in the Canadian Treasury Board, the Carter Commission, the Ontario Economic Council, and the Government of Botswana. It is the dilemma which all of us involved in policy discussion must solve. What I hope to do today is to provide some specific guidance to the policy oriented economist in dealing with this dilemma – guidance which will be more likely than not to generate net economic benefits to society.

There is an emerging literature on this issue which is already too large to survey in a conference paper. However, to give the reader a flavour, let me cite a few of the more interesting pieces. Central to the debate is the question of whether or not potential Pareto improvements are foregone.

One strand of the literature argues that, in a manner analogous to the way perfect competition yields an economic Pareto optimum, a democratic system yields a social optimum. Donald Wittman (1989) assumes that democracies are organized to achieve wealth maximization. Given the objective, he argues that because the market for government is highly competitive in a modern democracy. Political entrepreneurs are rewarded for efficient behaviour. Consequently, democracies produce efficient results. He asserts further that models of political failure must assume one or more key ingredients of efficient markets are not present. He then goes on the argue that political failure is no more prevalent than market failure. The logic is: competition for political office reduces the potential for opportunism by politicians; voters are not constantly fooled any more than consumers are; and political institutions reduce transaction costs, making the efficient exchange of political rights possible. He thus concludes that democratic markets work as well as economic markets.

Another strand of the literature looks to reasons why one would expect political failure to exist. Most prominent among these is Mancur Olson (1996) who contended that rationality would not necessarily result in an efficient society. The really big gains cannot be achieved by un-coordinated individual actions because of collective action problems. For this reason, the most important explanation of differences in incomes across countries must be the differences in their collective economic policies and their institutions. Hence, he maintained, when appropriate
collective arrangements are missing there are "Big Bills Left on the Sidewalk...." This followed from his earlier work (1993) where he argued that because individuals respond to individual incentives, there is a tension between collective interests and specific interests, and society finds it difficult to act in the collective interest.

Several others have contributed. For example, Besley and Coate (1997, and 1998) develop a formal model of political failure in an environment where potential Pareto improvements are not made due to the fact that the political horizon is not infinite. Joseph Stiglitz (1998) looks at incentives and institutions. He sets out various reasons why potential Pareto improvements may not be made, derived from his experience on the US President's Council of Economic Advisers. Particularly important in his list is the inability of government to make commitments on all the dimensions of a policy. This is in keeping with a theme developed by Przeworski (1991), and by Weingast (1995), that political institutions affect economic outcomes. Weingast, in particular, emphasises that not all agreements can be enforced ex-post, and different political systems have varying degrees of success in organizing institutions to deal with the problem. Empirically, Alesina (1998) and many others have shown via cross-sectional studies that institutional quality is important for growth.

Enough has been said to suggest that this debate over government failure depends crucially on what is assumed about the political process. The critical question is whether or not there is a collective action problem. It is common to assume that individuals are wealth maximisers. But that does not imply a democratic society would collectively choose to maximize its wealth. If individuals vote for politicians and policies that maximize the voters' own individual wealth, the outcome may be substantial redistribution of wealth. Such a redistribution may be done in a way that reduces social wealth relative to its potential.

For example, while competition between candidates could lead to platforms that maximize social welfare, as soon as different weights are given to different groups in the welfare function -- e.g., income weights rather than equal weights (one person one vote) -- then the social optimum would no longer follow from a democratic political equilibrium. The issue is well known to

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2 Note the parallel between "political failure" and "market failure". In each it is a failure to achieve a Pareto optimum that is the problem. The "failure" is that of either the market or the political system to generate a Pareto optimum.
those who contemplate why the United Nations General Assembly comes to quite a different balance of interests than the International Monetary Fund and the World Bank -- it is the difference between the outcomes of one member one vote and one dollar one vote.

Further, the economic and political outcomes depend not only on the assumptions about the underlying political process, but also on the nature of the real world. An observation by Albert Breton and Margot Breton (1997) in a different context is particularly apposite: "real world governmental systems, not unlike real world market systems, are never perfectly competitive." In other words, the actual situation almost invariably reflects significant departures from the idealized assumptions embodied in our formal models.

In light of the foregoing, it is clear that the economic policy adviser has a complex problem to deal with: proposing policy to achieve optimal outcomes, in the real world where many of the idealized assumptions are not valid and where political failure is the order of the day. In such circumstances, how should an economist approach the design of economic policy which is more likely than not to yield a net economic benefit to society?

