UNITED NATIONS UNIVERSITY

UNU-WIDER

World Institute for Development Economics Research

Research Paper No. 2007/35

Aid and Rent-Driven Growth

Mauritania, Kenya and Mozambique Compared

Richard M. Auty*

June 2007

Abstract

This paper conceptualises foreign aid as a geopolitical form of rent in order to help distinguish the conditions under which aid is detrimental to sustained economic recovery from those where it is beneficial. Foreign aid shares with natural resource rent and contrived (i.e., government monopoly) rent the property of being a large revenue stream that is detached from the economic activity that generates it, and elicits political contests for its capture. Rent-driven models suggest such contests have two adverse effects: (i) they deflect government incentives into rent-channelling at the expense of promoting wealth creation; and (ii) the resulting *political* allocation of the rent distorts the economy and precipitates a growth collapse, which is protracted. In this context, the three principal causes of aid failure identified in the literature (corruption, a poor policy environment and Dutch disease effects) are all symptoms of the destabilizing impact of rent streams on immature political economies. Consequently, the deployment of foreign aid to revive collapsed economies runs the risk of perpetuating rent-seeking and thereby postponing essential economic restructuring. This paper compares the varied impacts of aid on the development trajectories of Mauritania, Kenya and Mozambique. It argues

…/.

Keywords: Africa, aid, rent, resource curse, economic development

JEL classification: H53, O19, O55

Copyright © UNU-WIDER 2007

* Lancaster University, email: r.auty@lancaster.ac.uk

This study is a revised version of the paper presented at the 16-17 June 2006 WIDER development conference on ‘Aid: Principles, Policies, and Performance’, directed by George Mavrotas.

UNU-WIDER gratefully acknowledges the financial contribution to the conference by the Finnish Ministry for Foreign Affairs.

UNU-WIDER also acknowledges the financial contributions to the 2006-07 research programme by the governments of Australia (AusAID), Denmark (Royal Ministry of Foreign Affairs), Norway (Royal Ministry of Foreign Affairs), Sweden (Swedish International Development Cooperation Agency—Sida) and the United Kingdom (Department for International Development).

ISSN 1810-2611 ISBN 92-9190-978-5 ISBN 13 978-92-9190-978-0

that successful aid deployment requires: recognition that aid modalities differentiate aid's effectiveness; stronger public accountability; and the construction of a cohesive pro-reform political constituency. The paper proposes a dual track strategy as a politically practical means of deploying geopolitical rent to restructure distorted economies.

The World Institute for Development Economics Research (WIDER) was established by the United Nations University (UNU) as its first research and training centre and started work in Helsinki, Finland in 1985. The Institute undertakes applied research and policy analysis on structural changes affecting the developing and transitional economies, provides a forum for the advocacy of policies leading to robust, equitable and environmentally sustainable growth, and promotes capacity strengthening and training in the field of economic and social policy making. Work is carried out by staff researchers and visiting scholars in Helsinki and through networks of collaborating scholars and institutions around the world.

www.wider.unu.edu *publications@wider.unu.edu*

UNU World Institute for Development Economics Research (UNU-WIDER)
Katajanokanlaituri 6 B, 00160 Helsinki, Finland

Typescript prepared by Liisa Roponen at UNU-WIDER

The views expressed in this publication are those of the author(s). Publication does not imply endorsement by the Institute or the United Nations University, nor by the programme/project sponsors, of any of the views expressed.

1 Context

This paper starts from the premise that the political economy of rent extraction and deployment in low-income countries profoundly impacts both government incentives and the development trajectory. It conceptualizes foreign aid as a geopolitical form of rent that along with natural resource rent and contrived (government monopoly) rent is one of three key sources of rent in low-income countries. Natural resource rent is defined here as the surplus revenue from an economic activity after deducting all production costs, including a risk-related return on investment. It may be regarded as a gift from Nature, because in theory it can be taxed by governments from resource-based activity without impairing incentives to produce. Foreign aid has shared this unearned or 'windfall' characteristic, until the aid community became more discriminating through the 1990s (Collier 2006).

The rent from natural resources in developing countries typically comprises between one-tenth and one-fifth of GDP (World Bank 2006a, see also Table 1). In recent decades the scale of geopolitical rent relative to GDP in many low-income countries has matched that of natural resource rent (Svensson 2000), while contrived rent (derived largely from government manipulation of trade policy, the exchange rate, licensing and credit) can be of similar magnitude (Krueger, Schiff and Valdes 1992), taking the *total* rent within the economy to one-fifth to one-third of GDP, and more. The management of a revenue stream on such a scale, which is detached from the economic activity that generates it and is also fungible, would challenge the stability of even mature political economies.

The economic literature suggests that a high rent/GDP ratio can facilitate economic development if the rent is used to boost capital formation and if the associated foreign exchange is deployed to enhance capacity to import the capital goods required to build a modern economy. But the potential economic benefits will only accrue if the rent is deployed effectively, i.e. by a developmental political state, which after Lal (1995) is one that has both sufficient autonomy to pursue a coherent economic policy and the aim of maximizing social welfare. In the absence of such a political state, rent is likely to feed patronage networks and destabilize the political economy (Collier and Hoeffler 2006).

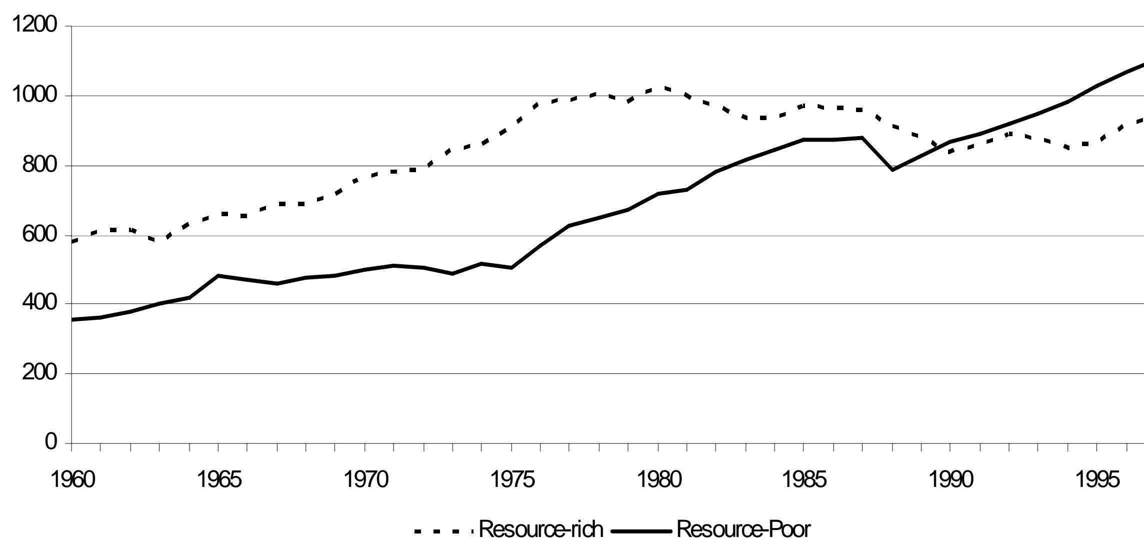
Since the mid-1970s high *natural resource* rent in the developing economies has been linked with economic growth collapses (Sachs and Warner 1995). Rent-driven political economy models explain that high rent triggers political contests, which within immature political states deflect government effort into redistributing rent at the expense of promoting wealth creation. The resulting rent allocation locks the economy into a staple trap of increasing dependence upon a primary commodity with diminishing competitiveness. In the absence of economic reform, which powerful rent-recipients oppose, the economy is vulnerable to shocks and a growth collapse from which recovery is protracted because the preceding cumulative distortion of the economy runs down all forms of capital. The recent growth collapses are rooted in fashionable post-war development theories that advocated intensified state intervention in the economy, but over-estimated the integrity of political states (Auty 2001). Policies to override markets were frequently captured by vested interests and used to boost rent-seeking in ways that distorted the economy, an outcome that could be sustained for longer periods and with larger cumulative impacts in high-rent (resource-rich) countries than in low-rent countries (Table 1 and Figure 1).

