State weakness in developing countries and strategies of institutional reform – Operational Implications for Anti-Corruption Policy and A case-study of Tanzania

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State weakness is a critical factor constraining development in all poorly performing developing countries and is particularly evident in Africa. The recent concern with accelerating African economic development has raised once again in a very powerful way the question of the governance reform priorities for Africa. Economists addressing this question have broadly divided into two camps. On the one hand is the very influential argument coming from Jeffrey Sachs and his associates (Sachs, et al. 2004), which argues that the specific characteristics of Africa in terms of low population density, vast areas, poor infrastructure and the prevalence of difficult diseases makes many of the conventional governance arguments irrelevant. What Africa requires, according to this argument is a "big push" in terms of massive investment in infrastructure and disease control before attention to governance can have any meaning. On the other hand, the mainstream opinion as expressed for instance in the Commission for Africa (2005), argues that conventional concerns with corruption, accountability and rule of law are critical for improving the capacity of African states to deliver to their people. According to this view, these governance reforms are a precondition for the proper use of greater inflows of aid and investment.

Both these positions have an element of truth, but they miss much that is very important. Sachs is certainly right in saying that Africa needs a big push in the form of a massive injection of funds, though the political will in advanced countries to fund such a programme is still far from evident. Moreover, Sachs is right in arguing that many of the governance objectives identified in the standard reform agenda, such as significant reductions in corruption and improvements in accountability are very likely to be unattainable in the short to medium term. Nevertheless, the downplaying of *all* governance capacities is not convincing given that African states will have to play a critical role both in ensuring the productive deployment of development funds, but also, and more critically, in ensuring that the takeoff that these investments induce is a long-term and sustainable one. Thus, while Sachs may be right in implicitly rejecting the good governance agenda, there are alternative governance requirements that we need to identify.

On the other hand, the governance capacities identified in the mainstream reform agenda such as that of the Commission for Africa also raise significant questions about their relevance and sequencing. The evidence that these good governance characteristics are a precondition for development is very weak. In the East Asian tiger economies, governance structures did not correspond to the requirements of the good governance model (Khan 2004a, 2005b). Levels of corruption were often very high during the early period of rapid economic growth and poverty reduction, property rights were not stable in critical respects, the rule of law was far from satisfactory, and accountability was often far removed from the democratic ideal. Yet states in these successful economies had *other* critical governance capacities that allowed them to sustain high levels of investment, and to absorb and learn the use of advanced technologies rapidly.

The implications of these observations for DFID's overall governance agenda are explored in our review of DFID's governance TSP and this document will draw on the argument developed in that review (Khan 2005b). African states are often starting with lower initial capacities and often much less extensive states than the more successful countries in Asia. For instance, in Africa, civil servants constitute an average of 1% of the population, compared to 3% in other developing country areas, and their training is often poorer. While the capacity of the average state in Africa is undoubtedly lower than the Asian average, nevertheless they have much to learn from the Asian examples in terms of the directions in which they need to develop their state capacities for accelerated development. The Asian example tells us that the governance capabilities critical for development are those necessary for the rapid transformation of productive capacities. Unfortunately, the conventional governance approach that focuses primarily on transparency and accountability to ensure efficient pro-poor service delivery by the state tends to ignore these critical state capacities. The focus on a particular type of corruption in conventional anti-corruption strategies is closely linked to a particular economic analysis of the state that argues that a state that enables efficient markets is sufficient for accelerating development in poor countries. In Part A, this paper we develop some of these general points that are relevant for the wider African context by showing how anti-corruption analysis is closely linked to an analysis of state failure and the critical areas in which state capacities need to be developed. The state has to play many other functions besides maintaining tolerably efficient markets, and consequently there are different types and drivers of corruption in developing countries. This understanding is critical for devising effective and achievable anti-corruption policies in developing countries. In Part B we illustrate these observations with reference to evidence from Tanzania. We summarize our main conclusions below.

Conclusions and Implications for Anti-Corruption Policy in Africa.

i) Corruption refers to all types of illegal activities that benefit public officials. However, while corruption itself is *always damaging* (because it is an illegal tax), the underlying state activities with which the corruption is associated can be either legal or illegal, and may be socially beneficial or damaging. This insight allows us to distinguish between four different types of corruption, with very different policy responses that are appropriate for tackling them.

ii) For effective policy, we need to distinguish between these different types of corruption and prioritize attention on the most damaging types. Most anti-corruption policies target a type of corruption that is associated with legal but socially damaging state interventions that restrict markets. This market-restricting type of corruption is an important constraint on development but we argue it is not the most serious type of corruption facing developing countries. Moreover, an excessive focus on this type of corruption can have undesirable if unintentional effects. A second type of corruption constrains beneficial state interventions because it is associated with legal and potentially beneficial state activities. This state-constraining corruption is damaging, but the policy response has to be very different. We need to focus on how to enhance state capacities, even if we cannot get rid of all of the associated corruption immediately. A third type of corruption is political and structural in nature and is not amenable to standard policy measures at all. The drivers of these types of corruption in developing countries are poor fiscal capacity and the low productivity of productive assets. In this context, transfers through patron-client networks are a major mechanism for maintaining social order and these generate political corruption. Low productivity assets are difficult to protect because they do not generate enough income to pay for their protection and this leads to non-market processes of asset 'protection' and 'transfer' that we describe as primitive accumulation. While the corruption associated with these problems is undesirable and deserves to be rooted out (like all types of corruption), these types of corruption are difficult to remove till the economy has already made considerable progress. But it is important to identify the sources and manifestations of these types of corruption to ensure that we do not waste anti-corruption efforts on unattainable goals that only serve to disappoint and dishearten policy-makers. The fourth type of corruption is predatory corruption. This is possibly the most serious variant and here too, conventional anti-corruption policy measures are inappropriate. Here corruption is directly associated with state weakness or even impending state collapse and has to be tackled by addressing the (difficult) political and institutional issues that allow states to exercise a monopoly of *legitimate* violence.

iii) We discussed the danger of focusing *only* on market-enabling state capacities and the associated market-restricting corruption in our review of DFID's governance TSP (Khan 2005b). We argued there that in developing countries market transaction costs are likely to remain high because of structural factors that conventional economic and governance policies cannot address. As a result, we cannot rely on markets alone to allocate resources efficiently, particularly (and paradoxically) in poor countries with weak states. In fact, rapidly growing developing countries have had institutions and regulatory capacities that complemented the market by accelerating the transfer of resources to emerging capitalists, assisting them in technology acquisition and disciplining failure by ensuring that assets and resources were effectively re-allocated. And they did this while using non-market transfers to maintain political stability, often using unconventional patron-client networks.

iv) The policy focus on market-restricting corruption in Africa, and the susceptibility of African countries to policy agendas set by donors has come about as a result of the failure of statist and interventionist policies followed by most African countries in the 1960s and 1970s. These policies failed because African countries by and large did not succeed in developing state capacities for managing the social transformations that they attempted. The specific policies and strategies were often misguided and doomed to fail, particularly given the limited attention given to developing a viable capitalist sector and the attempt in many countries to construct socialism in very poor countries. We can find evidence of such policies in Tanzania too. However, it is dangerous to write off 'socialist' strategies in developing countries in their entirety as they did perform some functions that a successful transformation strategy must have. In Tanzania, the high level of social cohesion and comparative inter-tribal and inter-communal peace is traceable to policies of nation building followed by the pre-liberalization regimes. The loss of these capacities is likely to damage the cohesion achieved.

v) While state-led African strategies by and large failed in the past, many Asian countries achieved spectacular success because their states focused on pro-actively accelerating the growth of a viable private sector. Instead of learning from the Asian experience and adapting this to African initial conditions, the new policy assumes that trade opportunities and open capital markets will be sufficient to drive growth in Africa. If so, the removal of market restrictions is the obvious priority. This expectation has directed attention away from how Africa can rapidly develop broad-based *capacities to produce*, without which trading opportunities are at best likely to yield growth in low-productivity sectors in intense competition with other low-wage countries.

vi) Some resource-rich African countries (like Tanzania) have temporarily benefited from liberalization as a result of extractive industry multinationals coming into specific sectors, but this too is unlikely to lead to broad-based national development. Donors are aware that extractive industry investment is not necessarily developmental but the response has been to hope that greater transparency in this area will be sufficient to achieve developmental outcomes in the future. In fact, even the achievement of significantly greater transparency is unlikely in the near future. The scramble for natural resources is likely to intensify in the coming decades, with Chinese and eventually Indian resource companies entering Africa as major players and adding to the already great competitive pressures and political compromises involved in natural resource extraction. Realistically, the international governance of resource companies is unlikely to achieve significant results in this context. A rapid development of state capacities to use natural resource rents for national development is required in African countries like Tanzania if these resources are not to be squandered. Tanzania is a relevant case where the expectation that open markets and an enabling state are sufficient for ensuring investment and development has led to missed opportunities in the exploitation of its reserves of gold and other minerals for broad-based national development.

vii) If these critical developmental governance capacities are important, the focus of anti-corruption policy should shift to prioritizing the reduction of damaging corruption in these areas but without setting an unattainable zero-corruption goal. If zero corruption becomes the goal of governance policy, state activities and capacities could be inadvertently restricted to a relatively small range of service delivery tasks that external donors spend all their time monitoring. This can have serious effects on the prospects of development, as we are likely to ignore the development of the critical state capacities required for accelerating the development of productive capacity.

viii) Developing transformational state capacities has risks. Occasionally there will be mistakes, and more seriously, successful development in developing countries will empower groups and classes that are not the poorest in society. These groups are unattractive from the perspective of donor agencies. It is much easier to develop public support in donor countries for redistributing to the poor than for developing state capacities that will accelerate the emergence of productive capitalists (particularly in a context where some corruption exists). But if we are serious about development, there is no alternative to creating national capacities for competing in international markets. This is the lesson Africa should learn from the experiences of successful developers of East Asia.

ix) Many African countries appear to suffer more seriously from the most damaging types of predatory corruption. This directs our attention to what Chabal and Daloz (1999) describe as the 'institutionalization of disorder' in Africa. Why does this happen, and why does it appear to happen to a greater extent in Africa? We argue that culture or purely institutional explanations do not take us very far. Understanding state weakness in Africa requires going back to the political history of colonial times and even earlier. State weakness has deep historical roots and we cannot address these problems using conventional anti-corruption policy. There is no alternative to painstakingly improving the capacity of states to maintain order and accelerate the creation of productive capacity.

x) Governance advisors focusing on anti-corruption can play a useful role by using corruption as a lens through which to analyse areas of critical state weakness in particular countries, and joining up this analysis with other governance activities that seek to develop critical state capacities to accelerate development. This approach can *set achievable targets* for anti-corruption policy by identifying the *most damaging corruption bottlenecks* that are impeding development, while joining up corruption analysis with a broader analysis of the institutional and political constraints facing economic development.

xi) The Asian experience tells us that while rapidly growing countries did not have the most damaging types of corruption, *no* developing country managed to remove corruption across the board at early stages of development.

Part A is organized as follows. Section A.1 very briefly summarizes the argument presented in our review of DFID's Governance TSP and reminds us of the lack of statistical fit between good governance and economic performance in high-growth economies at early stages of their development. Section A.2 takes a closer look at the drivers of corruption in developing countries, developing our framework distinguishing between four types of corruption. Section A.3 summarizes the implications of our survey for governance policy in Africa. Part B is a detailed study of Tanzania, using this framework to identify critical areas of concern.

Part A

A.1 Corruption, Property Right Stability and Rule of Law in the Good Governance Approach.

The policy recommendations of the good governance analysis are well known. The argument is that economic development in poor countries requires a significant reduction of corruption, stable property rights and a rule of law. These objectives are not just desirable in themselves; the good governance analysis tells us they are also necessary for development. The implicit argument here is that well-working markets require low transaction costs and transaction costs are lowered if corruption is low, property rights are stable and there is a good rule of law enforcing contracts.

There are at least three essential problems with this view of market-led development. First, while the theory is plausible, there is a chicken and egg problem when we try to understand how these governance reforms are to be achieved in poor countries. Each of these goals, the reduction of corruption, the achievement of stable property rights and of an effective rule of law requires significant expenditures of public resources and significant fiscal space. Poor economies do not have these resources and requiring them to achieve these goals *before* economic development takes off is the chicken and egg problem referred to above (Khan 2005b). It is not surprising that developing countries do not generally satisfy the good governance criteria at early stages of development even in the high-growth cases. Nevertheless, the high-growth countries had specific governance capacities that allowed their states to promote development in these contexts.

Secondly, the good governance approach assumes that efficient markets are sufficient to ensure rapid development in developing countries. We have already argued that efficient markets are expensive institutions that are unlikely to be effectively established in developing countries. For this reason, historically, much of the asset and resource re-allocations necessary for accelerating development in developing countries have often taken place through non-market processes. Markets are obviously important, but at early stages of development, states also need to have institutional and political capacities to ensure that the non-market asset and property right restructuring that is inevitable at this stage is growth-enhancing, and does not descend into predatory expropriation or generate intolerable injustices and conflicts.