My search for an answer that question begins by noting Olson's point "... that the great differences in the wealth of nations are mainly due to differences in the quality of their institutions and economic policies" (1996, p. 19). The role of economic policies in explaining differences in economic growth has been shown repeatedly by multi-country regressions that Barro and many others have run. The great advantage of that approach is the large number of observations and hence the potential for statistically significant results. However, the multi-country regression approach is often lacking in the subtle detail of institutional arrangements that may be a major explanatory factor. To capture the institutional detail, it is necessary to look at individual cases.

One case of rapid economic growth has been Botswana. Doug Hartle and I served as policy advisors in Botswana: he in the Ministry of Commerce and Industry; I in the Ministry of Finance and Development Planning and later in the Bank of Botswana. It seems appropriate, therefore, for me to draw on that experience to try to understand the nature of the institutions and policies which explain Botswana's remarkable record of economic growth.
Based on the Botswana case, I will argue that the focus of the policy advisor must be much broader than simply designing the optimal economic policy. The economic policy advisor should also be concerned about all sources of sub-optimal economic performance, be they missing markets, market failures, political failures, or whatever. Only in this way will it be possible to obtain at least some of the potential gains from better economic policies.

**The Botswana Case**

For those unfamiliar with the Botswana story, a bit of background is in order. It is one of a very few developing countries in the contemporary era that has sustained rapid economic growth for an extended period -- 7.3% per annum for the past three decades. It is virtually the only African country to grow rapidly. At independence in 1966 it was one of the continent’s poorest countries. Three decades later, its per capita GDP is approximately on a par with South Africa and, looking outside the region, with Malaysia.

Botswana’s record in human development is equally impressive. Major emphasis has been placed on providing basic education and primary health care throughout the country. The rapid growth of real per capita GDP has not brought a deterioration of the relative income distribution.

Botswana has a long history of democracy. Free and fair parliamentary elections have been held regularly as prescribed by the constitution, with an active articulate opposition in Parliament. There have been orderly presidential transitions on two occasions (1980 and 1998). The judiciary has on repeated occasions brought the government up short, declaring specific government actions illegal.

My current work in progress is addressing the question: Why did Botswana prosper? There are many parts to the answer, and this is not the place to tell that story in detail. A major part of the answer is that growth promoting policies were followed. Yet that begs an important question. Why were such policies pursued in Botswana, but seldom elsewhere in Africa?

The answer, in its simplest form, is a staple-cum-political economy explanation. It runs as follows:

- Substantial rents were obtained from the mining of diamonds, which were discovered shortly after independence.
• Linkages from the booming diamond sector with the rest of the economy were primarily via government revenue.
• The revenue was spent on growth promoting activities, because it was in the rational interest of those in power to use the new government revenues constructively, rather than dissipate them in patronage.
• In the process, government accepted several important restraints on its discretionary power, making it more difficult to intervene in response to narrow political pressure.
• In several important cases where such restraints were not present, the resultant policy mix was growth-retarding.
• On balance, the policies and institutional arrangements remain growth-promoting.

With this background in mind, let me review briefly a few key policy areas: trade; money; exchange rate; fiscal; and state-owned enterprises.

Trade
Shortly after independence, Botswana, Lesotho, and Swaziland renegotiated the long-standing customs union with South Africa. They were able to obtain an increased share of the customs union’s revenue (derived from tariffs on imports from outside the customs union). Furthermore, the revenue accruing to each of the smaller members was set as a function of that member’s own imports from all sources. Hence Botswana’s import boom, initially associated with the development of new mines, but later more generally from overall economic growth, further augmented government revenues. Yet this tax did not appear to fall on the shoulders of the voters, as the bulk of imported goods came from within the customs union.3

Other effects of the customs union were also important. One was to secure access to the South African market, and to transit rights through South Africa for goods in transit to other destinations. But perhaps most important of all, as a member of the customs union, Botswana was not free to set its own import tariffs to protect domestic producers. For a small country, in an era when many developing countries were pursuing an import-substitution growth strategy,

3 This should not be taken to suggest that the consumers were not bearing any burden. On the contrary, because of the relatively high common external tariff consumers throughout the customs union were paying substantially more than world prices for a large component of their expenditure. The welfare effects of the customs union are spelt out in Leith (1992).
the pressure to grant virtually infinite protection to all local producers of import-competing goods would have been nearly impossible for an elected government to resist.