Table 1
Share of rent in GDP 1994 and per capita GDP growth, six natural resource endowment categories

Resource endowment	Pasture and cropland rent (% GDP)	Mineral rent (% GDP)	Total rent (% GDP)	Per capita GDP growth 1985-97 (%/yr)
Resource poor[1,2]				
Large	7.34	3.22	10.56	4.7
Small	5.41	4.45	9.86	2.4
Resource rich				
Large	5.83	6.86	12.65	1.9
Small, non-mineral	12.89	2.53	15.42	0.9
Small, hard mineral	9.62	7.89	17.51	-0.4
Small, oil exporter	2.18	19.04	21.22	-0.7

Notes: 1 Resource-poor = 1970 cropland/head < 0.3 hectares;
2 Large = 1970 GDP > $7 billion.
Source: Auty (2001: 17).

Figure 1
Median GDP per capita (constant 1995 US$) resource-rich and resource-poor developing countries



Source: Auty (2005: 5).

Foreign aid increased sharply through the 1980s to help revive the collapsed economies. Although Gomanee, Girma and Morrissey (2005) and Karras (2006) estimate that each 1 per cent rise in the aid/GNP ratio raises per capita GDP growth by 0.14-0.25 per cent,[1] the provision of *geopolitical* rent to revive collapsed resource-rich economies invariably

1 More specifically, Karras (2006) finds for 71 countries during 1960-97 that an increase in aid equivalent to 1 per cent of GDP raises the PCGDP growth rate by 0.14 to 0.26 per cent, irrespective of policy effects. Similarly, Gomanee, Girma and Morrissey (2005) report a 0.25 per cent increase in per capita GDP growth from a 1 per cent rise in the aid/GNP ratio for 25 Sub-Saharan African countries during 1970-97. However, aid must help to restructure the economy to achieve self-sustaining GDP growth.

disappointed (see Figure 1 and Svenssen 2000). The literature disputes whether the modest outcome is because rent feeds corruption (Boone 1996), causes political instability (Islam 2005) or triggers Dutch disease effects (Rajan and Subramanian 2005). This paper argues that all three 'causes' are symptoms of the destabilizing political competition that aid triggers in immature political states as a large and fungible revenue rent.

In assessing the efficiency of foreign aid during the period 1971-90, Boone (1996) finds that it did not increase the investment rate in recipient countries, but went mostly into boosting consumption and expanding the scale of government. Nor did this increased consumption benefit the poor in any of three different types of political state that Boone analysed (autocratic, egalitarian and oligarchic laissez-faire). Burnside and Dollar (2000) seek to refine the gloomy conclusion that *the elite capture foreign aid*. They argue that although aid has no discernible effect on countries with maladroit policies it has a strong positive effect on countries pursuing sound policies regarding fiscal balance and trade openness.

Burnside and Dollar (2000) receive little support, however, from subsequent research (Hansen and Tarp 2001; Islam 2005; Rajan and Subramanian 2005). Islam (2005) finds that although sound policies are a necessary condition for growth, they are not sufficient in the absence of political stability, which is required to encourage investment. In the *absence of political stability*, aid is likely to be dissipated in unproductive consumption, much as Boone describes. Svensson (2000) confirms that for countries with weak political institutions, increases in foreign aid exacerbate corruption because much of the aid feeds rent-seeking activity. Collier and Hoeffler (2005) warn that aid is more likely to be dissipated through rent-seeking in democracies with weak political accountability than in autocratic political states.

Rajan and Subramanian (2005) identify a third channel for aid's adverse impact: they find that domestic *expenditure of overseas aid within the public sector triggers Dutch disease effects* that constrain labour-intensive manufacturing growth (whereas expenditure of private sector remittances does not).[2] This finding echoes that of Bevan, Collier and Gunning (1987) that windfall natural resource rent is less likely to be saved and also invested effectively when it is concentrated on governments than when it is diffused across many economic agents. Similarly, Gelb and Associates (1988) demonstrate that the concentration of the 1974-78 and 1979-81 oil windfalls on governments led to over-rapid domestic absorption of the rent that triggered Dutch disease and rent-seeking, which depressed economy-wide investment efficiency.

The three identified 'causes' of malfunctioning aid are interlinked: rents trigger contests that feed corruption, distort policy and cause over-rapid rent absorption (amplifying Dutch disease effects). This is not the case for all forms of aid, however, so the argument must be further nuanced: if foreign aid flows are disaggregated, some forms are less prone to political capture. For example, Collier (2006) finds that foreign aid outcomes have improved in Sub-Saharan Africa since the 1980s compared with oil rent outcomes due to a learning curve that has directed rent into economies that demonstrate

---

2 Mahon (2007) also reports that remittances are deployed more effectively than aid in southern Mexico.

Table 2
Evolution of political accountability, under political states with differing autonomy and aims