Last but not least, growth in developing countries requires catching up through the acquisition of new technologies and learning to use these new technologies rapidly. Trying to construct efficient markets to attract capital and technologies in the way prescribed by most economists runs into the chicken and egg problem described above but also faces significant market failures to do with the organization of learning and overcoming low productivity that can only be overcome through learning-by-doing (Khan 2000a). Attracting capital and technology that allows rapid improvements in technology requires state action to compensate for current low levels of productivity. Successful developers had states that could provide these incentives through different types of interventions that created what economists call rents, but they also had the institutional and political capacity to manage these rents and to withdraw them when performance was poor. The interventions in question include a wide range of explicit or hidden subsidies for investors in sectors where current productivity was low but where future productivity promised to be high, including through such mechanisms as infrastructure prioritization, tax breaks, subsidies for training schemes, subsidized credit, technology licensing, and so on. These capacities are so important that we argue that they have to be developed even in very unpromising circumstances.

State capacities that potentially enhance growth can also have costs. These capacities and regulatory roles increase the chances of corruption and other forms of rent seeking. But these costs have to be set against the possible gains, and even more so, against the possibility that without these state capacities sustainable development may not be possible. The argument that is often made is that East Asian developers had strong state capacities that allowed their states to intervene in these ways, but that other states with weaker capacities can make things worse by intervening. This plausible argument needs to be challenged. Weaker states that are catching up from a less favourable position may indeed not be able to do many of the types of things that states in East Asia could do, but there is little evidence that any nation developed without significant state capacities in supporting the different aspects of the economic transition described above. Our argument on these necessary *transformative capabilities* of the state has been developed in greater detail in (Khan 2004a, 2004b, 2005c, 2005b) and our subsequent argument will develop this argument in the context of the weakness of African states and the implications for anti-corruption policies in particular.

A.2 Drivers of Corruption in Developing Countries.

The brief discussion earlier suggests that there are different types of interventions that states in developing countries carry out. Interventions in this context simply refers to what states do, they do not refer only to deliberate and planned policy interventions that have a specific goal such as the correction of market failures. In our review of DFID's Governance TSP (Khan 2005b), we distinguished between four types of corruption associated with different "interventions", depending on whether the intervention with which the corruption was *associated* was itself damaging or beneficial, and whether that underlying "intervention" was legal or illegal to begin with. As a matter of definition, beneficial state activities and interventions work by creating beneficial "rents", while damaging activities create damaging rents (see Box 1 for some definitions).

Box 1. Interventions, Rents and Corruption

Rents have various definitions in economics but for our purposes, *rents are incomes that are created by state interventions*. For instance, the profits of monopolists whose monopoly rights are created or protected by the state, the incomes of natural resource owners whose ownership rights have been created by the state, of owners of technology and information whose rights are protected by states, of subsidy recipients of different types, are all rents. *All state intervention creates rents by definition*. Thus tracking rents allows us to track the beneficiaries of state interventions as well as to use economic theory to ask if the intervention is socially beneficial or just beneficial for the rent recipient. Clearly, not all rents are socially damaging, which is another way of saying that many state activities are beneficial not just to those directly benefiting from the extra incomes (or rents) but for society as a whole.

The presence of rents motivates individuals to engage in rent seeking to capture the potential rents for themselves. *Rent seeking is all activity that seeks to create, capture or re-allocate rents.* Rent seeking is always a social cost because resources and time are used up that could otherwise have gone into production. But the net effect of rent seeking can be positive if the rents created or protected are very beneficial. Rent seeking can also be damaging if the rents created are socially damaging or if the amount of rent seeking is very high, wiping out the potential benefits of useful rents.

Corruption is a type of illegal rent seeking, where public officials break the law for their personal benefit. It is rent seeking because somebody (in the public or private sector) is spending resources (in the form of bribes, creating political factions or in other forms) to capture a rent, or to avoid the extraction of a rent. The economic effect of the corruption thus depends on exactly the same considerations as with legal rent seeking: how big is the rent seeking cost, and what was the underlying rent that was created, distorted, transferred or wiped out? In Figure 1, different types of corruption are classified in terms of whether the rent/intervention with which corruption is associated was socially beneficial or damaging, and whether the intervention was legal or illegal. The underlying *rent* should not be confused with the associated *rent seeking* or corruption, since corruption is always illegal and the resources used up (say in bribes) are always a cost.

For further reading see Khan (2000a; 2000b).

The four-fold classification of corruption in terms of the type of intervention or rent it is *associated* with is shown in Figure 1. This is followed by a discussion of each type of corruption, the drivers of each type, and the policy implications for a reform strategy that seeks to enhance pro-poor growth outcomes in developing country and specifically African contexts.

	Legal Interventions	Illegal Interventions
Potentially Beneficial Interventions	**2) State-Constraining Corruption**. Net effect can be beneficial or damaging depending on how seriously corruption subverts interventions. Policy should seek to legalize rent seeking and strengthen state to prevent subversion of desirable interventions.	**3) Political Corruption and Primitive Accumulation**. Net effect depends on stability achieved and whether a productive sector emerges. Policy should seek to increase fiscal capacity for legal political stabilization and legal property right protection.
Damaging Interventions	**1) Market-Restricting Corruption**. Net effect of intervention always negative. Anti-corruption policy should remove these state capacities through liberalization and privatization.	**4) Predation/Theft**. Net effect always negative: possible descent into warlordism. Anti-corruption policy has to strengthen centralized coercive power of the state.

Figure 1 Four Types of Corruption in Developing Countries

1) Market-Restricting Corruption. The type of corruption most often discussed in the policy literature on corruption is *market-restricting corruption.* Mainstream or neoclassical economics mainly focuses on this type of corruption. This corruption is associated with rents/interventions which are formally legal but which reduce the efficiency of markets. The neoclassical policy literature assumes that most state activities create artificial restrictions in market economies, which create socially damaging rents for small groups of beneficiaries of these rents but damage the economy as a whole. It is often assumed that corruption in developing countries is primarily of this type.

Rents/interventions that are legal but socially damaging because they restrict the operation of markets are usually relatively easily to identify. These include the imposition of unnecessary red tape that creates jobs in bureaucracies but does not contribute to any necessary regulation of markets; damaging restrictions on trade and investment that create monopoly rents for a few traders or investors without any immediate or eventual social benefit, and so on. From a policy perspective, these interventions are relatively easily to identify because they are legal and therefore clearly visible and they restrict the operation of markets in ways that cannot be justified in terms of regulation or social need. These damaging interventions inevitably create rents for some individuals even though society as a whole is worse off. But in these cases rent seeking in the form of corruption adds to the social cost because the loss of additional resources in the form of bribes and other rent-seeking costs increases the social cost of these interventions.

Here the driver of corruption is the (damaging) interventionist capacity of the state to restrict markets, together with the relatively low opportunity cost of corruption for most public officials in developing countries, which allows them to engage in corruption with impunity. The low opportunity cost of corruption is due to three interrelated factors. First, the low salaries of public officials mean they stand to lose very little if they lose their jobs for being corrupt or for any other reason. Secondly, the lack of transparency and accountability means that in any case they face a very low probability of detection in the first place. Finally, even when detected, the ineffective justice system means there is a low probability of successful prosecution and loss of employment. Together, these factors conspire to ensure that public officials have little disincentive when deciding to restrict markets to create damaging rents or to collect bribes when individuals in society seek to capture these rents or avoid the restrictions created. The drivers of market-restricting corruption have been extensively analysed by mainstream economists and are shown in Figure 2.

The net effect of market-restricting corruption is always negative because the interventions create damaging rents (through restrictions on markets) and the illegal rent seeking in the form of bribes and corruption as individuals seek to capture the rents or work their way around the useless restrictions uses up more resources. The total effect is a dual negative effect, consisting of the negative effect of the restrictions and the negative effect of the resources lost in the rent seeking in the form of bribes, lost time and effort and so on. The policy response to corruption in developing countries follows largely from this analysis, as do the usual policy instruments for dealing with corruption.

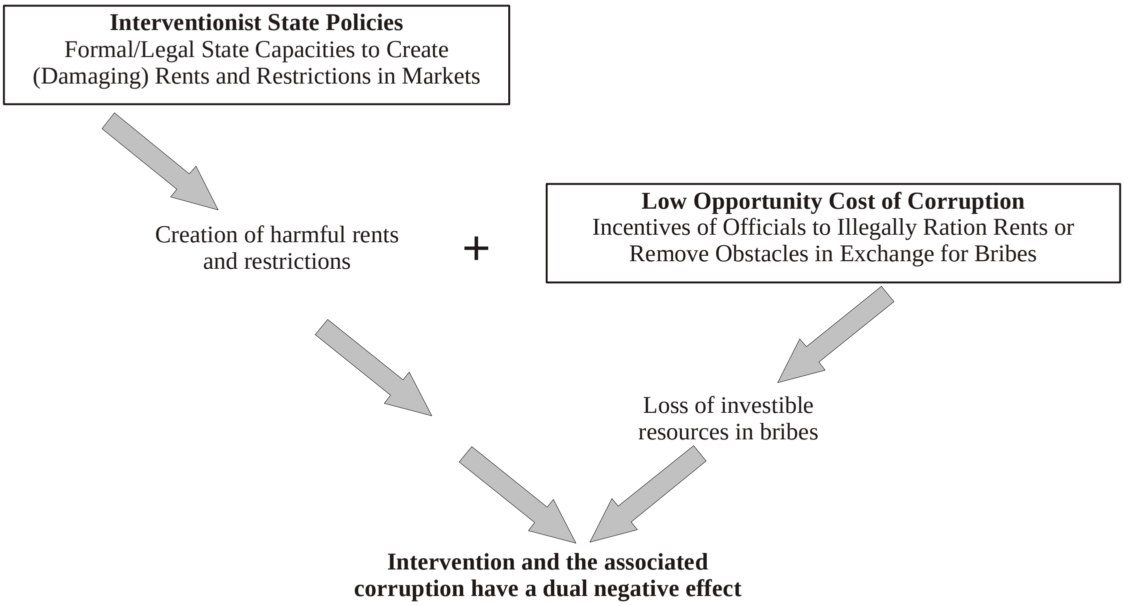

Figure 2 Drivers of Market-Restricting Corruption

Box 2 Rents/Interventions Associated with Market-Restricting Corruption

Examples of rents and state activities that are legal and restrict markets in socially damaging ways:
Red tape and regulation that serves no desirable social or regulatory function.
Subsidies for privileged groups that serve no growth or welfare function.

Associated corruption:
Bribes to bypass useless red tape
Bribes to capture privileged subsidies

Policy responses:
Remove damaging state activities and rents
Increase cost of corruption for public officials through transparency, legal sanctions and higher salaries

Mainstream economic policy analysis suggests the need to attack both of the key drivers of this type of corruption. The attack on the interventionist capacities of the state for damaging interventions takes place through privatization and liberalization, while the response to the low opportunity cost of corruption is higher public sector salaries, greater transparency, greater accountability and improvements in the efficiency of the judicial system. These recommendations are well known. However, despite over a decade of effort, policies focusing on these drivers have little success to report. This is because this type of corruption is not the only type afflicting developing countries, and it may not even be the most important variant of corruption in these countries.

2) State-Constraining Corruption. Much more serious in terms of consequences is the corruption associated with legal and *potentially* beneficial state interventions. Here, the intervention and the associated rent created by the state are beneficial for the individuals capturing it as well as for society as a whole. Examples of these types of rents and interventions include subsidies for technology acquisition, natural resource rents that enable optimal rates of extraction of exhaustible resources, subsidies for learning in emerging industries, interventions that protect technology rents, and so on. As with all rents, the existence or potential existence of these rents induces rent-seeking behaviour, which may include corruption in a developing country context. This type of corruption *constrains* state intervention to varying extents. The corruption could constrain the quality of intervention to a small degree in which case the intervention remains beneficial though constrained. But it can also constrain it to the extent that the intervention becomes harmful. The critical question here is thus the extent to which corruption affects the implementation of the intervention. We call these types of corruption *state-constraining* corruption.

The distinctive feature of this type of corruption is that here state activity creates potentially beneficial rents and the corruption is associated with these interventions. If we want these state activities to continue, *we have to be willing to tolerate some amount of rent seeking around these rents*. As all state intervention creates rents, the state can never intervene without inducing some rent seeking. It is important to remember that rent seeking around state interventions is widespread in advanced countries; the only difference is that in advanced countries, much of the rent seeking around necessary and legal state interventions is also legal, and can therefore be regulated. Corruption in contrast is rent seeking that is illegal and is therefore difficult to regulate. The limited legitimacy of those who have acquired money in developing countries makes it difficult to legalize with immediate effect all of the rent seeking associated with necessary and beneficial state interventions. Nevertheless, *the long-term objective here must be to convert illegal rent seeking into legal rent seeking*, and to regulate this rent seeking properly so that the damage to potentially beneficial state intervention is limited.

In the short run, the outcome of state-constraining corruption depends on whether the corruption and rent seeking subverts the implementation of the policy so seriously that it is no longer socially beneficial, and on the extent of the resource loss due to bribes and other rent-seeking costs. Figure 3 summarizes two different levels at which politics and institutions determine the outcomes of state-constraining rent seeking/corruption. First, political and institutional conditions determine the types of beneficial rents that states attempt to implement. The stability of some regimes and the political imperatives of their leaders are more conducive for beneficial interventions than other regimes. We do not yet fully understand where the political imperatives for growth-enhancing interventions come from, but we can observe some interesting patterns. Secondly, politics and institutions also determine the extent and implications of the associated rent seeking/corruption, and whether the latter subverts the implementation of the intervention, turning the intervention into a value-reducing intervention.