Government also played a crucial role in securing access to markets for two key exports: beef and diamonds. Under the special provisions of the Lome Convention, signed in 1975, Botswana's beef exports have been able to enter the European Union market with a rebate of 90% of the EU import levy, thereby obtaining a net price very nearly equal to the internal European price. For diamonds, Botswana has willingly participated in the De Beers led Central Selling Organization. This has ensured long-run profitable access to a highly successful cartel, with substantial mineral rents. 4

**Monetary Policy**

At independence, Botswana had a rudimentary financial sector. Money in circulation was South African, and the few permanent commercial bank branches in existence were branches of South African banks. In 1973, Botswana simultaneously took up the question of whether or not it should establish its own currency and (together with Lesotho and Swaziland) attempted to negotiate a monetary agreement with South Africa. Botswana broke off these negotiations in 1974, and preparations for the creation of a central bank and currency issue were commenced. 5

This move immediately created the need to establish a monetary policy. Initially, since the central bank did not yet exist, this task was left to the Ministry of Finance and Development Planning to devise. The basic strategy was set out in a government “white paper”: to regulate interest rates "with a view to satisfying domestic business and general economic requirements." 6

As the newly formed central bank developed its own ability to evaluate monetary policy options, the formulation of monetary policy evolved into a joint process between the central bank and the ministry. For several years the approach was to change the regulated rates in response to changing circumstances. But in the mid 1980s circumstances began to change rapidly. Substantial balance of payments surpluses, largely due to a major new diamond mine, were not

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4 For more details on Botswana's trade policies, see Leith (1997).

5 For more details, see Hermans (1996).

fully sterilized by offsetting increases in government balances, creating a significant liquidity overhang. Changes in regulated interest rates were slow and inadequate, frequently delayed by the need to reach consensus between the central bank and the ministry, the need to take such changes to the central bank’s board, and further delayed by the need to reach consensus there.

As a result, real interest rates were often negative for extended periods. In the late 1980s and early 1990s, credit expanded at very high rates.

Part of the problem was that there was no money market for the central bank to influence via open market operations. It was not until 1991 that such a market was artificially created by the central bank. A system of regular auctions of interest yielding short term deposit certificates was created to absorb the substantial accumulation of excess liquidity. After a couple of years using this instrument to gradually bring the interest rate on these certificates up to the rate of inflation, in 1993 the central bank established a “target of approximate equality to real interest rates in industrial countries, with variations around this target to counter excess demand or deflationary situations.” By the end of 1993 the real interest rate on these certificates became significantly positive, and in 1994 it reached the indicated target, where it has since remained.

In the process of moving from regulated interest rates to the auction system, and in accepting the target, the central bank’s board effectively ceded to the international market, and the central bank’s officials’ interpretation of that market, their previous role in setting regulated interest rates. While this was not nearly as confining as Botswana’s complete absence of control over tariffs, it served to effectively insulate monetary policy from immediate domestic political pressures. Many members of the central bank’s board openly and repeatedly indicated a preference for lower interest rates, but did not act to revert to the old system.

In addition to monetary policy, the central bank carried two other important policy responsibilities: supervision of the banks, and management of the foreign exchange reserves. As has become painfully evident in Asia and Russia in recent months, the quality of domestic banks is a crucial ingredient in avoiding financial melt-downs. Botswana has so far been able to avoid

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such catastrophes by virtue of applying strict criteria in the licencing and supervision of deposit-taking commercial banks.\textsuperscript{8}

Initially, the country was served by two of the major British banks. While various local interests would have liked to establish their own banks, they were generally deterred by the strict requirements on capital adequacy and restrictions on practices such as lending to own directors. The strict approach to banking supervision was established at the time the central bank was set up, largely on the basis of advice from advisors drawing on the experience of other countries. It was reinforced over time by the existence of a network of banking supervisors organized by the Bank for International Settlements. Eventually additional commercial banks were licenced, including subsidiaries of the Bank of Credit & Commerce International (1982), and Zimbank (1989). The importance of strict banking supervision became evident when BCCI collapsed, leaving the still solvent Botswana subsidiary up in the air, and when Zimbank Botswana breached its capital adequacy requirements. In both cases the central bank stepped in, forcing the shareholders to arrange for an orderly sale of going concerns to another institution.