				Strength of sanction against anti-social governance		
Autonomy of state	Basic aims of state	Critical features	Rent pattern	Political accountability	Social capital	Rule of law
LOW RENT INCENTIVES						
Benevolent autocratic nation builder	Secure rapid GDP growth to sustain compact elite + build social unity	Low rent; external threat; poor have low opportunity cost	Low rent siphoning: efficient diffuse rent raising + dispersal	Weak; but predation curbed by priority for social unity	Bonding social capital dominant; slow expansion of bridging + linking	Nominal; elite dispense justice, at times arbitrarily
Diffuse factional oligarchy	Expand elite to deter policy capture and sustain rapid GDP growth	Low rent; Intra-elite (land/ethnic/army) rivals; rapid equal GDP growth	Low diffuse rent extraction for public goods + (skewed) wealth creation	Moderate: growing parliament power v. executive	Competitive urbanization builds autonomous linking + bridging social capital	Strengthening legal protection; common law fairer > civil law
Consensual factional democracy	Growth then equity via providing basic social entitlements	Low rent; middle class growth saps elite + shrinks poor	Diffuse extraction + dispersal for growth > redistribution	High: independent parliament + second chamber	Autonomous linking + bridging social capital; risk of Olson effects	Legal independence cuts transaction costs + risk
HIGH RENT INCENTIVES						
Predatory autocratic dictator	Maximize elite rent siphoning through force if necessary	High rent; violent predation; staple trap trajectory	Point rent extraction by elite slows GDP growth	None: power held by violence, which only elite contest	Weak: intense elite rivalry; poor have bonding social capital	None: elite controls by force; poor rely on custom
Concentrated factional oligarchy	Dominant faction captures policy to sustain rent + power	High rent; unequal asset share; staple trap trajectory	Point extraction but some public goods benefit mainly elite	Minimal; puppet legislature run by oligarchy;	Dependent on elite; repressed civic associations	Skewed to favour elite > poor
Polarized factional democracy	Capture policy to benefit tribal clients even if slows long-term GDP growth	Democracy polarized on tribal lines; retarded GDP growth	Rent extraction + skewed distribution to tribal clients > GDP growth	Fragile: parliament liable to wild policy swings + some dictator risk	Polarized civic associations feed polarized democracy	Judiciary subject to capture + biased to tribal clients

Note: Moving down the table, political accountability strengthens incrementally and endogenously under low rent (spawning developmental political states). It is retarded is the presence of high rent (favouring non-developmental political states), but after a growth collapse exogenous democratization can occur abruptly if neighbourhood effects are accommodating.

the capacity to use it effectively and also into applications that are subject to public accountability. He suggests that whereas oil rent lowers the share of government revenue from taxation, which is scrutinized, relative to 'sovereign' revenue that is not scrutinized, foreign aid may be subject to adequate scrutiny if it is channelled to: technical assistance; projects that are subjected to competitive tender; programmes managed by governments with proven records of effective deployment; and forgiveness of debt that can never be serviced. Mavrotas and Ouattara (2006) also qualify the differential impact of aid modalities: they report with reference to Côte d'Ivoire during 1975-99 that increased *programme* aid boosts investment (that can be monitored) and also lowers government consumption, whereas higher *project* aid boosts government consumption (as do technical aid and food aid) but shrinks investment.

This paper applies two rent-driven political economy models to compare the development trajectories of Mauritania, Kenya and Mozambique in order to distinguish the conditions under which geopolitical rent is detrimental to sustained economic recovery from those where it is beneficial. It finds that aid can reinforce the strong inertia of rent-seeking and retard essential economic restructuring but that the selective deployment of aid as part of a dual track reform strategy can improve outcomes. The paper proceeds by introducing rent-driven political economy models in section 2. The models are then applied to explain why streams of geopolitical rent have been counter-productive in Mauritania and Kenya in sections 3 and 4, respectively. Section 5 explains the mainly beneficial outcome of rent deployment in Mozambique. Section 6 sets out the policy implications.

2 High-rent and low-rent political economy models

The low-rent competitive industrialization model and the high-rent staple trap model demonstrate how differences in the scale of natural resource rent affect the incentives of the political state and the development trajectory (see Auty 2007). The competitive industrialization model provides a useful comparator for the high-rent staple trap model. It shows that low rent motivates governments to create wealth because the principal means of increasing revenue is through the taxation of a dynamic economy. The interests of the elite align with those of the majority poor in the provision of public goods and maintenance of efficiency incentives in order to generate wealth for the government to tax. These incentives yield an autocracy that is benign rather than predatory (Table 2); an oligarchy that is self-liquidating (as early competitive industrialization (described below) triggers rapid social change that proliferates competing interest groups able to form alliances to check policy capture by any one faction); and a democracy that is consensual (reflecting public satisfaction with policies that bring rapid socioeconomic gain).

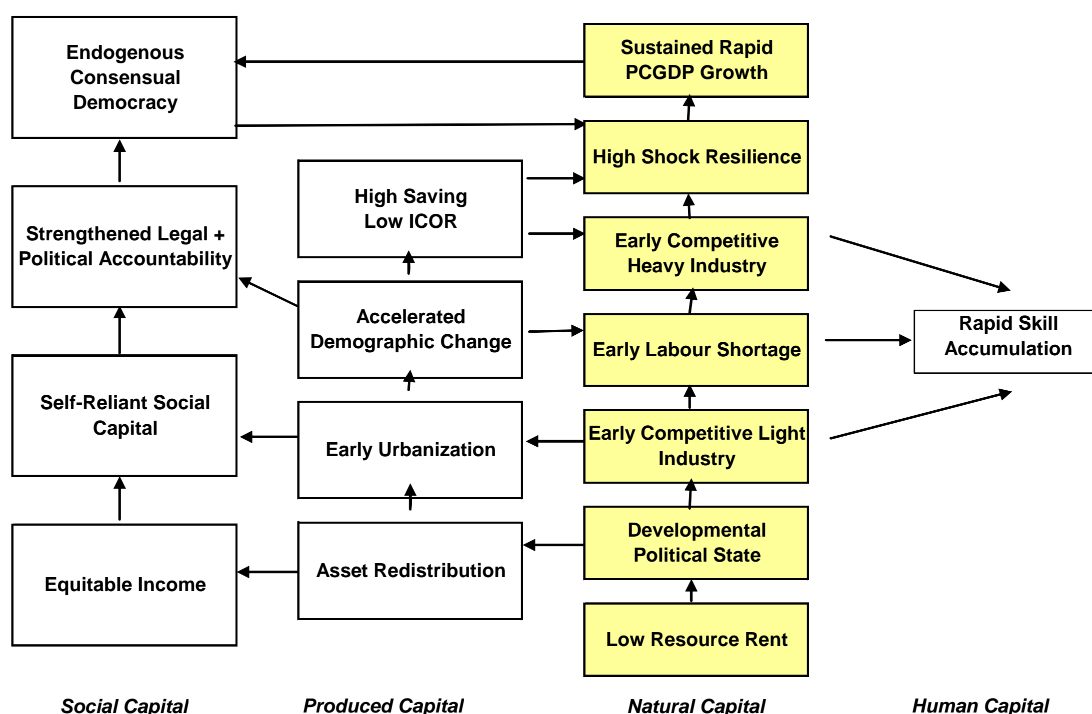
In contrast, high rent increases the ratio of 'sovereign' revenue relative to tax revenue and sparks political contests for its capture that deflect government effort into revenue distribution at the expense of promoting wealth creation, *an outcome that foreign aid can perpetuate*. Rent confers immediate (often personal) gain on governments whereas the benefits from wealth creation are deferred and may therefore accrue to the government's successors. The high-rent incentives render an autocracy likely to be predatory (Table 2); whereas an oligarchy will remain concentrated (in the absence of rapid structural and social change); and a democracy will be polarized because the high

income inequality associated with resource-rich economies (explained below) polarizes political parties between income redistribution and the status quo, so that change in government brings large swings in policy that deter investment.