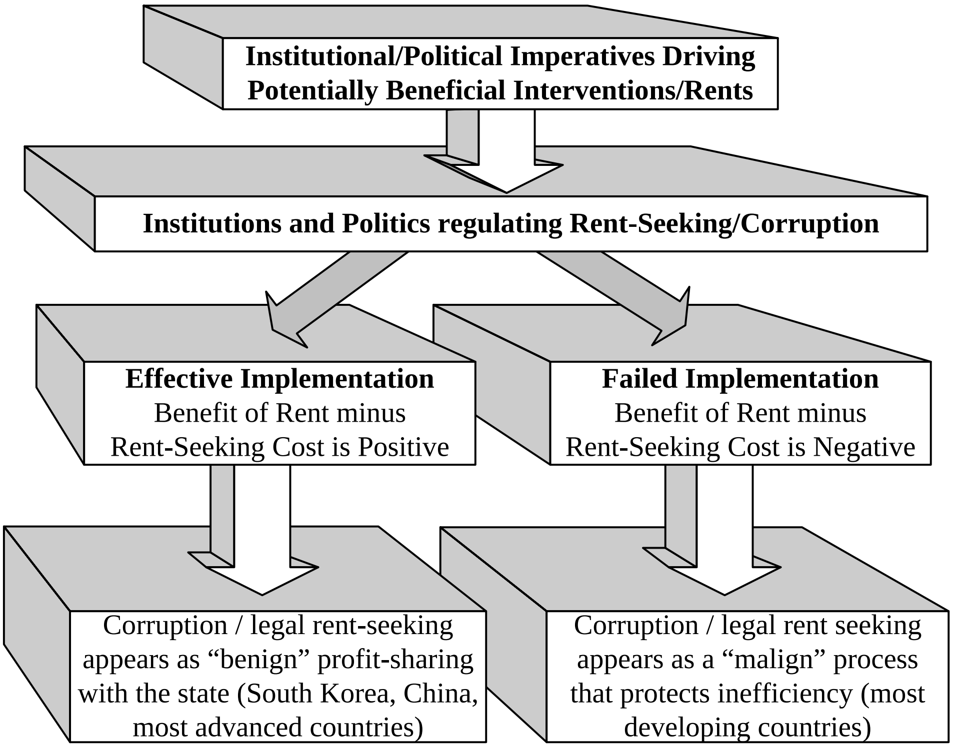

Figure 3 Drivers of State-Constraining Corruption

Figure 3 shows that state-constraining corruption can be associated with both good or bad economic outcomes (even though the corruption is always a constraint or cost when we compare the situation to a hypothetical one where corruption did not exist but the same intervention could by implemented). When the outcomes of potentially beneficial interventions are poor, the appropriate strategy would be to look at the political and institutional problems preventing the implementation of beneficial interventions, and the ways in which corruption and rent seeking may be subverting this process. The aim should be to attack corruption in ways that improve implementation, and in the long run, convert the corruption into legal forms of rent seeking. Focusing on reducing corruption alone is inadequate in the case of state-constraining corruption, as this may inadvertently damage state capacities to intervene effectively even further. It is always possible to remove corruption by removing the intervention in question. But in this case, it would not necessarily be desirable to do that, or even to significantly reduce the autonomous capacity of the state to engage in the necessary interventions.

Anti-corruption strategy for state-constraining corruption should therefore focus on *strengthening state capacities* (both institutional and political) to promote growth and welfare and to *convert illegal rent seeking into legal forms*. In doing so, policy should recognize that when corruption or rent seeking subverts the implementation of beneficial state activities, it is not because of the corruption or rent seeking per se, as the latter is always present whenever states intervene. But where states are institutionally and politically strong, rent seeking and corruption changes the distribution of some of the benefits of state rent creation while rents continue to be managed in socially beneficial ways. Consider the industrial policy in South Korea in the 1960s and 1970s, or the role of the Chinese state in making land and infrastructure available for investors. In both cases, considerable rent seeking and corruption was associated with these state activities. But in institutionally and politically strong states like these, the state is able to allocate benefits to maximize economic returns and extract a share of these gains for itself. In contrast, in institutionally and politically weak states, state leaders are unable to allocate rents in ways that maximize economic returns, and the bribes or kickbacks they extract are paradoxically lower than their counterparts in strong states. This is why we should focus on strengthening state capacities in these cases, with a secondary emphasis on reducing and regulating corruption.

In African countries, transformative state capacities for promoting growth are particularly weak. In these countries, early attempts at industrialization using the public sector and variants of import substituting industrialization proved relatively unsuccessful. In many cases, an industrial base *was* created from a very low starting point. But there were significant differences in terms of the level of industrialization. Tanzania was one of the less successful African countries with some of the lowest levels of industrialization in the region. But by the 1980s, infant industry policies began to be abandoned across Africa as in other poorly performing developing countries in Asia. Strategies of liberalization and privatization in these countries could be easily justified given the large losses incurred by the public sector as a direct result of these policies. Consequently, the range of state capacities began to shrink significantly in the subsequent period.

While state weakness in the post-independence emerging African states had undoubtedly resulted in very poor results, this was very largely due to the weakness of the states and their failure to manage rents and discipline the rent allocation process. Some of the policies were also misguided and lessons were not learnt in time about the futility of some of the strategies of industrialization that were being attempted. But the failure to learn from mistakes is itself a very good indicator of state weakness and of the capture of critical rents by powerful groups who cannot be dislodged because of the political and institutional weakness of the state. We have argued that at early stages of development there are critical transformative functions of the state to promote technology acquisition and upgrading. The challenge for African countries as indeed for all poorly performing countries is to identify critical transformative capacities and build up these capacities. Anti-corruption strategies in these areas should be aimed at limiting the subversion of critical state capacities and enabling legal and well-regulated rent seeking around these necessary and critical state functions whenever possible.

From the policy perspective, it is important to be able to distinguish between market-restricting corruption where it is appropriate to focus policy on directly attacking the damaging interventions and state-constraining corruption where the appropriate policy response is almost entirely the opposite, to strengthen and enhance state capacities. The applied problem is often that if the implementation of potentially beneficial interventions goes wrong, the potential net benefit is not realized. Thus, observed *ex post* potentially beneficial interventions are often difficult to distinguish from damaging interventions. To decide on the appropriate reform strategy, governance reformers need to ask whether the underlying state activity or intervention could *potentially* benefit society, even though it may not be doing so now, perhaps because the intervention was being subverted by corruption. Judging the potential benefit of an intervention is to some extent a matter of judgement, but it is nevertheless a judgement that has to be made. If our informed conclusion is yes, and if the intervention is legal, the corruption associated with such interventions is *state-constraining* corruption.

Box 3 Rents/Interventions Associated with State-Constraining Corruption

Examples of rents/state activities associated with State-Constraining Corruption:
Subsidies that potentially serve useful welfare functions (poverty reduction)
Subsidies or regulations that aim to accelerate technology acquisition and learning

Associated Corruption:
Bribes to capture subsidies
Kickbacks to public official from beneficiaries of subsidies

Policy Responses:
Strengthen political and institutional capacity to prevent subversion of policy (even though rent seeking/corruption cannot be rooted out entirely)
Legalize rent seeking whenever possible to make it easier to regulate

3) Political Corruption and Primitive Accumulation.

a) Political Corruption: The pervasiveness of corruption in *all* developing countries cannot be explained by either of the two types of corruption discussed so far. Every developing country has high levels of corruption, irrespective of the size of the public sector, government policies, culture, religion, ethnic fragmentation and political institutions. All of these variables have at best a small effect in explaining differences in corruption across developing countries in cross section studies. To explain the pervasiveness of corruption in all developing countries we need to look at the political and economic features that are common to *all* these countries. One of these common features is political stabilization using off-budget transfers. This is discussed in this sub-section. The other is property right instability and the pervasiveness of non-market transfers in which states play a critical role, discussed in the next sub-section. In both cases, the state activities are themselves illegal and cannot be made legal but are potentially necessary for the operation of the emerging capitalist economy. In both cases, the interventions are by definition directly corrupt and are likely to be associated with secondary corruption in ways discussed later.

Political corruption is a structural problem in developing countries given the limited availability of fiscal resources. In advanced countries, political stability depends not just on the high levels of average incomes but also on significant transfers of income organized through the fiscal system. These transfers provide rents to critical constituencies through the fiscal mechanism. The share of GDP that is taxed in advanced countries ranges from 35 to 50 per cent. As much as half or more of the total is disbursed as a pure income transfer and a significant part of the rest is an effective transfer of public goods to constituencies that could not have paid to purchase these services. In contrast, developing countries are lucky to be able to tax 10-20 per cent of much smaller national incomes. After paying the salaries of civil servants, many of the poorer developing countries find they are already running budget deficits, and even in the relatively better off ones, there is little left for redistribution after infrastructure and essential public good have been provided. So how is political stability maintained in these contexts?

The answer is that political stability in developing countries depends on off-budget transfers to critical constituencies using patron-client networks operated by the parties and groups in power. Powerful constituencies in developing countries do indeed demand transfers for themselves, but the absence of fiscal resources means they are organized in patron-client networks to get access to resources that states dispense but cannot by definition account for in a transparent way.

These off-budget resources are by definition political corruption. In addition, political corruption also induces secondary corruption as state leaders or their parties have to engage in corrupt activities to raise off-budget resources for sustaining themselves in power. Without these resources developing country political regimes would not remain viable for very long, given that fiscal resources cannot be rapidly increased in the immediate future. Thus, we find that developing country regimes need to raise grey resources through corruption for distribution down patron-client networks or they need to allow critical clients to engage in corruption to directly raise the resources they require for giving their political allegiance to the group in power. This also explains why political entrepreneurs in developing countries are often individuals well known for their corruption or are known criminals. But they keep getting re-elected even in countries with strong democratic traditions like India, because clients of these politicians know they can 'deliver'.

This type of political corruption can only be countered by public pressure when fiscal resources are available for political parties to make electoral commitments to key constituencies that they can legally deliver through the budget. It is also worth noting that the fiscal resources required for political stabilization would also have to be significantly greater than the resources that are available through patron-client networks. This is because transparent fiscal transfers would have to be allocated to everyone satisfying particular criteria of poverty or need and could not just be targeted to the constituencies posing the greatest potential political danger for the ruling regimes.

Figure 4 shows that the drivers of this type of corruption have little to do with the type of economic policies or political institutions that the developing country has. Nor is it dependent on the political will of the leadership to fight corruption or the degree of transparency. The example of India shows how transparently corrupt and even criminal politicians can be routinely elected because they have the resources to deliver to their clients and to spend in elections. Clearly, this type of corruption cannot be affected by any of the reforms appropriate for market-restricting corruption.

Political corruption cannot be seriously dented till countries have achieved middle-income status or better and significant fiscal resources are available for political stabilization through transparent budgetary transfers. However, even in poor countries political corruption raises issues that are relevant for governance advisors and reformers. As Figure 4 shows, the institutional and political capacities of states can help to determine whether the off-budget allocation of resources for political stabilization actually succeeds in achieving sufficient political stability for economic development. If it does not, political corruption is no different from predation (examined in section 4). While political corruption cannot be entirely removed in most developing countries given the nature of the drivers, governance reform can focus on strengthening the institutional and political conditions that enhance the capacity of the state to maintain political stability with the resources available.

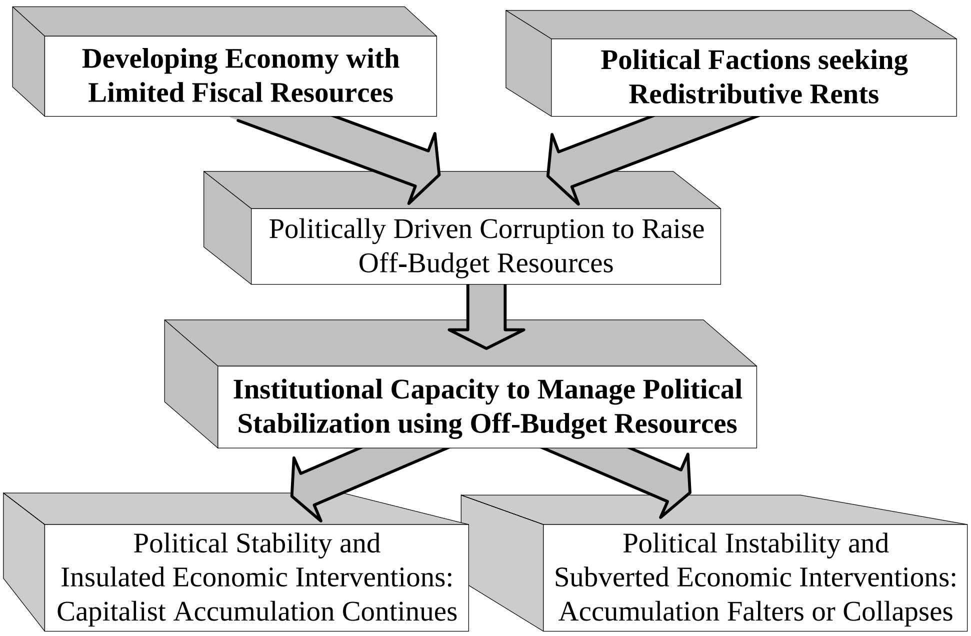

Figure 4 Drivers of Political Corruption

If the state and the polity are highly fragmented, the distribution of rents through the state will fail to achieve stability and the extraction of resources from society for redistribution to powerful factions can appear to be increasingly predatory. In extreme cases, the outcome shown in the right hand fork in Figure 4 is no different from the predatory outcome discussed in our next section. We will see that predatory behaviour by the state is the worst form of corruption. However, not all types of political corruption should be confused with predation because while predation is avoidable and damaging, most forms of political corruption are not avoidable and programmes that seek to eliminate this problem in the short to medium term are doomed to fail in poor country contexts.