Management of the foreign exchange reserves became an increasingly important task as the size of the reserves grew. The task evolved from one of managing cash flow, ensuring that adequate foreign exchange was available to meet the various demands, to one of handling substantial investment assets worth more than two times annual current account payments. With the co-operation of the World Bank, a strategy for investing the reserves was devised. Commercial fund managers were engaged, and assigned performance benchmarks based on international indexes, against which they were judged. At the same time, as the expertise in fund management developed within the central bank, a larger volume of the reserves was assigned to internal management. However, the precedent of testing performance against an external benchmark was established, and applied to in house managers as well.

\textsuperscript{8} This responsibility did not extend to those state-owned financial institutions which were not deposit-taking. Many of these ran into difficulty, requiring either restructuring or closing.
Exchange Rate

Having created an independent currency in 1976, Botswana was faced with setting not only monetary policy, but exchange rate policy. The first question that had to be answered was whether to adopt a fixed or a flexible exchange rate. At the time the South African Rand was pegged to the US dollar, and fixed exchange rates were still widely used. Botswana chose to continue with a fixed exchange rate, standing ready to buy and sell foreign exchange at posted rates. While there were exchange controls, they were liberal, and within the parameters of those controls, there was no rationing of foreign exchange.

Given the decision to fix the exchange rate, the principal policy question was the level. The central bank built up substantial foreign exchange reserves, now amounting to over two years worth of current account payments. Such an accumulation reveals a choice to set the currency at a level below what would have been indicated by a flow equilibrium. This was deliberate, in order to avoid the well-known “Dutch Disease” effect of a strong currency crowding out all but the most robust export activities. In itself, this has not been particularly controversial, as it is widely recognized that the non-diamond export activities are substantially more employment intensive than diamond mining.

The switch from the Rand to the Pula in 1976 had been done on a one-for-one basis. This was accomplished by pegging the Pula against the US dollar because the South African rand was also pegged to the dollar. However, when the Rand was floated in 1979, changes in the Rand/dollar exchange rate were fully echoed in the Rand/Pula exchange rate. This created an additional policy dimension: the choice of currency or currencies to peg to.

South Africa is the major source of Botswana’s imports and inward direct investment, as well as the destination for most non-traditional exports. In the years since 1979, the peg was changed in various stages from a peg against the US dollar to a peg against a basket of regional currencies and the SDR, with a relatively heavy weight on the Rand. Since some interests were more affected by one bilateral exchange rate than others, the question of what currency or currencies to peg to became the focus of contention. particularly in periods when the rand fell sharply against

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9 For more detail, see Leith (1996 and 1997).

10 This was equivalent, in the Canadian context, to fixing the Canadian dollar to the British pound, and letting the changes in the pound US dollar exchange rate affect the Canadian dollar/US dollar exchange rate.
hard currencies. Importers of dollar denominated goods, dollar based portfolio investors, and those educating their children overseas, favoured a closer link to the dollar. Those competing with South African producers were much more concerned that the Rand/Pula exchange rate did not appreciate sharply. (Some even expressed the hope that they could have a stable exchange rate against both the rand and the US dollar.)

The institutional arrangements for exchange rate policy differ subtly from those for monetary policy. Unlike monetary policy which is solely in the hands of the central bank, exchange rate policy, although initiated by the central bank, requires the approval of the President. And, to reach the President, the support of senior officials and the Minister of Finance and Development Planning, effectively, is required. In practice, therefore, officials in both the central bank and the ministry have been involved in exchange rate policy matters on an ongoing basis.

The history of policy-making in this area is one of a tug-of-war between those focussing on balancing the full range of national interests and those focussing on their specific interests. While a look at the record of exchange rates of the Rand/Pula and the US dollar/Pula shows that the policy choice generally placed a heavier weight on the Rand/Pula rate, there were occasions when the coalition of specific dollar-based interests swayed the balance of policy in their direction. In this area, the policy outcome was more due to the balance of forces in government’s internal decision-making process than due to an “agent of restraint”.

**Fiscal Revenues**

Shortly after independence in 1966, DeBeers discovered diamonds. The government was successful in negotiating an agreement with DeBeers which, in return for the mineral rights, provided a substantial share of the profits to government. This was followed by other major mining projects, including a large copper-nickel mine, and an even larger diamond mine.