Differences in rent also affect the development trajectory. The short dependence upon commodity exports of low-rent economies triggers industrialization at a relatively low per capita income, so the industry is labour-intensive and also competitive in the absence of rent subsidies. The resulting development trajectory (the shaded column in Figure 2) triggers virtuous economic and political circles. The economic circle sees early industrialization bring early urbanization, which accelerates passage through the demographic cycle so population growth slows sooner than in high-rent countries, and the falling dependency/worker ratio raises the share of investment in GDP relative to consumption. The expansion of labour-intensive manufacturing also absorbs surplus rural labour and encourages diversification into skill-intensive and capital-intensive manufacturing to boost labour productivity. In the absence of rent subsidies this diversification is competitive and boosts the resilience of the economy. It also proliferates market-oriented firms that shrink the scope for rent-seeking and maintain the efficiency of investment so economic growth is rapid and can double per capita GDP every seven to ten years.

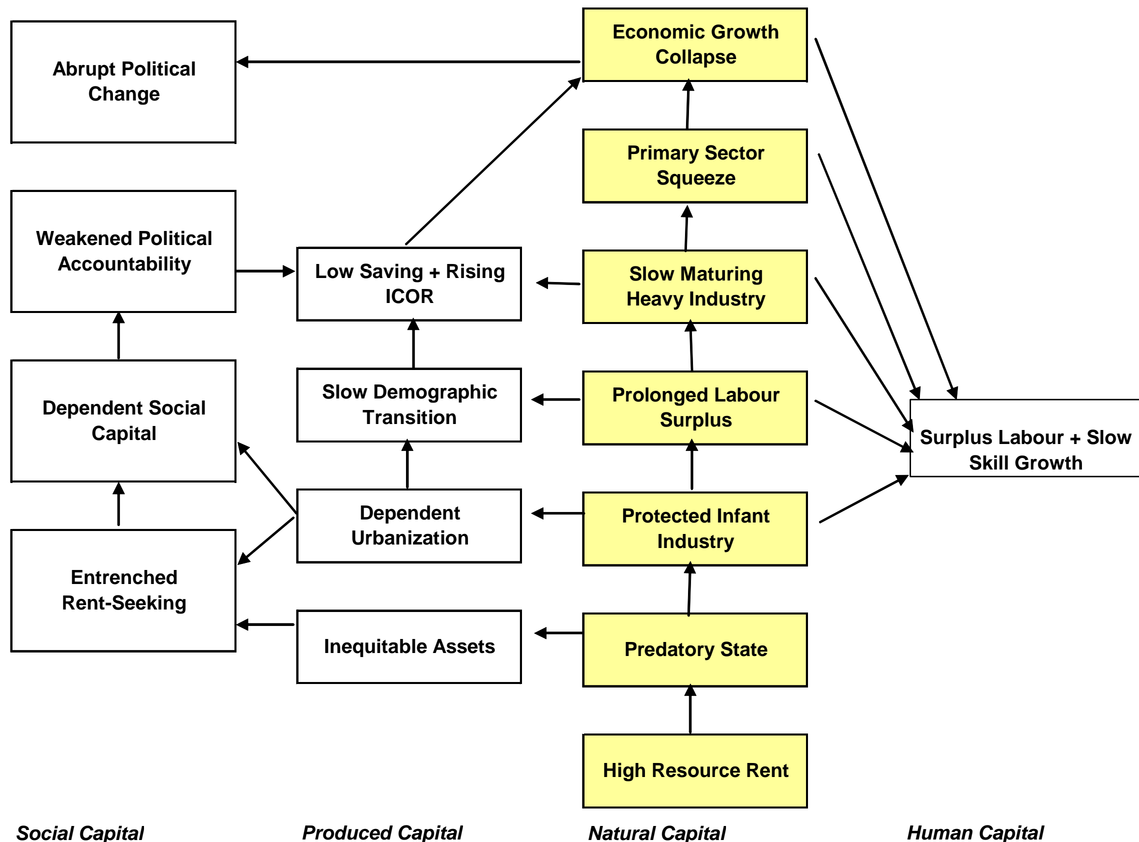
In addition to encouraging wealth-generation, competitive industrialization spawns a virtuous political circle that maintains a relatively egalitarian income distribution. This is because the early elimination of surplus labour puts a floor under the wages of the poor while the rapid expansion of skills caps the skill premium. Moreover, sustained rapid per capita GDP growth strengthens three sanctions against anti-social governance (Auty 2007) as: (i) taxation soon diversifies away from commodity exports towards income, profit and expenditure taxes and strengthens demands for the political accountability of public spending; (ii) early competitive industrialization generates self-

Figure 2
Low-rent and the competitive industrialization model



Source: Auty (2007: 572).

Figure 3
High rent and the staple trap model



Source: Auty (2007: 573).

help social capital that strengthens civic voice; and (iii) the proliferation of competitive enterprises intensifies demands for the rule of law and property rights to protect investment returns. These pressures yield an incremental and endogenous democratization as they propel the political state from a benign autocracy through a diffusing oligarchy to a consensual democracy (Table 2).

In contrast, the high-rent economy's longer dependence on rent from primary exports aborts competitive diversification and locks the economy into a staple trap. The development trajectory (the shaded column in Figure 3) skips labour-intensive manufacturing with three adverse consequences. First, later industrialization retards urbanization and delays passage through the demographic cycle so the dependent/worker ratio remains high and consumption continues to absorb a high share of GDP. Second, late manufacturing is capital-intensive so it fails to absorb surplus rural labour so that income inequality widens. The resultant social tensions encourage governments to subsidize employment by using rent to protect infant industry and over-expand the bureaucracy. The expansion of the subsidized sector depresses the economy-wide efficiency of capital, so that economic growth decelerates. Third, entrepreneurial talent is misallocated because lobbying for government favours is more remunerative than investing in productive activity.

The expanding subsidized sector outstrips the rent as the relative size of the primary sector contracts, due to either on-going structural change or shifting terms of trade. But

rent-seekers block economic reform so governments find it politically expedient to raise revenue in addition to the rent by extracting the returns to capital and labour from the primary sector as well as the rent. This depresses incentives in the primary sector and saps its viability even as the rest of the economy increases its dependence upon it. This staple trap trajectory of increasing dependence on a primary commodity with declining competitiveness renders the economy vulnerable to shocks and a growth collapse from which recovery is protracted. This is partly because the cumulative misallocation of investment causes all forms of capital to run down and partly because rent-seekers exhibit strong inertia by exerting their political muscle to oppose market reform because it shrinks their rent-extracting opportunities.

The high-rent staple trap trajectory also weakens incentives to build sanctions against anti-social governance because rent recipients make fewer demands for political accountability than taxpayers do; social capital is dependent on state largesse, a condition that discourages civic voice; and entrepreneurs lobby government officials for favours instead of pushing for competitive markets, property rights and the rule of law. Tornell and Lane (1999) demonstrate that economies with powerful elites grow more slowly than those in which elites wield less power: in the presence of powerful groups, oil and coffee booms sharply increase government expenditure and debt, and also double the share of transfers in GDP. Where power is diffused among many groups, growth is faster. This is consistent with the low-rent competitive industrialization model, in which structural change proliferates interest groups so that autocracies and oligarchies self-destruct and diffuse into democracies.