3b) Primitive Accumulation. Primitive accumulation refers to the *non-market transfers of assets* that are typical in emerging capitalist economies before a broad-based capitalist market economy has emerged. The absence of some state capacities and the presence of others play a vital role in these transfers, and we argue that these state roles are unavoidable in emerging economies where the capitalist sector is very small to begin with. At these early stages of development, these critical non-market transfers cannot be legalized for reasons that we discuss below, so once again, we have a set of essential state functions that cannot be legalized. By definition, many of these state activities or state-supported activities are corrupt, and they trigger secondly corruption as rent seekers try to influence the state to benefit from these non-market transfers of assets.

The background to these non-market transfers is that in a developing economy the bulk of economic activity is still carried out in pre-capitalist (traditional) economic sectors that face growing economic collapse. This collapse is due to the fact that the existing owners of assets, who are organizing production using pre-capitalist methods, and using backward technologies, are increasingly unviable in terms of the incomes they can generate for themselves and for their workers. This means that they are unable to pay for the protection of their assets either through a public system of taxation or through the private purchase of protection. This, rather than the inefficiency of the state, explains why property rights are universally weak and unstable in developing countries. The common policy response to this property right instability is to attempt to strengthen the legal system and thereby stabilize property rights. This ignores the fundamental structural factors driving property right instability in developing countries. If the driver of property right instability is the absence of a wide range of viable firms that can generate the economic surplus to pay for property right stabilization, then trying to achieve stabilization as a precondition for a viable economy is putting the cart before the horse. How will society pay for this stabilization when its productive sector does not produce a significant economic surplus? The assumption that property right instability is due only to the mendacity of state leaders is wrong. Advanced countries have stable property rights and low market transaction costs because productive enterprises in these countries can pay significant amounts for the protection of property rights through their states.

One of the effects of low productivity assets is that in developing countries, much if not most asset transfers take place through non-market mechanisms. Non-market transfers refer to "politically negotiated" transfers where the transfer is not based on a voluntary contract negotiated by individuals. In the context of the type of system change that developing countries are going through, we refer to non-market transfers as "primitive accumulation". The non-market transfers at issue include taxes and subsidies that favour particular groups, allocations of resources by the state through compulsory purchase orders or outright appropriations, zoning and planning permissions that create privileged access for some in the allocation of land, state price fixing that privileges the acquisition of assets by some individuals over others, to give a few examples. At the other extreme, non-market transfers can include outright theft of resources by individuals with military or political power.

But all non-market transfers involve the state (or its absence) in the exercise of political power to capture resources. In dynamic countries, the transfers benefit emerging entrepreneurs who are subsequently able to protect their investments as their productivity increases, and generate greater surpluses, while in lagging countries resources are captured by political entrepreneurs who are unable or unwilling to make productive investments. In the latter case, non-market transfers appear to be increasingly predatory, as discussed in the next section. Figure 5 shows the drivers of primitive accumulation are structural features of developing countries that cannot be easily addressed by standard anti-corruption measures. The important point is that in extreme cases, the damaging outcomes shown along the right hand fork in Figure 5 are no different from predatory outcomes discussed in the next section.

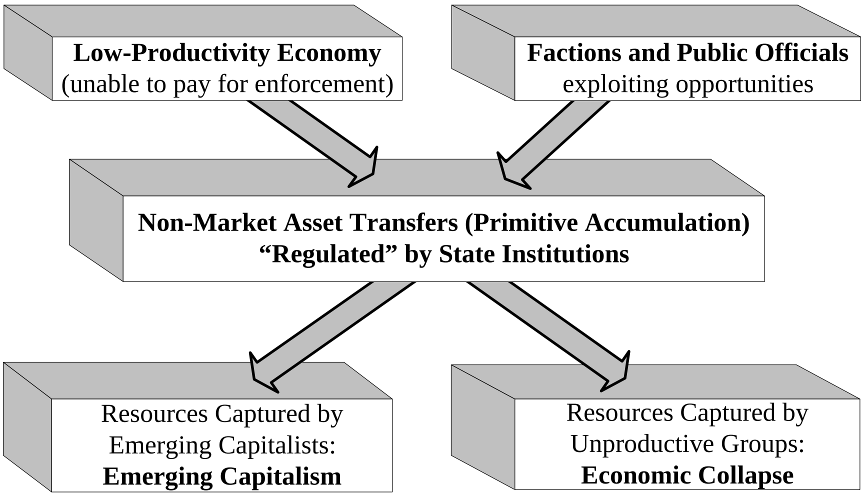

Figure 5 Drivers of Primitive Accumulation

While predatory outcomes can result from the same factors that drive primitive accumulation, it is important to remember that primitive accumulation was a feature of *all* developing countries (including, for instance, the case of the enclosures in England that transferred common land to emerging capitalist landlords). If we look only at the failed cases, we could easily conclude that the problem is the prevalence of non-market transfers, and that therefore the solution is to stop these transfers by strengthening property rights, enforcing individual contracts and bolstering the court and legal system (Clague, et al. 1997; Kauffman, et al. 1999). This is indeed the strategy forward by many donors attempting to reduce 'expropriation risk' by strengthening court systems and spending resources on the rule of law. These attempts are not necessarily misguided as long as we do not expect to see dramatic results.

The historical evidence does not support the claim that expropriation risk can actually be significantly lowered in countries with low productivity assets. While long term historical data is unavailable for expropriation risk, some authors such as Acemoglu et al. (2001) try to find support in very long run data using instrumental variables. Despite the huge impact of their work, their data and the methods are questionable because it is difficult to prove that the countries and periods in the past that they describe as having low expropriation risk really did have low expropriation risk across the board. Colonies where European colonists went and settled in large numbers did better than countries where they did not, and Acemoglu et al. interpret this as showing that in the first group of countries Europeans introduced a good rule of law and low expropriation risk, from which the country eventually benefited. However, the historical evidence does not necessarily support this argument. The countries where Europeans went to suffered huge expropriation risk for many indigenous peoples who lost access to land and resources rapidly. The only difference was that since Europeans came from countries that were already capitalist, the gainers from this early primitive accumulation in European settled colonies were emerging capitalists while in other colonies the transition to capitalism was delayed by imperial trade and industrial policies that reserved these countries as markets for European manufactured products. Without attempting to resolve these historical debates in this paper, all we need to note is that the thesis that successful development happened in countries with stable property rights is not proven. *Capitalists* enjoyed low expropriation risk in successful countries, but in general, there was a lot of expropriation going on from non-capitalist sectors.

Rents/Interventions Associated with Political Corruption and Primitive Accumulation

Examples of rents/interventions associated with political corruption and primitive accumulation:
Transfers of resources through patron-client networks to sustain power and maintain stability.
Transfers of low productivity assets/land through non-market mechanisms

Associated corruption:
Many of these activities are directly corrupt as public officials break the law for their personal survival or benefit.
Secondary corruption can emerge as political leaders raise funds for political expenditures.
Secondary corruption can emerge as expropriators bribe public officials to assist non-market asset transfers.

Policy Responses:
Significant reductions of these types of corruption are unlikely before asset productivity and fiscal space has improved.
Interim policy has to concentrate on preventing the collapse of these types of corruption into predation (see next section) by strengthening institutional coordination across state agencies, and countering political fragmentation by promoting political capacities to maintain political order.

The recent experience of countries like South Korea, Thailand, or China suggests that low expropriation risk in high growth developing countries is at best a privilege of productive investors, and certainly not a privilege enjoyed by pre-capitalist and traditional sectors that are losing assets to the emerging sectors through the very processes of primitive accumulation (Khan 2004a). The difference between high and low growth developers is not that property rights are stable across the board in the former, but rather that property rights are stable for productive investors in the former, whereas in the latter, property rights are stable for unproductive expropriators or for no group at all.

The policy question should therefore be why productive entrepreneurs do not emerge in Africa from the property right instability that is characteristic of the collapse of pre-capitalist economic systems. Since political power is implicated in all transfers, why do politically powerful groups not use their power to transform themselves or their clients into capitalist entrepreneurs and thereby generate much higher payoffs for themselves than the wealth they can expropriate through looting? The factors that could explain why non-market transfers degenerate into predation in many African countries will be discussed in the next section.

4) Predation. The worst type of corruption from a development perspective is shown in box 4 in Figure 1. This corruption is associated with state activities that are illegal and that do not play any potentially beneficial role in society. Extortion and theft by public officials are examples of such state activities. The drivers of this type of corruption are similar to both political corruption and primitive accumulation, except that while the latter may *potentially* play a functional role during the developmental transition, predation and extortion do not. A number of factors could help to ensure that processes similar to political corruption or primitive accumulation have very damaging effects. We will discuss a number of these factors that may be relevant in the African context but the one that appears to have the greatest significance in comparison to the Asian context is the institutional and political fragmentation of the state. If the institutional and political capacity of the state to enforce its will is weak, processes like political corruption and primitive accumulation are likely to display predatory characteristics.

Political corruption or primitive accumulation are certainly *not* desirable, but in the absence of alternative processes that can feasibly achieve political stabilization or the restructuring of assets through efficient markets, given the fiscal constraints discussed earlier, they *may* play a potentially necessary role during the developmental transition. But for that to happen, we require that the state has the minimal institutional and political capacity to maintain political stability (using political corruption as one of its tools) and we require that those who gain assets through non-market transfers are secure enough in their possession of these assets to begin to engage in productive activities. Otherwise, political corruption and primitive accumulation will both have all the characteristics of extortion and predation.

Thus, the only distinctive feature of predation compared to the processes discussed earlier in section 3 is that in the case of predation, the state is politically and institutionally weak. As a result, claim for transfers from competing factions are likely to escalate and even significant transfers to factions may fail to achieve political stability. At the same time, the fragmentation of the state means that those who gain assets through non-market processes are themselves likely to be under attack from other factions or parts of the state. In such circumstances, it is very likely that appropriators will use their appropriations in unproductive ways, for instance in conspicuous consumption or hoarded outside the country. Thus, predatory corruption is most likely to emerge with a weak and/or fragmented state that is unable to control the factional competition for rents, and is unable to ensure that even the emerging powerful groups in society have any security over their new possessions.

The drivers of predatory corruption are shown in Figure 6. They are very similar to the drivers of political corruption (Figure 4) and primitive accumulation (Figure 5) except that predatory corruption has an additional driver: a weak and/or fragmented state. African countries differ significantly from the more successful Asian countries in that the fragmentation of their polities and states is more serious and this can explain why corruption in Africa frequently has predatory characteristics. The policy conclusion here for anti-corruption strategies is that where the fragmentation of the state is a major causal factor behind predation, it needs to be addressed directly with institutional and political reforms. A general anti-corruption strategy will not do, particularly since many of the reforms associated with fighting market-restricting corruption (such as liberalization and privatization) may further fragment very fragile states.

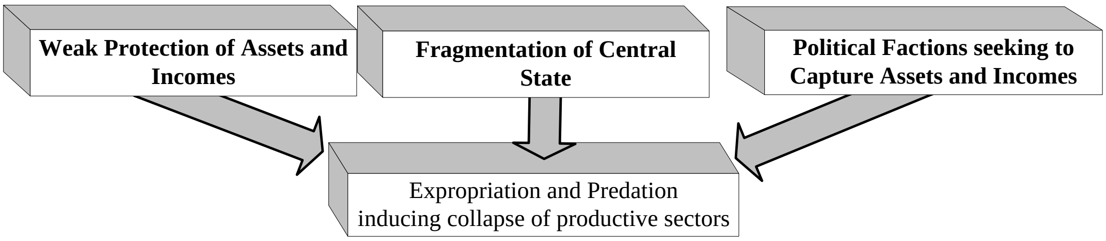

Figure 6 Drivers of Predatory Corruption

The importance of the effective capacity of the state to enforce rights and rents in preventing predatory strategies is most clearly demonstrated in an Asian context by the very different roles played by Chiang Kai Shek and the Kuomintang in mainland China and Taiwan. The historical record tells us that Chiang Kai Shek mysteriously transformed himself apparently overnight from a notorious predatory warlord in China in the decade up to 1948 to one of the most remarkable developmental leaders of the twentieth century when he arrived in Taiwan in 1949. This transition coincided with the defeat of his party, the Kuomintang, in mainland China and their migration to Taiwan. *We can make sense of this incredible transformation simply in terms of the effective power of implementation of the leadership, and the implications this had for leadership strategies.*

In mainland China, Chiang was only one of many warlords, none of whom could effectively enforce their will on the others. In such a context, looting is a rational response of each since any gains that are invested are subject to the predation of others. But in Taiwan, Chiang suddenly achieved an effective capacity to discipline factions and to protect the rights of those who could deliver growth. While in China, the Kuomintang was not large enough or organized enough to impose order, it was more than sufficient in tiny Taiwan. It no longer made sense to engage in looting because much greater rewards were available to the dominant party by engaging in development (Khan 1995). This example powerfully demonstrates the importance of the power of enforcement, rather than the intrinsic preferences of the leadership in determining leadership strategies. It also underlines the importance of effective parties or other political organizations in developing countries as a precondition for the establishment of developmental institutions.