Mineral revenues were sizable, quickly becoming government’s principal revenue source. The great political virtue of such a revenue source was that the burden did not appear to fall directly on the shoulders of the voters, nor did it pit one domestic interest against another. Rather, the burden appeared to fall on foreigners.

In the eyes of a myopic government, the fact that mineral taxation was paid by a large foreign company, could have led to excessive tax rates, as so often happened elsewhere. This is a
particularly serious problem in mining, because the expenses of exploration and investment in development of the mine sites are sunk costs, leaving the mining companies vulnerable to exposure to opening of contracts by governments. Wisely, the Botswana government chose to nurture this revenue source, not over use it. It recognized that Botswana had some monopoly power in the world market for diamonds, and bought into a strategy aimed at capturing a share of the monopoly rents. The most important feature of the mineral taxation was a requirement that, in addition to a modest royalty rate, government is provided, at no charge, with a portion of the equity in the mining operation. In the case of diamonds the share was a minimum of 50%.\textsuperscript{11} As a result of the application of the regular company tax, the royalties, plus the shareholdings, a substantial portion of the diamond rents accrued to government.

Clearly this was relatively easier to do in the circumstances: First, government did not face a collective action problem, such as happens in peasant agriculture, where the incentives for the individual to cheat on monopoly arrangements can be significant. Second, government did not have to arbitrate between competing domestic interests. Third, the ruling party’s grip on power was not threatened in the short run. This permitted government to take a long-run view, choosing a tax policy that would maximize the value of the rents.\textsuperscript{12} Finally, because government was able to obtain such a substantial portion of the diamond rents directly, it chose not to dissipate those rents in costly patronage-ridden marketing arrangements which many other African countries employed as a go-between the producers and the international market.

The revenue effect of minerals development was augmented in two important ways. First, the customs union arrangement on imports, under which imports from all sources generated revenue for government, meant that the import surge from mining development brought additional revenues to government. Second, with the coming on stream on the second major diamond mine in the 1980s, a substantial surplus in the balance of payments on current account emerged. The resulting accumulation of foreign exchange reserves created a further revenue source in the form of central bank earnings on those reserves. By the 1993/94 fiscal year the earnings on the foreign exchange reserves became the second largest source of government revenues. Overall then, these

\textsuperscript{11} Government also exercised its option to purchase additional equity. For more details, see Gaolathe (1997).

\textsuperscript{12} Another way of stating the point is that the discount rate of the decision makers was not excessively high.
three sources, none of which appeared to fall directly on the voters, and all of which were
denominated in foreign exchange, provided 85% of budgeted government revenues in 1997/98.

**Fiscal Expenditures**

With such substantial revenues available to it, government was faced with enormous demands to
spend. Accelerating government expenditures could readily have put pressure on the capacity of
the economy, and turned rapid growth into an inflationary spiral. Fortunately, a carry-over from
the days when the bulk of the budget was financed by donor agencies proved to be an effective
agent of restraint: multi-year planning of expenditures.

As Botswana got ready for independence (1966), a process of preparing multi-year national
development plans was instituted. While initially the emphasis was on raising the funds from
donors to cover government’s operations and to put infrastructure in place, the planning process
has since evolved into a relatively sophisticated exercise. Desired expenditures over the
projected plan period (5 or 6 years), both recurrent and capital, are developed in the spending
ministries and state-owned enterprises. Major policy issues facing each are articulated and
resolved in the planning documents. Feasible paths of expenditure are projected by the Ministry
of Finance and Development Planning. An important element in those projections is the
sustainability of recurrent expenditures. Even if the capital budget is affordable in the plan
period, it is trimmed if the ongoing costs cannot be covered with confidence. Priorities are then
set in an extensive consultative process, which includes a series of lengthy meetings of all
ministers and senior officials, and culminates in adoption of the plan by parliament. This is
supplemented by annual reviews of projects underway, and an extensive mid-plan review of the
overall picture.

This process has become an effective self-imposed agent of restraint on excessively fast growth
of government expenditure over the long-run. Like any self-discipline, it isn’t always followed.
There have been occasions when the rate of growth of government expenditure has been too fast,
relative to the growth of capacity in the economy. This has been particularly evident in the year
before elections when government typically awarded a generous salary increase to the public
sector. The one occasion when this was not done -- the 1994 election -- is blamed by some in the
governing party for the success which the opposition had on that occasion. Nevertheless, the
national development plan has remained the benchmark against which the actual expenditure is
compared. On the whole, the record of maintaining macroeconomic balance over the long-term, has been good.