This paper argues that the provision of geopolitical rent to revive resource-rich economies after a growth collapse can perpetuate distortion of the political economy by feeding rent-seeking, easing pressure for reform and retarding economic restructuring. The consequences include corruption, a poor policy environment and Dutch disease effects. The next three sections compare the rent streams, government incentives and development outcomes for the three case study countries, commencing with Mauritania.

3 Sustained high geopolitical rent and Dutch disease in Mauritania

For three decades, Mauritania has received a rent stream of around one-third of GDP, mostly from geopolitical rent (Table 3). Prior to that, rent from an expanding new iron ore mine had triggered rapid economic growth through the 1960s. Barely 2 per cent of Mauritania's one million inhabitants were urbanized then, three-quarters being herders scattered across one million square kilometres of arid land and one-quarter being farmers beside the Senegal River (Cour 2004). Mining generated two-thirds of modern sector income and 80 per cent of exports by 1974, when foreign aid quadrupled to one-quarter of GNI to help Mauritania adjust to the 1973 oil shock. Aid persisted at that level with minor fluctuations (Table 3). Subsequently, a fishing agreement with the EU conferred quasi-rents that were worth 8 per cent of GDP by the early 2000s. This sustained, large and weakly monitored rent stream has been associated with low transparency in public finances; severe Dutch disease effects and a dominant rent-driven urban economy. These are unpropitious pre-conditions for managing an oil boom that is projected to generate an extra 25 per cent of GDP annually in public revenue during 2007-16.

Table 3
Foreign aid flows, 1960-2003 (Aid % GNI)
Mauritania, Kenya and Mozambique

	Mauritania	Kenya	Mozambique
1960-64	3.1	6.4	NA
1965-69	6.7	4.7	NA
1970-74	10.1	3.8	NA
1975-79	32.9	4.7	NA
1980-84	26.9	6.8	5.8
1985-89	24.8	8.9	26.2
1990-94	25.0	13.6	48.4
1995-99	22.4	5.2	32.5
2000-2003	20.2	4.0	28.2

Source: World Bank (2005).

As a consequence of IMF conditionality, Mauritania restored a *nominal* democracy in 1993, after suspending it in 1978. The elite maintained power by channelling rent through a clientelistic system so that regime change occurred through military coups rather than elections. The government that ruled for two decades until May 2005 won three elections during 1993-2003 with over two-thirds of the vote by using public office to co-opt tribal leaders and fracture the opposition. The rapid rotation of office conferred short tenure that encouraged maximum rent siphoning, however, which some estimates put at one-quarter of public revenue. The elite exploited the IMF and ODA as sources of rent. For a decade prior to 2004, the government secretly ran off-budget expenditures substantially in excess of those reported to the IMF so the national accounts since 1995 are now being revised to determine how the economy actually performed. The governance indices in Table 4 are little better than those of Malawi, a country with one-third of Mauritania's per capita GDP.

In addition to feeding corruption, Mauritania's rent-driven clientelism also engendered a dependent form of social capital that looked to the government and extended family for sustenance. It was common practice for poorer relatives to migrate from the countryside and expect their wealthier urban relatives to provide for them until they found a government job or other employment. This passive social capital contrasts with the resilient self-help and civic voice of the competitive industrialization model.

Mauritania's rent-driven economy also exhibits pronounced Dutch disease effects. The share of agriculture in GDP contracted after the mid-1970s' growth collapse (Table 5), although stagnant per capita GDP (Table 6) would be expected to have stabilized its share. The IMF (2005a) estimates the share of agriculture in GDP at 16 per cent in 2004, barely half that expected for a country at Mauritania's level of development while manufacturing is two-thirds the size expected. Agriculture employs more than half the workforce but generates only one-sixth of GDP, half of which is subsistence. Barely half the herding subsector's 12 per cent of GDP is commercialized while cropping exhibits even more neglect: it generates a meagre 4 per cent of GDP, one-quarter of which is commercial, but it employs three-quarters of the rural workforce. Yet Mauritania's 150,000 irrigable hectares, if integrated with improved livestock management and roads to access markets, could lift agriculture's share of GDP above the expected one-third level.

Table 4
Index of institutional quality 2004:
Mauritania, Kenya, Mozambique and regional comparator countries

Country	PCGDP (US$ PPP 2005)	Voice + accountability	Political stability	Effective governance	Regulation burden	Rule of law	Graft	Overall index
Malawi	667	-0.45	+0.15	-0.78	-0.58	-0.35	-0.85	-2.86
Zambia	1,040	-0.35	+0.02	-0.94	-0.62	-0.62	-0.82	-3.33
Kenya	1,165	-0.12	-1.16	-0.78	-0.32	-0.94	-1.01	-4.33
Nigeria	1,183	-0.69	-1.77	-0.92	-1.01	-1.38	-1.22	-6.99
Mozambique	1,364	-0.06	+0.04	-0.34	-0.60	-0.72	-0.68	-2.36
Zimbabwe	2,048	-1.65	-1.58	-1.42	-2.20	-1.47	-1.24	-9.56
Mauritania	2,228	-1.09	-0.31	-0.19	-0.14	-0.54	-0.26	-2.53
Angola	2,425	-1.15	-0.82	-0.96	-1.24	-1.28	-1.09	-6.54
Lesotho	2,764	+0.28	+0.31	-0.29	-0.55	-0.19	-0.15	-0.59
Swaziland	5,137	-1.28	-0.04	-0.84	-0.44	-0.75	-0.60	-3.95
Namibia	7,803	+0.36	+0.50	+0.09	+0.11	-0.01	+0.06	+1.11
Botswana	10,790	+0.68	+0.94	+0.79	+0.76	+0.70	+1.10	+4.97
South Africa	12,347	+0.82	-0.10	+0.84	+0.59	+0.19	+0.54	+2.88

Source: World Bank (2006b).

Table 5
Structural change: Mauritania, Kenya and Mozambique, 1960-2004

	1960-64	1965-69	1970-74	1975-79	1980-84	1985-89	1990-94	1995-99	2000-04
					MAURITANIA				
PCGDP (US$2,000)	206.9	239.4	298.7	330.9	348.2	310.3	311.2	339.2	366.6
Agriculture (% GDP)	43.1	31.1	31.2	29.3	31.6	29.2	28.1	25.1	20.4
Industry	24.8	38.2	35.4	30.6	24.4	29.5	30.1	30.5	30.3
Manufacturing	NA	NA	NA	NA	NA	12.6	11.5	10.4	9.0
Services	32.0	30.7	32.7	40.1	44.0	41.2	41.8	44.3	49.3
					KENYA				
PCGDP (US$2,000)	228.4	311.1	341.2	324.9	317.2	353.0	363.4	360.3	343.3
Agriculture (% GDP)	39.4	35.6	34.2	37.1	33.3	31.8	29.5	27.5	17.5
Industry	17.0	18.8	20.4	19.6	19.9	18.9	18.4	16.5	18.9
Manufacturing	9.7	11.4	12.1	11.8	12.2	11.7	11.2	10.8	13.0
Services	43.6	45.6	45.4	43.3	46.8	49.3	52.0	56.0	63.6
					MOZAMBIQUE				
PCGDP (US$2,000)	NA	NA	NA	NA	130.06	133.1	150.9	182.9	241.2
Agriculture	NA	NA	NA	NA	34.8	44.6	32.5	35.2	26.6
Industry	NA	NA	NA	NA	29.7	19.9	19.2	20.7	28.6
Manufacturing	NA	NA	NA	NA	NA	NA	8.4	11.2	14.8
Services	NA	NA	NA	NA	35.6	29.2	48.3	44.8	44.9

Source: World Bank (2005).