Our emphasis on the institutional and political fragmentation of states can be contrasted with a number of other alternative explanations of why African states are weak and prone to predatory characteristics. The most important explanations and the main problems that they face are as follows.

Alternative Explanations of Predatory Politics in Africa.

a) Neo-patrimonialism. The argument here is that African states are distinctively pre-modern. This analysis goes back to Médard who has written a number of pieces, with the main arguments summarized in Médard (2002). The neo-patrimonial state contrasts with a modern Weberian state that is supposed to be impersonal, formal, accountable and non-corrupt. The neo-patrimonial state is the precise opposite, with personalized and informal relationships between the boss or patron and his clients. The patron is accountable and hugely corrupt, treating the public domain as a private fief, and dispensing benefits to clients to stay in power. *While all these characteristics are clearly visible in Africa, we have argued that these features are common to all developing countries going through the developmental transformation.*

Médard argues that the problem in Africa is the absence of accountability that allows leaders to treat the public domain as their private fief. The policy suggested is the support of democratization and accountability as a way of making the state eventually become more modern and Weberian. This strategy is based on a theoretical argument and not backed up by any historical observation that democratization has driven (rather than having followed) the emergence of a modern Weberian state anywhere in the world (Khan 2005a).

b) African Culture. A variant of the neo-patrimonial argument is that the personalized politics observed in Africa is due to particular characteristics of African peasant culture. The 'economy of affection' emerges in the fragmented economy of African agriculture where exchange has to be based on personalized relationships and patrimonial politics results from this economy (Hyden and Williams 1994). But again, a comparison with the Asian experience suggests there is nothing unique about the African peasant economy. James Scott had made exactly the same observations about the Asian peasantry in his account of the *moral economy* of the Vietnamese peasantry (Scott 1977). These accounts are consistent with our explanation of why property rights are not protected through formal institutions in poor economies and why exchanges that do not conform to modern market transactions dominate in these economies. However, this did not preclude *transitions* to productive capitalist economies in Asia. It is not clear why peasant culture alone should be playing this negative role in Africa.

c) Ethnic fragmentation. A third common response about Africa refers to the *ethnic fragmentation* in Africa, and the fact that many African states have not resolved fundamental questions about their territorial limits and ethnic compositions. The argument here is that this prevents any dominant group in an African polity being able to enforce rights or even decisions about the allocation of social resources. There is an element of truth in this argument but ethnic fragmentation should not be overstated as an explanation of state weakness. The extent of fragmentation varies across African countries. Often conflicts over resources can take an ethnic form, but these conflicts would probably have been just as intense in ethnically homogenous societies where cleavages would have been organized along other lines. It is also worth remembering that many African countries are relatively new, having just emerged from colonial occupation as in Mozambique and Angola. The Asian experience of post-independence development shows periods of considerable turmoil can follow independence even in ethnically homogenous societies (think of Bangladesh in the 1970s).

It is equally important to remember that national identities even in states that now appear to be ethnically homogenous were always products of social engineering. Successful states in Asia and Europe have created national identities with differing degrees of success. Asian states like Thailand that appear to be ethnically homogenous today, achieved this through very specific state policies of nation-building that were often not very pleasant for minorities (such as the Chinese in the case of Thailand). Examples of states working to create homogenous or at least cohesive national identities are not absent in Africa: the case of Tanzania is particularly interesting because the creation of a composite national identity was one of the primary goals of the Nyerere years, and by all accounts, the results were quite remarkable in the African context. The Tanzanian experience shows that nation building is a long process where outsiders can contribute little but could potentially do much damage by suggesting easy options that may not exist. While it is clear that a minimal national consensus is required for a society to embark on any development strategy, the challenge is to identify what needs to be done in terms of institutional reform priorities once a minimal national consensus emerges in countries like Tanzania.

d) Africa's Resource Curse. It is often also argued that Africa's problems with weak states and the descent into predation stems from the easy availability of *natural resource rents,* while Asia was helped by the absence of these natural resource rents. The argument is that warring factions in Africa can sustain conflict by financing themselves using natural resources. Conversely, the leadership of resource-poor Asian countries had to concentrate on how to produce wealth through industrialization. But while the easy availability of resources can sustain conflict, it does not explain why fragmentation exists in the first place since the discovery of windfall incomes in a country with a strong state could be a spur to development. Industrialization requires resources for investment, and where states with some enforcement capacity exist, natural resources can be very helpful in generating resources for high rates of investment in industry. This strategy was very successfully followed, for instance, by Malaysia.

In themselves, natural resource rents are not damaging (see for instance Khan 2000a). Indeed, these are necessary rents from an economic perspective, as they help to achieve a rate of extraction of natural resources that is closer to the sustainable or optimal level. As with all rents, the existence of natural resource rents will induce rent seeking and possibly corruption, but the overall effects would be beneficial as long as the corruption did not subvert state policies completely. In other words, natural resource rents are necessary rents that states should protect by creating and protecting the rights over natural resources on which these rents depend. The corruption directly associated with this state activity would then be a variant of the state-constraining corruption discussed earlier. The argument suggested here somewhat different. It claims that the presence of natural resource rents can unleash rent seeking on a scale that destroys the unity of the state, allowing the emergence of predation. While this is theoretically possible, there is no reason to believe that it is inevitable. Even in Africa, there are already plenty of counter-examples. Botswana's success has been based on natural resource rents but it has not succumbed to civil war. Ghana exports large amounts of gold but is relatively peaceful, and even Angola is moving into a more peaceful era as well as being Africa's largest diamond exporter.

We can accept the argument that natural resources can sustain conflicts that would otherwise have to be fought using more primitive weapons, but this does not mean that in the absence of these rents the fragmented states would have become cohesive. Fragmented states without natural resources can always discover new ways of generating income to sustain conflict, ranging from drugs to intervening in conflicts in neighbouring countries. It is quite plausible for instance to argue that Saudi Arabia without the oil may have been more like Afghanistan than South Korea. Thus, without denying the complications (both positive and negative) created by the presence of natural resource rents, we need to ask why states remain institutionally fragmented and politically weak in some contexts but manage to reform themselves and become developmental in others. The Asian experience suggests that developmental states emerged in both resource poor countries (South Korea, Taiwan) as well as in resource rich countries (Malaysia). Equally, weak states have persisted in many Asian countries that are resource poor (Nepal, Bangladesh). These observations are particularly relevant for Africa where large natural resource endowments should be seen as an opportunity rather than a curse. Institutional and governance capacities should be developed that allows resource rich African countries to manage these rents for economic development. This includes national capabilities for exercising greater control and regulation over multinationals coming to exploit natural resources, not less as is often assumed is necessary for efficiency (Amsden and Hikino 2005).

e) Institutional Fragmentation of the State. While we do not deny that some of the previous explanations can play a limited role in some countries, we find the next two approaches more fruitful because they stand up to a comparative Asia-Africa analysis. As a general observation, the *institutional fragmentation of the state* can result in predatory behaviour because different parts of the state can behave in uncoordinated ways. Given the structural factors driving political corruption and primitive accumulation in developing countries, a centralized state would soon recognize that its interests were best served by moderating political corruption to a level that maintained political stability while at the same time allowing asset transfers to productive capitalists. In other words, if the political leadership of a developing country had the capacity to enforce the rights it chose to enforce, even a moderately intelligent leadership would soon realize that even its selfish interests would be best served by economic development. This is the argument put forward by Olson when he contrasted stationary bandits (a cohesive and stable state) with roving bandits (a fragmented and unstable state) (Olson 2000). A very similar point is made by Shleifer and Vishny in their analysis of the effects of corruption in fragmented and centralized states. They argue that corruption has worse effects if the state is institutionally fragmented (Shleifer and Vishny 1993; Khan 1996a).

Not all Asian states were institutionally cohesive in the post-colonial period. But colonial powers had often been in Asia longer and had fashioned more developed colonial states from the already more established pre-colonial states that existed in most Asian countries. Weak institutional capacity and the fragmentation of states are clearly very important in explaining the somewhat more frequent observations of predatory behaviour in Africa. But in the very successful Asian countries, it was not just that states were more institutionally developed when the colonial powers left, but in addition, institutional development took them rapidly towards even more capable states. Our problem is to understand better why if weak and fragmented state institutions are so damaging, they also appear to be so persistent in some countries but not in others.

If the problem were purely an institutional one, developing countries and their leaders would themselves have strong incentives to put this right, without much advice from economists or donors. Clearly institutional fragmentation is rarely a purely institutional problem that can be resolved by changing the structure of ministries or departments. Underlying the institutional fragmentation of the state is usually a political problem whereby different parts of the state may have been captured by different factions or interests and establishing a cohesive state may require the resolution of the underlying conflicts between factions. This takes us to the last, most important factor underlying state weakness, and driving corruption towards predatory forms.

f) The Political Fragmentation of Polities. The persistence of institutional fragmentation and weak state capabilities may have a lot to do with the *political fragmentation* of the polity, particularly taking the form of multiple well-organized factions that each seek to gain maximum power and rents for itself. Just as with the fragmentation of state institutions, political fragmentation can result in different factions attempting to appropriate rents for themselves. But as no faction can be sure that their gains are secure, winning factions do not begin to invest in production and the slow transition to productive capitalism does not begin. The metaphor of roving and stationary bandits can be used here too, but the problem here is to with political fragmentation rather than the institutional structure. While institutional fragmentation can be addressed by institutional reforms, political fragmentation can only be addressed by political reorganizations, for instance through the construction of new parties and political movements. Donors are obviously less keen about these instruments, but we should at least understand their importance and the limitations of what can be done in the absence of political measures to address political problems.

The political fragmentation of polities in Africa has been frequently commented on. For instance, Chabal and Daloz (1999) in an influential argument observed that in African states *disorder was institutionalized*. What they refer to is precisely the disorder that allows the transfer of resources down patron-client networks. The weakness of their argument is that what they refer to as a specifically African problem is actually at a general level a characteristic of all developing countries. In terms of our discussion of political corruption and primitive accumulation, the institutionalization of disorder is a characteristic of all developing country societies. Or to put it differently, the institutionalization of order (stable property rights, entrenched democracy, low or negligible corruption, the accountability of leaders and so on) requires a significant level of development in order to be effectively implemented.

So what is distinctive about Africa? Chabal and Daloz, and most commentators on Africa appear to be saying that African leaderships do not have the political will to make the difficult transition of imposing order and then trying to capture productive surpluses by enhancing production instead of the easy surpluses that can be captured through unproductive means. We are suggesting that the focus of attention should be on the institutional and political fragmentation of African states, and not on the political will, integrity or other characteristics of the leadership, important though these may also be in some contexts. The importance of political fragmentation in Asia in explaining the differential performance of Asian countries has been explored in Khan’s work (Khan 1996b, 1999, 2000b). Some of these ideas have been developed in the African context in the recent work of Lockwood (2005). The Asian experience suggests that the same political leaderships (and therefore the same political will) achieved very different things when political organizations and their ability to enforce changed. Of course, building the mass organizations and enforcement institutions that may eventually allow African societies to make more rapid transitions to productive economies is also a matter of conscious political activity, but this is the activity of many people doing many things, and is not the same as the attribution of absent political will to a specific leadership.

Part B: Case Study of Tanzania

B.1. Introduction

Tanzania has emerged from twenty years of economic and political reform as one of Africa's fastest growing economies, with GDP growth taking off in 1997-98 and rising to 6.3 percent in 2004 (URT, 2005). Tanzania has also maintained its status as one of the continent's most peaceful and politically stable countries. Underlying this success story however is the fact that the average growth rate of GDP per capita from 1990 – 2003 was only 1.1%. There is also concern that weak institutions of governance are hampering the ability of the Tanzanian state to sustain growth and bring about widespread poverty reduction. In particular, concern has focused on pervasive corruption, lack of transparency and accountability of government, weak democratic systems, inefficient market distortions and endemic rent seeking (URT 1996, 2003, 2004; World Bank 2000).

The purpose of this case study is to explore how the framework developed in Part A can enhance the understanding of governance and growth in Tanzania. The case study traces the historical evolution of political and economic power in Tanzania in order to identify the broad institutional and political factors that have influenced patterns of rents and rent seeking. We then review five key policy areas of the governance agenda, placing these issues within the framework outlined in Part A and suggesting ways in which DFID can use this analysis in designing its governance programme for Tanzania.

Our analysis uses secondary data, published and grey literature on Tanzania's political and economic history as well as previous studies on rent seeking. We also undertook interviews with Tanzanian representatives from the public and private sector and DFID staff in Dar es Salaam and in London in 2005.