The success in maintaining macroeconomic balance is not intended to suggest that the level and composition of government expenditure were optimal. On the contrary, with ample funds in the bank, and in the absence of restraining influences, it was all too easy for government to give in to demands for particular expenditures of one kind or another. Gradually the ratio of government expenditure plus net lending to GDP grew, becoming one of the highest in Africa. The effect which this had on crowding out potential sources of modern sector employment growth was far more serious than the more common routes found elsewhere -- exchange rate overvaluation and/or high real interest rates. In other words, the existence of an agent of restraint in one area, did not necessarily preclude an ill-advised policy thrust in another area which lacked such a restraint.

State-Owned Enterprises
At independence Botswana's modern sector was virtually non-existent. There was no electricity system, no telephone system, no pipe-borne water or sewage. The housing stock consisted almost entirely of the traditional rondavels. There was one 5 km. stretch of paved road, and no public transportation service. All the facilities for a modern economy had to be constructed from scratch.

For electricity, telephones, and water and sewage, the standard "natural monopoly" case for government intervention certainly existed -- a downward sloping average cost curve over the relevant range of demand. In keeping with the approach taken in many countries, Botswana chose to set up a series of state-owned enterprises. Each of these enterprises has evolved in its own way. The lumpy nature and substantial size of investments required for electricity, telephone, and water meant a heavy reliance on capital loans from external agencies, particularly the World Bank. Attached to each of the World Bank loans was a covenant requiring pricing to achieve a specified real return on revalued assets. This effectively prevented these state-owned enterprises from becoming a drain on the public purse.

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13 Initially, some of these activities were simply carried out by government departments, and later launched as state-owned enterprises.
The covenants with the World Bank did not guarantee that all public utilities were effectively managed. In spite of the importance of efficient telephone and postal services in attracting foreign investment, the telephone company had chronic shortages of lines for new customers, and the postal service proved incapable of keeping pace with the demand for new post office boxes.

In the case of housing, government chose also to set up a state-owned enterprise to construct and rent out modern sector housing. While there was no normative reason for establishing such a public sector entity, it was in keeping with the traditional approach that land belongs to the tribe, and not to individuals.

The performance of the housing corporation, in contrast to the traditional public utilities, became a serious problem. It failed to meet the growing demand for urban housing, frequently ran substantial deficits in spite of low interest loans from government, and in the early 1990s was at the centre of one of the few cases of serious public sector corruption. Numerous reports and special commissions examined the problems facing the housing corporation. The problems identified were many, and rational recommendations made to solve them. But the central problem was that decisions to adjust rental rates were made by cabinet. Inevitably, in the absence of any agent of restraint, cabinet failed to keep rental rates in line with costs.

The Policy Advisor in the National Context
In many of the foregoing policy areas Botswana utilised foreign economic advisors. The project for which Doug Hartle and I worked in the 1980s and 1990s had been initiated by the Ford Foundation in the early 1970s. It was subsequently funded by various other donor agencies, and finally funded entirely by the Botswana government because it saw the ongoing need for such advisors. Management of the project was handled initially by the Ford Foundation, later by Williams College, then the University of Toronto under Doug Hartle's leadership, and finally by a newly established think tank resident in Gaborone, the Botswana Institute for Development Policy Analysis (BIDPA). But we were not the only ones. The IMF provided considerable expertise to the central bank; the World Bank supported several important policy reviews; the British ODA, the USAID, the German GTZ, the Australian aid agency, the Canadian CIDA, the Norwegian NORAD, and the Swedish SIDA, each financed several experts in a whole range of activities.
The Ford/Williams/Toronto/BIDPA Project had one key characteristic: it was clear to each advisor that he was working on behalf of Botswana, not some external funding agency. We worked inside the machinery of government, participating fully in the policy processes. It quickly became clear to each of us that key features of important policies were almost always established by a process of consensus -- first at the working level, then among the senior bureaucracy of the ministry, or agency, and finally with the relevant board or minister. Our advice was accepted when it was supported by the evidence and was persuasive to the relevant group, not simply because we were foreign “experts.”