This disappointing outcome reflects the fact that the aid-dominated rent stream eased pressure for politically risky economic reform until rising foreign debt necessitated IMF help in the 1990s.[3] The resulting prolonged rural neglect denied most Mauritanians the opportunity to acquire the assets and skills required to take advantage of a market economy. In addition, their low incomes conferred not only sizable welfare losses but also a substantial loss of purchasing power that in the early stages of economic development stimulates the local supply of basic manufactured goods and services (Mellor 1976). Moreover, the remarkably low *commercial* farm output cut the sector's capacity to stimulate agro-processing, which is also a key feature of early industrialization.

The corollary of rural neglect is a rent-cycling urban sector, centred upon the capital Nouakchott, which generates three-fifths of GDP and houses one-third of the population (Cour 2004). Large private trading monopolies and inefficient state-owned water and electricity companies are permitted to skim rent from the urban economy at the expense of domestic private producers whose margins are shrunk by high-cost water and intermittent power as well as by expensive transport that reflects a haulage monopoly, unpaved arterial roads and the inefficiency of Nouakchott port. The monopolies also dominate bank credit at the expense of small private firms, whose perceived 'high risk' elicits interest rates of 20 per cent or more. Large commercial monopolies reserve domestic markets for imports like German dairy products and Dutch onions, even when local producers are cheaper. The monopolies, whether public or private, are indifferent to inflation and the exchange rate because they can pass costs on to their captive markets. If expanding oil rent is not to further distort Mauritania's political economy and end in a growth collapse, safeguards proposed in section 6 must be adopted.

4 Geopolitical rent retards Kenya's competitive industrialization

Failure to sustain GDP growth and thereby pass through the demographic transition expanded Kenya's population six-fold during 1948-2004 and transformed Kenya from a resource-rich economy into a resource-poor one (World Bank 1963, 2005). The rent-driven models predict that the resulting fall in resource rent would eventually provide incentives to diversify the economy into competitive manufacturing, as in Mauritius after it exhausted its land frontier in the 1960s. Yet although at independence in 1963 the Kenyan economy had already developed a sizeable export-oriented manufacturing sector upon which to build, industrial competitiveness subsequently regressed. This section argues that rent from agriculture subsidized this regression and then foreign aid (Table 3) helped to perpetuate it.

The Kenyan elite initially supported open trade to facilitate export production from the large landholdings they acquired from white settlers at independence, which policy also constrained rent-seeking. However in 1968 the elite amended the law in order to acquire urban manufacturing and importing businesses (Bates 1983), activities that were already major sources of contrived rent extraction elsewhere in Sub-Saharan Africa (Bigsten 1993). This triggered a drift into protectionist policies that shifted the internal terms of

---

[3] When external debt was twice GDP and debt service absorbed one-quarter of export earnings (World Bank 2005).

trade in favour of manufacturing and against agriculture. By 1984, subsidies to manufacturing comprised 60 per cent of its value added (7 per cent of total GDP) and absorbed 28 per cent of the previous twenty years' growth in farm output (Sharpley and Lewis 1990). The share of exports in manufacturing output regressed to 10 per cent by the early 1980s compared with 40 per cent in the mid-1960s. A coffee boom during 1976-79 conferred extra rent equivalent to 8 per cent of GDP annually (Cuddington 1989), which the Kenyan government squeezed from farmers, leaving them with only one-third of world prices to cover their costs (World Bank 2003: 44). Other crops subject to state predation like maize and sugar also lost viability whereas less regulated crops like tea and horticulture did not.

When the coffee boom faded, external debt became unsustainable and Kenya's growth collapsed: the rate of per capita GDP growth, which averaged 2.8 per cent annually during the 1960s and 1970s, fell to 0.3 per cent during the 1980s and –0.5 per cent in the 1990s (Table 6). Although the growth collapse not only depressed incomes but also intensified pressure on natural resources, the economy still failed to diversify into competitive manufacturing (Table 5) because rent-seekers undermined governance and derailed IMF-backed trade liberalization efforts (Table 4). Increased aid facilitated rent-seeking by allowing the successor to Kenya's founding president (who died in 1978) to play off the dominant tribes against each other and maintain a political coalition of smaller tribes in the western rift valley (Ndegwa 2003). The new leader shored up his coalition by drawing on geopolitical rent, which more than doubled to 11.4 per cent of GNI annually during 1986-95, peaking at 13.6 per cent in the early-1990s (Table 3). The aid was inadequately targeted and officials and businessmen extracted rent through scams, including one that recycled four hundred million dollars through fictitious mineral exports (Economist 2006). Aid did raise per capita GDP slightly but it was also associated with Dutch disease effects that halved agriculture's share of GDP (Table 5). Donors eventually responded in the 1990s by cutting aid to 4 per cent of GNI, causing incomes to fall, but the government was still re-elected in 1997, albeit with barely two-fifths of the vote, courtesy of a fractured opposition.

The cumulative welfare loss from postponed economic restructuring has been considerable: Kenya's mean per capita GDP growth rate during 1960-2000 of 1.5 per cent is 3.5 per cent slower than the high-performing Asian economies although Kenya's lower per capita income implies its underlying growth potential was 1.5 per cent *higher* than the Asian economies (World Bank 2003: 29). Although the ruling party finally lost power in 2002 to a fifteen-party coalition that captured two-thirds of the vote, the welfare losses are likely to persist because rent-seeking exhibits strong inertia. When donors expanded aid to encourage economic reform the new government muted its attacks on corruption and reverted to rent-seeking to balance factions within its diverse coalition, as some observers had predicted (Ndegwa 2003).

5 Targeting geopolitical rent on wealth creation in Mozambique

In contrast to Mauritania and Kenya, geopolitical rent in Mozambique has been relatively successful. Efforts to restructure the Mozambique economy after it had been distorted by a failed experiment with central planning and years of civil strife, attracted unusually high flows of foreign aid, which averaged 42.4 per cent of GNI annually during 1987-2003 (Table 3). Aid lifted Mozambique's investment rate to more than

double the expected level, at almost 50 per cent of GDP, and expanded import capacity, removing a severe constraint on growth (de Sousa and Sulemane 2003). The rent stream triggered a strong economic recovery from the mid-1990s after resurgent civil strife ended (Table 5). It is also associated with a revival of democracy and creditably high indices of governance for a country with Mozambique's per capita income (Table 4). These favourable outcomes appear to reflect the scrutiny of public expenditure by a credible political opposition and also donor preference for financing import-intensive investment that it could monitor.