B.2. Background: Economic and Political Overview

Tanzania ranks amongst the world's poorest countries with a GDP per capita of 330 USD (World Bank 2004). It has gone through very little structural change since its independence in 1961, remaining predominantly an agrarian society with around 80% of its population of 36 million still employed in low productivity agriculture. It was during colonial rule from 1880 to 1961 that the structure of the Tanzanian economy and the roots of its internal political power structure were established. After the First World War and the end of German colonial rule in 1917, Tanzania[1] was made a British protectorate under a League of Nations Mandate, which effectively put it "at the bottom of the imperial pecking order" (Iliffe 1979: 302). Tanzania's protectorate status implied a time-constrained period of colonial rule and this meant that a significant transformation of the country's economic systems was even less a priority for the colonial state compared to other colonies. Instead, the primary objective of the colonial state was the maintenance of political stability over the medium term.

In terms of the economic structure of Tanzania, the most important changes that occurred during the colonial period were in the agriculture sector. Unlike many Asian countries which had established peasant systems of agriculture for hundreds of years prior to colonialism, peasant agriculture came to prominence during the colonial period with the consolidation of settled small-holder agriculture across the country. The system of peasant production, once established, received little challenge from large-scale settler agriculture. Settler farms received limited state support and expropriation of land was relatively low, compared to neighbouring Kenya where the development of large-scale settler agriculture had important implications for the emergence of a landless working class and for rural development, in contrast to Tanzania.

It was only after the Second World War that the colonial authorities, in response to European post-war shortages and the growing demands of richer peasants for a more rapid pace of agricultural transformation, began to promote commercial farming by Africans. Prior to this, the native administrations actively discouraged emerging African capitalist agriculture by limiting the availability of credit and banning commercial land transactions. At independence the peasant system of agriculture was

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[1] Prior to the union with Zanzibar in 1977, Tanzania's official name was Tanganyika. This report shall use the name Tanzania throughout.

firmly entrenched and while capitalist African agriculture had taken root, this group, consisting only of a few hundred farmers (Iliffe 1974) had very little political clout.

The enduring strength of smallholder agriculture has important implications for understanding the strategies of the Tanzanian state following independence. In terms of the capacity to invest and generate productivity growth, we see peasant agriculture as a constraint for long-term development, in contrast to many writers on African agriculture. In this our position on the prospects of Tanzanian peasant agriculture (and African peasant agriculture more generally) is similar to that of Sachs et al. (2004). Our analysis of peasant agriculture is also different from authors such as Hyden (1981) who present Tanzanian peasant agriculture as a pristine and self-sufficient form of production more in line with indigenous culture. In Hyden's argument (referred to in Part A), the personalized relationships characterizing peasant agriculture explain the dominance of patrimonial relationships within the state. But instead of seeing the persistence of peasant agriculture as a problem, Hyden argues for the decentralization of the state to bring the state more into line with the logic of peasant production. As we argued in Part A, patrimonial politics and patron-client networks exist in all developing countries regardless of the organization of agriculture and their social cultures, and so patrimonial politics in Tanzania is likely to have wider causes than the prevalence of peasant agriculture. As in all developing countries, peasant agriculture in Tanzania faces the economic constraints of low investment and productivity, and as elsewhere, there is a slow transformation of rural production and ownership patterns. The colonial history and the dominance of peasant agriculture at independence do explain however why the transition has been much slower in Tanzania compared to some other countries in Africa.

From this perspective, the importance of enduring peasant production in Tanzania is that because peasant production depends very little on the state, it is much more difficult for the state to have effective power over the bulk of society living in traditional agriculture. It is also more difficult for patron-client networks to mobilize society for supporting national reform agendas. This makes the Tanzanian state weak vis-à-vis society as a whole, but it also explains why factions within the state made up of intermediate classes and capitalist groups also have limited bargaining power against each other within the framework of a state that does not penetrate most of society.

As well as the limited transformation of agriculture, the level of industrial development that occurred during the colonial period was very limited, even compared to Uganda and Kenya. State capacities to manage industrialization were therefore not a priority and very few Africans were engaged in commerce, trade or industry at the time of independence. In fact, there was a policy of active discouragement of African business by the colonial state. The state restricted access to credit to Africans through the 1923 Credit to Natives Law which required that loans to Africans be approved by a colonial administrative officer (McCarthy 1982) meaning effectively that lenders to Africans had no legal recourse to reclaim their debt and were inhibited from lending by extensive red tape. The prominent role of Asian Tanzanians in the private sector today was partly a result of colonial economic policy. The distance between Tanzania's big capitalists (who are by and large not black African) and the state can help to explain why industrial policy in the past has largely been about trying to develop a (black African) public sector. This contrasts sharply with the carrot and stick (conditional rent) strategies to assist the technological progress of domestic capitalists seen in many of the successful Asian countries.

The state capacities that developed during the colonial period were consistent with the very limited rents created and interventions engaged in by the colonial authority. These capacities were predominantly in low-level administration (McCarthy 1982), agricultural extension services directed initially towards settler farms and peasant agriculture, and in basic education to provide a flow of African staff to junior ranks in the civil service (Coulson 1981). The most important impact on emerging governance structures was the decision to implement a system of indirect rule from 1924.

Indirect rule was seen as a route to stability though the co-option of local elites into the colonial organizational framework. This process involved the identification of tribal chiefs by the colonial authorities. However, across Tanzania, tribe had always been just one of the competing forms of identity to which people subscribed, rather than the defining characteristic of the society (Iliffe 1979). Despite this effort to consolidate the tribal system, the fragmented nature of Tanzanian tribes, and the post-colonial nation building under President Nyerere meant that tribal divisions have always played a relatively minor role in Tanzanian politics.

The institutional authority of indirect rule depended both on the underlying coercive power of the colonial system and on the social control that native authorities had over tax revenue at a local level. Some, at least, of these tax revenues were used as an early form of technology enhancing rents, and were used to improve access to land and agricultural inputs. The expenditures had some technical success in terms of improving the productivity of peasant agriculture in some areas (Illife 1974), but they also had a function of ensuring local acquiescence with the colonial authority. Local chiefs who acted as patrons distributed transfer rents to those in the locality who presented the largest potential threat to the stability of colonial rule. The budgets of native authorities were, however, extremely limited and hardly stretched beyond the salary bill of the bureaucrats administering them.

The scope of the rents and capacity of the native authorities were too limited to be able to bring about the larger scale of economic transformation increasingly demanded by wealthier peasants and the small group of African traders and civil servants who were the backbone of the nationalist movement. As a result, on independence, the system of rent distribution through native authorities was largely swept away. However, the focus on strengthening a decentralized and traditional power system meant that on independence, the core state capacities needed to bring about the type of social transformation that was at the heart of the nationalist agenda were weakly formed.

The nationalist movement was a broadly based coalition, yet, as in other colonized countries, its leaders were mainly from intermediate social groups rather than poor smallholders. They were primarily teachers, junior civil servants and the richer peasants who were engaged in co-operatives or trading. The common ties within this group were their close contacts with the colonial state itself as well as their higher level of education that set them apart from the traditional bonds of the village and gave them the organizational skills to mount a successful nationalist campaign.

The institutional strength of the nationalist movement came from the highly structured organization of the Tanganyika Africa National Union (TANU) which became the Chama Cha Mapinduzi (CCM) in 1977 following the union between Tanganyika and Zanzibar. This organization originated from the urban-intellectual African Association, established in 1929. By the time of independence, it had grown into a successful mass party. TANU was led by Julius Nyerere who saw the party as the main vehicle for bringing about development in Tanzania. In 1962, Nyerere stood down from the position of president in order to focus his attention on strengthening the party. Under Nyerere the party became centralized and highly structured with party organs at all levels of society from village cells of 10 households up to the National Executive Committee (NEC).

Structurally, the institutions of the party held precedence over the institutions of the state. For instance, the National Assembly was constitutionally subordinate to the governing party while policy discussion took place primarily in party sub-groups rather than in parliament (Coulson 1981). In 1965, Tanzania became a one-party state, further consolidating the role of the party as the central vehicle driving Tanzania's development. In terms of organizational cohesiveness, the CCM overshadowed other institutions of the state. Membership or association with the ruling party was a necessity for those competing for rents as there was, and still is, no credible political institution that rivals this position. Further, the low level of social and economic differentiation allowed the ruling party to achieve a high degree of inclusiveness at a relatively low cost in terms of rent distribution. The Leadership Code[2] of the party went further, not only declaring limits to the rewards associated with rent seeking but also explicitly ruling out party leaders from capitalist associations. Given the relatively undifferentiated nature of most of the population who were not involved in any rapid accumulation, these declarations were initially fairly effective. While there was rent seeking during Nyerere's rule, the costs were low as factional competition within the party structure was *relatively* limited compared to other developing countries.

[2] The Arusha Declaration Stated that "every TANU and government leader should .. in no way be associated with the practices of capitalism or feudalism" (Nyerere 1967: 36) and the Leadership Code barred party leaders and civil servants from owning shares in companies, renting property or engaging in private business.

For the first five years of independence, the path of economic development in Tanzania continued along the lines established during colonial rule, with foreign ownership in industry and large-scale agriculture, continued growth of African capitalist farming and the dominance of Tanzanian Asians in trade and commerce. Yet the pressure to institute faster economic transformation for the benefit of the majority was growing. Together with Nyerere's own Christian-Socialist ideals, this led to the adoption of a more radical approach to economic development. The Arusha Declaration of 1967 committed the party to Ujamaa based on a state-led 'socialist' economic transformation with strict limits on private sector accumulation and social differentiation.

The declaration marks an important turning point in the nature of rent creation by the state and the associated rent seeking. The direct share of the state in the economy increased with the nationalization of banks and a large proportion of industry. Extensive administrative resource allocation and price controls, import quotas and foreign exchange rationing system were introduced. By the late 1970s, permits were introduced to control the internal movement of goods and state trading agencies in both international trade and domestic retail were established. The villagization scheme was a radical attempt to settle a shifting agricultural population into sedentary agriculture with cooperative landholdings in order to bring about an egalitarian form of agricultural transition. This involved the consolidation, often by force, of 80% of the rural population into co-operative villages, discussed further in section B.3.iii.

The purpose of these diverse interventions and the associated rent-creation was to bring about rapid capacity enhancement and productivity growth in agriculture and industry without the unequalizing pressures of capitalist development that, in Tanzania, would have favoured the already established Asian and European business against the newly emerging African 'middle class'. This helps to explain why the state took on the role of accumulation and distributed rents to state and party functionaries, primarily through the creation of parastatal institutions that created jobs for the new African constituencies and received subsidies and cheap credit from the state. Gross investment, mainly through donor and government funding, as a percentage of GDP increased from an average of 13.7% during 1961–67 to 24% during 1968–78.

The policies had a positive impact in terms of building up the productive capacity of the economy, with an increase in manufacturing value added from 15.8% in 1965 to 25.2% in 1970. However, by the end of the 1970s it was clear that ujamaa policies were running into difficulties. The fundamental problem was that the state was not effectively managing the rents transferred to new industries to ensure productivity growth. There was a proliferation of poorly performing parastatals, excess employment and excess capacity in industry. To make matters worse, concessionary donor finance funded much of the rents going to failing enterprises, and this continued for almost a decade even after privatization began.

This failure was partly due to weak technical state capacities in terms of understanding the needs and challenges of industrialization. More fundamentally, those within the state who wanted viable industries clearly lacked the power to provide credible threats to bureaucrats running industries, such as the threat to remove subsidies if they failed to achieve the productivity required for economic viability. This is not surprising given the fragmentation of power within the state and the absence of constituencies that could provide effective political power to modernizing leaders. Even though competing factions were weak in Tanzania, no faction or leader was strong enough to impose discipline on the others. As discussed in part A, factional groupings are a common feature of the politics of developing countries and often coalesce around ethnic, religious or tribal identities. In Tanzania, however the factional groupings are much more fluid, partly because of the very limited rural transformation, which meant that an established rural elite did not exist who could play the role of rural political entrepreneurs. This resulted in the paradox of Tanzanian politics that the centre was strong enough to keep virtually every faction together in the same party, but even the centre was too weak to impose discipline on all the factions benefiting from ujama development policies. We will discuss the implications of this political structure further in sections B.3.ii and B.3.v.

The failure of its industrialization strategy was put into sharp focus by the fact that by the early 1980s Tanzania was facing a severe fiscal crisis[3] and a foreign exchange constraint, which had a negative impact on the heavily import-dependent manufacturing sector. In addition, agricultural output decreased following villagization. The informal sector of the economy grew rapidly as the state's capacity to pay adequate wages and to enforce price regulations dwindled. In 1985 under the new leadership of President Mwinyi an agreement with the IMF was signed which heralded in a new approach to economic management.

The liberalization programme was based on the assumption that the poor performance of the economy was mainly a result of extensive state interventions that had been implemented under ujamaa and the remedy was therefore to roll back the state, remove the rents associated with failing interventions and allow the market to allocate resources. This involved a shift to a market-determined exchange rate, price deregulation, removal of tariffs and subsidies and an extensive privatization programme. Restrictions on private accumulation and foreign investment slowly disappeared and the model of market-led development took the place of the egalitarian self-sufficiency of ujamaa.