The emphasis on seeking consensus reflected a belief, strongly held in the traditional culture, in the value of compromise. This meant that the task of policy discussions was to find solutions which would be widely accepted, avoiding ones which could be highly contentious. While this might have ruled out some potentially profitable initiatives, it did serve to rule out the more egregious redistributive policies often pursued by governments with a narrow support base. It had the further advantage that this approach made it broadly acceptable to foster social stability. Most importantly, in my view, the need for consensus minimized the problem noted earlier in the discussion of the Weingast and the Stiglitz papers: a policy, whose success depends on unenforceable follow through by officials persuaded against their will, is much less credible than a policy supported by a consensus.

**Conclusion**

What conclusions might we draw from the Botswana experience?

Various types of problems identified in the literature were indeed manifested in Botswana. Olson’s collective action problem appeared in the case of cabinet’s unwillingness to authorize long overdue rental increases for the state-owned housing corporation, while continuing its stranglehold on the housing market. The short time horizon of political decision makers, cited by Besley and Coate, was evident in the high public sector salary increments awarded frequently in the year before general elections. The inability of governments to make commitments on all dimensions of policy emphasized by Stiglitz, and also Weingast, was clear in the slow response of the state-owned enterprises to the lengthening queues for postal boxes and telephones. Weak institutions, which both Alesina and Olson stressed, were also a substantial part of the problem with the housing corporation.
Despite some problems, it is also clear that sound economic policies and effective institutions have made a significant difference to Botswana’s growth over the past three decades. In the areas cited above -- trade, monetary, exchange rate, fiscal, and state-owned enterprises -- the balance has been towards what most economists would identify as growth-promoting policies. Rational policy advice, buttressed by rigorous but easily understood economic analysis, offered in the context of effective institutions, generated an impressive payoff for Botswana.

Policy advisors in Botswana played a significant part in both the policy formulation and the institution building. Yet, as insiders in the process, the policy advisors all too often observed undesirable features incorporated in otherwise well designed policies to make them politically acceptable. A purist would condemn such compromises and argue that the policy advisor should remain firmly on the outside. Such an approach would have had important shortcomings.

First, an insider in the policy process, has an enormous advantage of being able to influence the agenda. The typical policy agenda is very crowded, and the time available to press through important initiatives is limited. Yet the policy advisor can influence the order in which issues are tackled. When this ability is skilfully used, it is possible to tilt the balance in favour of better economic policies, thereby reducing the degree to which specific interests could lead to sub-optimal economic performance.

Second, the inside policy advisor is in a much better position than an outsider to design policies which reflect the nuances of the local circumstances, including the institutional capacity to implement agreed policies. This is particularly important in the context of a developing country, where standard cookbook recipes are constantly proffered to developing country governments, often with a complete absence of context -- both economic and institutional. Some of these were minor technical matters which professionals could sort out in due course. But all too often the recipe of a particular international agency would not permit substitutions.

Third, running through all the policy successes in Botswana was a common theme: well designed policies were far more likely to be introduced and carried through successfully when there was a mechanism constraining the political process from caving in to vociferous specific interests. This may sound a bit like an economist seeking a scapegoat -- complaining that if only the politicians would not respond to the voters, the economist’s favourite policy prescription would do wonders for the nation. However, the point is more subtle than that. It is that the political
process has a great deal of difficulty constraining itself to act always in the long-run national interest. If the political process can yield agreement on a sound policy that is in the national interest, the policy is more likely to be able to deliver its potential benefit if the political agreement cannot be undone subsequently.

In Botswana’s case the constraining mechanism took different forms. Sometimes it was in the form of the wide initial consensus underlying the initiative, making it virtually impossible for special interests to hijack the policy for their own purposes. Other times the constraining mechanism was an external agent of restraint such as the SACU, or the covenants on World Bank loans. And other times the mechanism was an entrenched institutional arrangement such as the planning system.

What does this experience suggest to an economist designing economic policy? Obviously, since good economic policies are preferred to poor economic policies, the first task is to weed out the latter from the agenda. But the task does not stop there. Within the set of economic policies that have the potential to yield net benefits to society, there remains considerable choice. In making that choice, the savvy economist promotes the subset that contains built in “agents of restraint” which will serve to constrain government’s discretion. Wittingly or unwittingly, such policies served Botswana well.
References