The restoration of democracy produced two relatively evenly matched political parties that drew support from the rival contestants in the civil war, so unlike Mauritania and Kenya the opposition was not fragmented and initially at least presented a credible threat to the ruling party. In addition, donors targeted aid at investment, which they could more effectively monitor than general budget support or current consumption. The investment drew on surplus domestic labour and was import-intensive. Adam and Bevan (2003) find with reference to Uganda that aid directed at import-rich infrastructure, which boosts the productivity of private sector activity, limits Dutch disease effects.

Targeted aid within a contested polity may also help to explain why Mozambique's stabilization policy succeeded in the late 1990s. Successful stabilization, boosted by generous tax exemptions, elicited a large inflow of FDI into capital-intensive projects, notably a US$2.2 billion aluminium smelter. The inflow renewed fears of Dutch disease that proved unfounded and during the construction phase 1999-2003 the real exchange rate actually fell from 76 per cent of its 1990 value to 60 per cent (IMF 2003: 27). But the foreign investment created few long-term jobs and boosted urban growth, mostly in the far south of the country. Although agriculture sustains 80 per cent of the workforce and grew at 6.6 per cent annually during 1996-2004, its share of GDP declined as heavy industry and tourism grew faster (IMF 2005b: 7). Nevertheless, the rate of rural poverty fell from 71 per cent in 1996 to 55 per cent in 2003, paralleling the national drop, which the IMF (2005b: 12-13) attributes to rapid GDP growth, some gain in market access for farmers and also broad-based advances in education and health.

Adams and Bevan (2003) warn, however, that aid targeted at infrastructure amplifies income inequality because it benefits urban households more than rural households. The resumption of rapid per capita GDP growth in Mozambique did not boost domestic consumption proportionately. This is partly because the withdrawal of geopolitical rent channelled much of the extra output into debt service and exports rather than into consumption (Personal communication, A. Gelb 2003). But it also reflects a long-standing urban policy bias that retards economic restructuring. Central planning had initially stressed heavy industry and large-scale agriculture at the expense of peasant farming and even before the FDI inflow, agriculture generated 8 per cent less GDP than expected for an economy at Mozambique's level of development, whereas industry produced 9 per cent more than expected (Tarp et al. 2002: 12). As in Mauritania, many farmers in Mozambique lacked market access and so could not take advantage of economic improvements. Although the fraction of smallholders engaging in markets doubled during 1996-2005, the ratio remained at barely one-quarter (IMF 2005b: 12).

Farmers need all-weather tertiary roads if they are to emerge from subsistence production and capture the productivity *and* environmental gains from crop specialization (Tiffin and Mortimore 1994).[4] Yet government and donors in Mozambique concentrated transport investment on primary roads (Tarp et al. 2002: 108), which bridge space between cities, rather than open it up for development. Despite the strong aid-led rebound, 60 per cent of Mozambique's population remain illiterate, one-third lack access to health care and one-eighth are HIV positive. Moreover, as with other regional aid recipients like Uganda and Rwanda (IMF 2005b: 34), weak tax enforcement leaves Mozambique taxation at 12.5 per cent of GDP, half the target level. Unfortunately, Mozambique government officials increasingly rely on aid to substitute for domestic public revenue, which they siphon away for personal gain (Hanlon 2004). The country's graft index deteriorated from -0.47 to -0.68 during 2002-04, although rising incomes should have brought improvement (World Bank 2006b). The consolidation of aid within the overall budget risks feeding this constituency rather than strengthening overall policy coherence, as intended.

As aid and donor influence wane, sustained development in Mozambique requires the mainly rural electorate to cohere in resisting policy capture by emerging urban rent-seeking interests. Fortunately, the economic case for supporting the rural economy is strong: an IFPRI simulation finds that as aid shrinks the strongest growth potential lies in agriculture because it is less adversely affected by the resulting cuts in public investment and import compression than either construction or urban services (Tarp et al. 2002: 76-85). The IMF (2005b: 16) concurs, stressing the need to promote labour-intensive growth and encourage new business formation.

6 Conclusions

The scale of natural resource and geopolitical rent in low-income countries is large in aggregate, ranging in recent decades from 20-33 per cent of GDP and more. Rent is detached from the activity that generates it and on this scale has strong potential to destabilize the political economy in immature political systems. The numerous growth collapses in resource-rich developing countries during 1974-85 reflect this process (Figure 1). They stem from fashionable policies to override markets through the 1950s and 1960s that inadvertently increased the risk that rent-seeking groups would capture natural resource rent and contrived rent to the detriment of sustained long-term wealth creation. The higher the rent the longer that maladroit rent deployment continued and the greater the distortion of the political economy. The provision of foreign aid to restructure collapsed economies risks perpetuating this distortion of the political economy if it merely provides a stream of geopolitical rent.

Kenya dramatically shows how such growth collapses retard the demographic transition and accelerate the shift towards resource scarcity. But although rent-driven models predict this condition will self-correct by motivating governments to create wealth and by shifting the development trajectory into competitive industrialization, this did not occur in either Kenya or Mauritania. The reason appears to be that rent-seekers treat aid

[4] In Mozambique, the penalty arising from high marketing costs ranges from 25 per cent of revenue for maize to 80 per cent for cassava and other basic food crops (Tarp et al. 2002).

as additional rent. They undermine reform to restructure of the economy and promote political accountability because they prosper from a distorted economy and lose if competitive markets expand.

The inertia of rent-seeking means that the provision of foreign aid to distorted economies can perpetuate all three adverse aid features that the literature has identified (corruption, poor policy and Dutch disease effects) *in the presence weak sanctions against anti-social governance and of a fractious society*. The Mozambique case suggests, however, that geopolitical rent can be beneficial where: (i) *donors target investment (rather than current consumption and/or budgetary support, which are more fungible) and monitor it and also encourage institutions for transparent macro policy and public finances;* and (ii) *a credible pro-reform political opposition coheres to hold the government to account.* In Mozambique the risk of renewed civil strife may have reinforced the democratic check on the government, at least initially.

Rajan and Zingales (2006) warn that institutional reform may not be sufficient to achieve development-enhancing change in the absence of supportive political constituencies. Consequently, the political economy should inform reform policies and reformers should ensure they build political constituencies to back such policies. A critical implication of the damaging inertia of rent-seeking is the utility of a dual track development strategy (which successful economies as varied as China, Malaysia, Mauritius and the UAE have pursued). The dual track strategy weans as fast as is feasible an increasing fraction of the economy off patronage-channelled rent distribution and into market-guided wealth creation. Track one creates a dynamic market economy that inflicts minimal immediate costs on the elite. In creating a dynamic market, track one also builds an increasingly powerful political lobby in favour of economy-wide reform. Meanwhile, track two promotes reform of the rent-driven (usually urban) economy, but slowly, in recognition of the political risk to the survival of reforming governments if they tackle vested interests head-on. In all three case studies analysed here, a dual track strategy would strengthen the large rural constituency that has much to contribute to early economic development, not least as a political check on urban rent-seeking, but it can do so only if ethnic factionalism does not fragment the rural vote.