Reform of the political system led to multiparty elections in 1995 and a decentralization programme that has sought to push political power and service delivery down to the local level. Nevertheless, CCM still dominates the political scene and continues to win national elections, increasing its parliamentary representation to 87.3% in the 2005 national elections. We discuss the implications of these political reforms for rents and rent seeking in section B.3.ii.

Structural change during the twenty years of reform has been slow and faltering, although the pace has picked up since 1995. The weakest impact has been in agriculture. While certain crops such as tea, tobacco and cashews have improved as a result of export and price liberalization, other major crops such as coffee, cotton and maize have declined (IMF 2004). Overall, there has been very little increase in

[3] The fiscal crisis resulted partly from the strain of financing Tanzania's military intervention in Uganda to remove Iddi Amin.

agricultural productivity and wages. This is reflected in the fact that rural poverty levels have hardly changed over the reform period (URT 2005).

Growth in the manufacturing sector started to pick up after a sustained downturn and now accounts for 7.8% of GDP which is the same level as in the late 1980s and well below the 12% achieved in the 1970s. These aggregate figures hide the fact that while certain manufacturing industries have registered significant declines since liberalization such as garment and textiles, there has been a broad-based increase in the output of a number of privatized industries including sugar, beer, soft drinks, cement and steel. We discuss the changing role of rents and rent seeking in manufacturing in section B.3.v.

The most dramatic change in the structure of the Tanzanian economy has been the rapid growth of the mining sector. This was fuelled by the introduction of very favourable foreign investment regulations that triggered massive foreign investment since the late 1990s, making Tanzania the second highest recipient of FDI in Africa. Gold has now replaced agricultural products in terms of export value, accounting for around 60% of exports; yet according to the IMF (2004) the growth in mining has yet to contribute significantly to GDP growth. The growth in mining and the emergence of natural resource exploitation as a dynamic economic arena in Tanzania poses particular challenges to rent management systems that are discussed further in section B.3.iv.

Despite the withdrawal of the state from many spheres of economic activity in Tanzania, the period of liberalization has also been associated with increasing concerns about corruption and weak governance. Further, continued aid dependency and the shift in aid delivery to general budget support has heightened donor fears about the financial probity of government. Within Tanzania, the Presidential Commission of Inquiry Against Corruption, undertaken in 1996 found that "there is no doubt that corruption is rampant in all sectors of the economy, public services and politics in the country" (URT 1996, p 46) and in 2005 Transparency International ranked Tanzania as 96th out of 158 countries surveyed (TI 2005). Far from liberalization leading to a reduction in corruption, the indications are that corruption in Tanzania is getting entrenched, if not increasing. In the subsequent sections we argue that examining different types of corruption in the country gives an insight into critical areas of state weakness, and in particular the limits of the current growth path.

B.3. Critical areas for anti-corruption policy and implications for strengthening pro-poor growth capacities of the Tanzanian government.

In this section, we look at a number of areas where observers and policy-makers frequently identify corruption as a serious problem in Tanzania. These include the drivers of bureaucratic corruption and of political corruption. In addition, we look at corruption in the key areas of land and property rights reform, corruption in the critical natural resource sector, and the implications of corruption for any type of transformative industrial policy. We argue that closer analysis of these areas shows the complexity of the problem and the interlocking of different types of corruption using the framework developed in Section A. We then discuss the implications of this analysis for anti-corruption policy.

i) Bureaucratic Corruption

Through our interviews and in our reading of the secondary literature on Tanzania it was clear that bureaucratic corruption is widespread in Tanzania. Evidence suggests that bureaucratic corruption is rampant in Tanzania across many areas of state activity including law enforcement, courts and taxation as well as service delivery in health and education. This corruption occurs at all levels of the bureaucratic structure. But even petty bureaucratic corruption has a disproportionate impact on the poor by raising the costs that they face in receiving services from the state. The Warrioba Commission of 1996 and subsequent reports on corruption in Tanzania such as that of the World Bank (2001) have extensively documented bureaucratic corruption in forms such as demands for bribes, the embezzlement of public resources and extortion by low-level state officials.

The impact of bureaucratic corruption on public expenditure and the tax system has been a major area of concern for the Tanzanian Government and development partners alike. Petty (and sometimes not so petty) bureaucratic corruption affecting public finances have been addressed through tighter monitoring of the budgetary process, the implementation of computerized financial tracking systems and through the on-going Public Expenditure Review process, strongly supported and financed by donors including DFID. However, considerable leakage persists at the level of actual service delivery.

Bureaucratic corruption within the revenue system includes the false classification and valuation of goods to avoid excise, sales or customs taxes, payment of bribes to tax officers, extortion by tax officers, sometimes using inflated tax claims, outright fraud and the embezzlement of collected revenue (Fjeldstad 2002). Such corruption leads to a significant erosion of the tax base and leakage of much needed revenue in Tanzania as in many other developing countries.

Using the categories of Figure 1 in Section A, some of this bureaucratic corruption is clearly *market-restricting corruption* (Type 1). These acts of corruption relate to underlying state functions that are legal but which are socially damaging in design, such as the continuation of legal impediments and rules that serve no purpose but which allow the collection of bribes from citizens who need to work their way around the system (World Bank 2001). Thus in these areas the policy prescription is based on reducing the unnecessary regulation while raising the opportunity cost of being caught by increasing salaries and enhancing accountability and transparency.

However, much of the bureaucratic corruption in Tanzania is also *state-constraining corruption* (Type 2 in Figure 1). In particular, the loss of public resources in the tax system is largely of this type. In principle, the focus of the public finance anti-corruption agenda addresses the problem of corruption affecting necessary state functions through measures such as the Civil Service Reform Programme, the Public Financial Management Reform Programme, the Public Expenditure Review, Legal Sector Reform Programme and Accountability, Transparency and Integrity Programmes. However, a major limitation with these programmes is the implicit donor analysis of the state functions that are considered beneficial. The new consensus is that necessary and beneficial state functions are essentially limited to service delivery, particularly to the poor, as well as some infrastructure construction in areas that cannot be provided by private sector providers. This means that Civil

Service Reform, PFM and transparency measures are all aimed at reducing the state's functions to a core set of service delivery activities and then concentrating on reducing corruption *in these areas.* Thus, while in principle the anti-corruption reforms described above address both Type 1 and Type 2 corruption, they address Type 2 (state-constraining) corruption by insisting that the range of essential state activities is limited to a very narrow range. We will argue later that responding to state-constraining corruption by shrinking the scope of state activities that are deemed to be potentially beneficial can itself damage the prospects of growth, making the sustainable reduction of corruption more difficult.

It is clear from the quarterly reports of Tanzania's Anti-Corruption Bureau as well as the annual reports of the Controller and Auditor General that these strategies have at best had limited success. For example, following the extensive reform of the revenue authority in 1996, which focussed on raising salaries and providing greater transparency and accountability of tax officials, there was an initial decline in corruption and an increase in reported revenue from 11% of GDP in 1995/96 to more than 12% in 1996/97. However subsequently tax revenue declined as a percentage of GDP and there were reports of increasing corruption within the revenue authority (Fjeldstad et al 2003).

One reason why even such narrowly defined anti-corruption strategies have failed is that they ignore the interdependence of different types of corruption. Bureaucratic corruption is not just due to the drivers of market-restricting and state-constraining corruption, but also by the other two sets of drivers of corruption. In particular, bureaucrats are often involved in political corruption (Type 3 corruption in Figure 1) where the driver is the resource demand coming from political masters. If politicians need to raise money for running parties or maintaining their support base of clients, they may involve bureaucrats in scams or in allocating resources to favoured clients. Bureaucrats may benefit from such corruption, but the conventional strategies described above are unlikely to work if political imperatives are driving the corruption. We can expect politicians to protect the concerned bureaucrats even while they pay lip service to anti-corruption strategies. Moreover, if political survival requires these funds, transparency in one area will drive political corruption into other areas. Not only are conventional strategies of salary increases, transparency, and limiting state activity to core service delivery areas unlikely to reduce overall corruption in this context, if conventional sources of rent for political redistribution in patron-client networks begin to delivery up, politicians are likely to seek new areas in which rent can be collected. We will see later that in Tanzania greater efforts in reducing corruption in budgetary processes (an area where donors have particular concerns in the context of GBS) have directed attention away from growing corruption in areas such as land allocation and natural resource licensing.

The evidence of bureaucratic corruption in Tanzania suggests that some bureaucratic corruption is of the predatory variety (Type 4 corruption in Figure 1), driven by weak or collapsing central control over lower level state employees. Although Tanzania clearly does not suffer from serious versions of predation, some of the petty corruption in Tanzania, in particular involving the police, have all the characteristics of predation and theft and relate to the failure of central agencies of the state to discipline its lower level staff even when their activities harm the state. Predatory variants of bureaucratic corruption are also not much affected by transparency reforms, as the problem here is not the lack of information about corruption but rather the inability of the central state to discipline public employees. There is informal evidence that predatory corruption is increasing in Tanzania, partly related to the institutional weakening of the state since the end of the 1970s and the on-going fiscal constraints that are limiting its effectiveness. The policy response here has to be to strengthen central state institutions through investment in human and infrastructural capital. The political fragmentation of the state is a more fundamental problem particularly as the wider processes of economic differentiation that are occurring in Tanzania are likely to heighten factional politics and increasingly stress the centripetal influence of the CCM party.

The capacity of state to maintain effective control over its operatives typically closely correlates with the ability of the state to impose order in society. In other words, societies where lower-level public officials begin to engage in predatory activities are also societies where lawlessness is rising and private mafias begin to engage in open extortion and theft. Maintaining social order is not merely a function a state’s ability to enforce security. The capacity of a state to impose discipline also depends on its legitimacy, which in turn depends on its ability to deliver growth in living standards to wide constituencies. Although Tanzania has achieved a higher rate of growth over the last decade, much of the country has not enjoyed the benefits of this growth process. This is because the new growth sectors of mining, minerals and tourism do not offer the widespread linkages and employment opportunities generated by the manufacturing sector. Thus, growth in these areas can only benefit the wider population if government can tax firms in these sectors and redistribute resources to others. Clearly, the prospects of doing this on a grand scale in a poor country hoping to attract foreign investment are limited. In contrast, manufacturing led growth has immediate effects on poverty reduction through job creation. This could help explain why social fragmentation appears to be increasing in Tanzania despite relatively high rates of growth, and with the growth of social divisions, it is not surprising that we found evidence in interviews and in the secondly literature of a decline in the effectiveness of the state in maintaining social order. This highlights the importance of focusing on feasible areas for manufacturing growth in countries like Tanzania, not only to achieve a more rapid pace of growth, but also to ensure that the state's legitimacy, and through that its effectiveness in maintaining social discipline is maintained.

ii) Political Corruption

Unlike bureaucratic corruption, it is much more difficult to get evidence of political corruption in Tanzania, compared to neighbouring countries like Kenya. We believe that this is only partly because political corruption may actually be less serious in Tanzania. The lower intensity of political competition in Tanzania because of the relative underdevelopment of the rural elite may have contributed to a more muted factional competition, and this in turn would reduce the demands for raising funds by political parties to keep their factions together. In addition, it is also likely that much of the redistribution to political factions that happens openly in countries like Kenya, happens within the closed domain of the CCM in Tanzania, making it difficult for outsiders to report on it. We would expect evidence of political corruption in Tanzania to become more widely available as political competition moves outside the CCM as multi-party politics becomes entrenched. Once this happens, and competition with opposition parties intensifies, we expect the ruling party to 'buy' factions from the opposition more openly than it has needed to in the past. This is likely to result in both an increase in political corruption as well as making some of the existing political corruption more transparent to journalists and outside observers.

As in many other developing countries political corruption in Tanzania involves raising funds through corruption for off-budget transfers to patron-client networks linked to the state. There is some evidence from our correspondents that these funds are used directly to purchase votes in national and local elections and also for on-going political stabilization not related to elections. This evidence suggests that political corruption (Type 3 corruption in Figure 1) does exist in Tanzania. Tanzania has maintained a high degree of political stability since independence suggesting that the political stabilization that occurs through payoffs to different factions within the ruling party CCM has been relatively effective. As outlined in section B.2, it is clear that the institutional strength of the CCM party has helped to maintain political stability by lowering the costs of factional transfers. In Tanzania, political stabilization has so far involved keeping fluid patron-client networks with relatively similar levels of bargaining power within the CCM structure. This helps to explain why the cases of political corruption that make headline news in Kenya have been less prevalent in Tanzania as in Kenya the greater power of different political groupings outside the currently ruling party provide a much greater threat to state stability. These external factions can therefore demand higher levels of payoffs in Kenya than in Tanzania, but this may change in the future as suggested above.

While Tanzania has clearly achieved political stability since independence, this has not led overall to a higher level of state effectiveness as there is an important distinction between *inclusive politics* and *strong party politics*. The CCM party in Tanzania has historically been an inclusive organization that has been able to contain factional competition through its well-developed and inclusive institutional structures in a political context where political entrepreneurs are not very powerful given the low level of economic differentiation and development. Further, the low level of social differentiation and weak economic transition has paradoxically reduced the costs of political competition given the existence of an inclusive one-party state that is still effectively a one-party state despite the beginnings of multi-party competition. So far, at least, the ability of different factions in the business community and within the state to mobilize broader social groups to demand or protect rents has been very limited. Clientelist political corruption in Tanzania therefore ensures that the centre remains stable through internal redistribution to diffuse power networks even though the centre itself lacks the political power to act as a strong state.