References

Adam, C. S., and D. L. Bevan (2003). 'Aid, Public Expenditure and Dutch Disease'. CSE Working Paper No. 184. Oxford: Department of Economics, Oxford University.

Auty, R. M. (ed.) (2001). *Resource Abundance and Economic Development*. Oxford: Oxford University Press for UNU-WIDER.

Auty, R. M. (2007). 'Patterns of Rent-Extraction and Deployment in Developing Countries: Implications for Governance, Economic Policy and Performance'. In G. Mavrotas and A. Shorrocks (eds), *Advancing Development: Core Themes in Global Economics*. Basingstoke: Palgrave Macmillan for UNU-WIDER.

Bevan, D., P. Collier, and J. W. Gunning (1987). 'Consequences of a Commodity Boom in a Controlled Economy: Accumulation and Redistribution in Kenya'. *World Bank Economic Review*, 1: 489-513.

Bigsten, A. (1993). 'Regulations versus Price Reforms in Crisis Management: The Case of Kenya'. In M. Blomström and M. Lundahl (eds), *Economic Crisis in Africa: Perspectives on Policy Responses*. London: Routledge, 61-74.

Boone, P. (1996). 'Politics and the Effectiveness of Foreign Aid'. *European Economic Review*, 89 (1): 22-46.

Burnside, C., and D. Dollar (2000). 'Aid, Policies and Growth'. *American Economic Review*, 90 (4): 857-68.

Collier, P. (2006). 'Is Aid Oil? An Analysis of whether Africa Can Absorb More Aid'. *World Development*, 34 (9): 1482-97.

Collier, P., and A. Hoeffler (2005). 'Democracy and Resource Rents'. Global Policy Research Group Working Paper 016. London: Economic and Social Research Council.

Collier, P., and A. Hoeffler (2006). 'Testing the Neocon Agenda: Democracy in Resource-Rich Societies'. Working Paper. Oxford: Department of Economics, University of Oxford.

Cour, J.-M. (2004). 'Première Esquisse de Maquette Démo-Économique de la Mauritanie et de la Wilaya du Guidimagha'. Nouakchott: World Bank.

Cuddington, J. (1989). 'Commodity Price Booms in Developing Countries'. *World Bank Research Observer*, 4: 143-65.

De Sousa, C., and J. Sulemane (2003). 'Explaining African Growth Performance: Case of Mozambique. Working Paper. Maputo.

(*The*) *Economist* (2006). 'Caught in the Act'. 28 January: 61-2.

Gelb, A. H., and Associates (1988). *Oil Windfalls: Blessing or Curse?* New York: Oxford University Press.

Gomanee, K., S. Girma, and O. Morrissey (2005). 'Aid and Growth in Sub-Saharan Africa'. *Journal of International Development*, 17 (8): 1055-105.

Hanlon, J. (2004). 'Do Donors Promote Corruption? The Case of Mozambique'. *Third World Quarterly*, 25 (4): 747-63.

Hansen, H., and F. Tarp (2001). 'Aid Effectiveness Disputed'. *Journal of International Development*, 12 (3): 357-98.

IMF (2003). 'Ex-Post Assessment of Mozambique's Performance Under Fund-Supported Programs'. Washington, DC: IMF.

IMF (2005a). *Islamic Republic of Mauritania: Selected Issues and Statistical Appendix*. Report 05/00. Washington, DC: IMF.

IMF (2005b). *Republic of Mozambique: Selected Issues and Statistical Appendix*. Report 05/311. Washington. DC: IMF.

Islam, M. N. (2005). 'Regime Changes, Economic Policies and the Effect of Aid on Growth'. *Journal of Development Economics,* 41 (8): 1467-92.

Karras, G. (2006). 'Foreign Aid and Long-Run Economic Growth'. *Journal of International Development*, 18 (1): 15-28.

Krueger, A. O., M. Schiff, and A. Valdes (1992). *Political Economy of Agricultural Pricing Policies*. Baltimore: Johns Hopkins University Press.

Lal, D. (1995). ‘Why Growth Rates Differ. The Political Economy of Social Capability in 21 Developing Countries’. In B. H. Koo and D. H. Perkins (eds), *Social Capability and Long-run Economic Growth*. Basingstoke: Macmillan, 310-27.

Mahon, J. (2007). *Revenue and Regimes*. Williamstown, MA: Williams College (forthcoming).

Mavrotas, G., and B. Ouattara (2006). ‘Aid Disaggregation and the Public Sector in Aid-Recipient Economies: Some Evidence from Côte d’Ivoire’. *Review of Development Economics*, 10 (3): 434-51.

Mellor, J. W. (1976). *The New Economics of Growth*. Ithaca, NY: Cornel University Press.

Ndegwa, S. (2003). ‘Kenya: Third Time Lucky?’. *Journal of Democracy*, 14 (3): 145-58.

Rajan, R. G., and A. Subramanian (2005). ‘What Undermines Aid’s Impact on Growth?’. IMF Working Paper No. 05/126. Washington, DC: IMF.

Rajan, R., and L. Zingales (2006). The Persistence of Underdevelopment: Institutions, Human Capital or Constituencies?’. NBER Working Paper No. 12093. Cambridge. MA: National Bureau of Economic Research.

Sachs, J. D., and A. M. Warner (1995). ‘Economic Reform and the Process of Global Integration’. *Brookings Papers on Economic Activity*, 1: 1-118.

Sharpley, J., and A. Lewis (1990). The Manufacturing Sector in the Mid-1980s’. In R. C. Riddell (ed.), *Manufacturing Africa*. London: James Currey, 206-41.

Svensson, J. (2000). ‘Foreign Aid and Rent-Seeking’. *Journal of International Economics*, 51 (2): 437-61.

Tarp, F., C. Arndt, H. T. Jensen, S. Robinson, and R. Heltberg (2002). ‘Facing the Development Challenge in Mozambique: An Economy-wide Perspective IFPRI Research Report 126.Washington, DC: International Food Policy Research Institute.

Tiffin, M., and M. Mortimore (1994). ‘Malthus Controverted: the Role of Capital and Technology in Growth and Recovery in Kenya’. *World Development*, 22 (7) 997-1010.

Tornell, A., and P. R. Lane (1999). ‘The Voracity Effect’. *American Economic Review*, 89 (1): 22-46.

World Bank (1963). *The Economic Development of Kenya*. Baltimore: Johns Hopkins University Press.

World Bank (2003). *Kenya: A Policy Agenda to Restore Growth*. Washington, DC: World Bank.

World Bank (2005). *World Development Indicators 2005*. Washington, DC: World Bank.

World Bank (2006a). *Where Is the Wealth of Nations?* Washington, DC: World Bank.

World Bank (2006b). *Estimates of Governance Quality*. Washington, DC: World Bank.