One of the few well-documented cases of grand political corruption in Tanzania supports our hypothesis on the processes through which the CCM maintains political power in Tanzania. This case involved a large power supply contract signed in 1995 between the IPTL company and the Government, which led to exorbitant increases in electricity tariffs (Cooksey 2002). IPTL was a Malaysian consortium backed by Tanzanians well connected with the CCM. Competing with it was a company called Songas, who offered a cheaper supply price to the Tanzanian electricity supplier TANESCO. From the evidence reported in Cooksey (2002) it is clear that despite the fact that it soon emerged that the agreement was clearly not in the economic interests of the country, and despite the fact that other competitors with better offers were available, the top leadership was not able to override the networks within the party who supported the deal. The eventual outcome was that Tanzania now has one of the highest electricity tariffs in Africa.

The deal is interesting because it allows us to examine, however tentatively, alternative hypotheses about the internal operation of the CCM. From the outset, the IPTL deal faced strong opposition from technocrats in the Ministry of Energy who were convinced that it did not offer a good deal to Tanzania. Even after the contract was signed, pressure from these groups and the Prevention of Corruption Bureau led the government to authorize a referral of the case to the International Centre for the Settlement of Investment Disputes in London. This could have resulted in the arbitrators changing or overturning the contract in London, but interestingly at the last minute, it appears President Mkapa who had allowed the case to go forward in the first place, prevented the disclosure of all information to the arbitration tribunal, and TANESCO lost its appeal. The question that arises in the analysis of this deal is why the competitors who offered better tariffs lost out.

One possibility is that IPTL was offering a bigger bribe to political managers within the CCM than their competitors. The fact that the CCM could stick to the contract despite public knowledge of the inferior deal suggests that it has sufficient political control over competing factions who could not exploit a potentially major scandal to their own advantage. The more interesting question is why the CCM failed to change the supplier or the contract in the light of all the information that became available in the course of the disclosures. The argument that this was possibly because of an implicit bribe that the company had paid can only be part of the explanation. We have to assume that more efficient competitors were unwilling to match the bribe, and we have no evidence of this. Some kickbacks are common in the international power contracting business. Unless IPTL had offered an absolutely incredible kickback, and again we have no evidence that it did, this episode also suggests that the CCM is in fact relatively weak when it comes to upsetting the internal applecart once factions have come to an agreement about how to share a kickback.

To understand why, consider how corruption operates in dynamic Asian countries like China. There too, private power suppliers compete in the domestic market to construct power plants and there is a lot of evidence that the political leadership of the CCP demand and get significant kickbacks. But the power sector in China is relatively efficient and the political leadership have no incentive in allowing inefficient power suppliers to get contracts. Why is that? Essentially, the CCP in China as the only party around expects to be in power for a long time, and therefore it has no incentive of making a very big cut on one project that is detrimental to its long-term prospects of collecting from many efficient projects. Even for a single project, a well-run and profitable project is likely to pay more in kickbacks over time than a project that is not (even ignoring all the other benefits to a government coming from well-run profitable projects). Thus, in countries like China, political corruption operates like an additional tax that is never set high enough to deter efficient projects that the state requires for its long-term viability and for maximizing its kickbacks over time. In this respect, we could also have expected the CCM in Tanzania as the dominant party in an effectively one-party system to take a long-term view, and withdraw support from a project that was clearly detrimental to its long-term prospects. It is no small achievement to end up with one of the highest electricity tariff rates in Africa.

Indeed, we saw plenty of evidence of disputes at the highest levels of the Tanzanian state on the wisdom of the project, and evidence that initially President Mkapa allowed the contract to be referred to the London arbitration. This suggests to us a deeper problem that could possibly distinguish the CCM from the Chinese CCP, and that is the inability of the executive to enforce decisions on internal factions. Changing the contract would possibly have changed the distribution of benefits within the CCM involving some losers, in particular the individuals close to the Tanzanians supporting the IPTL deal. While the CCM may well have been better off overall by going with the alternative contract, those who lost out would have to be contained and their opposition dealt with. The late stage at which the president backed off from supporting international arbitration suggests an internal weakness in this respect, and this would distinguish the CCM from strong parties like the CCP, which are able to take difficult decisions and impose them on internal factions that lose out in the interests of the collective interests of the party. This analysis is necessarily speculative, but we believe it is the most consistent with the facts.

Thus, our conclusion is that the diffuse power structure within the CCM leads to the *appearance* of centralized power in Tanzania, as there appear to be few solid blocks of opposition within the party. The apparent party strength also relates to the fact that opposition from CCM factions within parliament is muted due to the punitive mechanisms available to the party whip (Mmuya 1998) and the fact that most of the important decisions on rents occur outside parliamentary debate. Nevertheless, evidence of the type documented above also suggests that while factions are weak, so is the central power, and it is difficult for the leadership to override internal factions that emerge on an ad hoc basis when big rents and transfers are at stake. If the centre could impose its will on the party as a whole, corruption would not necessarily decline but the state would be more effective in ensuring that such efficient and profitable service providers were selected.

This analysis has implications for the deepening of multi-party democracy in Tanzania. Multi-party democracy will not necessarily lead to even more short-term decisions if at least one of the contending parties is strong and can hope to gain political dividends and extend its stay in power by moderating its extraction and selecting efficient projects. So far, the impact of multi-party democracy has been very limited in mainland Tanzania in terms of political stability and patterns of rent seeking. This is mainly because opposition parties have hardly made a dent on CCMs hegemonic position and in fact, the CCM has increased its parliamentary representation from 78% in the first multiparty elections in 1995 to 87.3% in 2005. Further, Kelsall (2003) reports that the advent of multiparty elections has actually led to decreased competition in around 13% of seats as under the one-party system the CCM fielded multiple candidates while now the weak opposition parties cannot afford to stand candidates in all seats.

The one area where CCM has faced serious opposition is in Zanzibar from the CUF party. In Zanzibar, factional politics has coalesced around regional identities causing greater political cleavages that have spilled over into social unrest and violence during elections. Nevertheless, CCM has managed to maintain the union through organizational and coercive strength and more recently through the manipulation of divisions between elites on the main island Unguja and those in Pemba.

However, there have been important changes in the nature of political representation and political rent seeking in Tanzania since liberalization that we cannot explain simply in terms of the emergence of multiparty politics. It has been argued that multiparty elections have caused an increase in the costs of competing in elections (Kelsall and Mmuya 2005) as well as heightening the importance of local level power networks for political representatives and requirements for service delivery by MPs to local constituents (Gibbon 2004; Kiondo 1995; Kelsall 2000). Kelsall (2000) has described this as a process of "districtization" as rent seeking associated with political corruption has descended to districts. However, we believe that we cannot say that the evidence of growing political corruption is the result of the growth of multiparty politics. This is because all the evidence suggests that the real threat of political opposition in Tanzania remains very weak. We would rather explain the evidence of growing political corruption in terms of the growing significance in Tanzania of primitive accumulation, which is the other variant of Type 3 corruption described in Figure 1.

The opening up of the accumulation process and the private sector under liberalization has enhanced the role of politics in primitive accumulation processes particularly where traditional structures of production are in the process of collapse (discussed further in section B.3.iii). The increasing evidence of political competition and corruption are more likely to be a reflection of the growing opportunities available to political representatives in managing the non-market transfers and allocations of assets like land and natural resources. These changes in political opportunities are also reflected in the fact that the socio-economic background of candidates has been changing away from lower income teachers and farmers towards richer private sector candidates (Kiondo 1990, 1995). In our analysis, whether Type 3 corruption will prevail in politics and lead to a more rapid pace of capitalist transition or whether such accumulation will become predatory Type 4 corruption depends very much on the ability of the state to limit further political fragmentation in the face of growing demands and economic differentiation. The logic here is very similar to the one discussed above where a weak state with powerful internal fragmentation can lead to poor project selection. Such a state is also unable to resist asset grabbing by political entrepreneurs and factions that are predatory, whereas a strong and coherent state is able to respond to the pressures for non-market asset transfers by ensuring that assets go to productive users who improve the sustainability of the ruling political group.

Development partners can have an important influence on whether these processes of non-market transfers described as political corruption and primitive accumulation (Type 3 in Figure 1) evolve into predatory corruption (Type 4). While both are undesirable, the latter is much worse. Tanzania is heavily aid dependent and direct budget support from donors now accounts for 20% of total budget expenditures, and around half of the total aid flow. This has been accompanied by a process of financial reform which has opened up the budgeting process to greater scrutiny by development partners through forums such as the PER and annual PRBS/PRSC review. This greater level of transparency for development partners may reduce some corruption associated with Type 1 and Type 2 corruption processes but paradoxically, greater external control over budgetary resources that does not take into account the necessary processes of political stabilization may force the state to achieve political stabilization by increasingly engaging in predatory extraction. In other words, an unintended effect of greater external control of the budget *may* be to convert some Type 3 corruption associated with political stabilization into Type 4 predatory corruption. While we cannot demonstrate this at this early stage, we are concerned at the evidence of greater predatory behaviour at the lowest levels of politics, with urban politicians shifting their sphere of interest from central CCM politics to political corruption and entrepreneurship at the local level.

In addition, development partners have played a key role in the process of formulating the Poverty Reduction Strategy Paper (Gould and Ojanen 2003) and its successor the National Strategy for Growth and Reduction of Poverty, known by its Kiswahili acronym MKUKUTA, which sets out the targets for public expenditure to achieve poverty reduction. One of the underlying features of these strategy papers is the idea that the capacity of the state to implement its development policy can be enhanced with greater inclusion of social stakeholders into a poverty reduction strategy formulation process. This type of public discussion inevitably results in the identification of pro-poor spending targets that donors are comfortable with but they ignore the critical requirements of political stabilization in the typical developing country context which requires political transfers and redistribution to relatively more powerful intermediate class groups. After all, it is very difficult in any developing country context to publicly articulate that the danger to the political stability of a society comes not from the very poor (who deserve service delivery on welfare maximizing grounds) but rather from the intermediate classes who can easily disrupt political stability if powerful factions are not accommodated. If the capacity of the CCM to accommodate these groups through budgetary processes declines over time, they will still have to be accommodated, but the accommodation will happen through other processes such as allowing factions to engage in land-grabbing or in mediating resource contracts that may be more damaging for long run development. This is not an argument for budgetary opacity, but rather an argument for realising that corruption has many dimensions and a narrow interpretation can inadvertently do more harm than good. One response to this problem may be to assist developing countries like Tanzania deal realistically with political stabilization effectively through other measures.

iii) Land and Primitive Accumulation

Land is still the most important productive asset for most households in Tanzania yet land ownership is increasingly subject to turmoil linked to corruption and theft associated with processes that in Part A we described as primitive accumulation. Part of the reason for the growing concerns of governance in this area is that Tanzania's agrarian structure has long been characterised by relative stability and equality in land ownership, with a gini co-efficient of land inequality of 0.35 in the 1980s (Ghai and Radwan 1984).

There are numerous historical reasons for the stability and relative equality of land ownership. During the colonial era, the Land Ordinance of 1923 established a dual approach to land law. Among peasants and pastoralists land ownership was established through membership of a “native” community. These “customary” ownership rights had no legal protection through the colonial State (Tenga 1995) while the land rights of the new settlers, plantation owners and residents of urban areas were provided with legal protection, were controlled by statute and required documentary proof in the form of title deeds. But the state held ultimate ownership and control of all lands as well as the legal powers to alienate lands from peasants to new settlers, for instance on the basis that it was not in productive use under peasant ownership.

As outlined in section B.2, despite the coercive abilities of the colonial administration and native authority structures, it is clear that the colonial state was unable to bring about substantive change in land rights either in favour of settlers or of African capitalist farmers. This was particularly evidence in the aftermath of the Meru land case in 1952[i] where peasants and the fledgling nationalist movement successfully opposed a planned expropriation of peasant land for new settler farmers. Thus despite the *de jure* ownership of all land by the state, the power of the colonial government to effect larger scale expropriation of peasant land was limited by the growing organizational strength of the nationalist movement and its power base amongst rural peasants.

A further example is the resistance mounted by the nationalist movement through TANU towards the proposals for changing the land laws to permit individual freehold in 1958. While in Kenya nationalists campaigned for years for freehold rights, the nationalists in Tanzania resisted this late colonial policy. Such laws would have hastened rural differentiation and led to the emergence of a stratum of richer peasantry that the nationalist movement saw as unacceptable. Within the structure of the economy at that time, the number of richer African farmers who could have benefited from this law was extremely limited and it was perceived that the only group who would benefit from a capitalist land market were the European and Asian farmers at the expense of the non-capitalist peasants.

Thus, the problems constraining low transaction cost land markets in developing countries in general were more glaringly obvious in Tanzania at the time of independence, since here basic property rights in land were much less developed compared to the average developing country. After independence, land reform took on a new path with the policy of villagization. This involved the expropriation of large landowners and the distribution of land to village based co-operatives. A secondary objective was to create a settled village population in a context where this did not yet exist. Despite the fact that around 13 million people who had previously lived in scattered and often shifting settlements were relocated to ujamaa villages, the overall redistribution of land was relatively small and it was widely observed that richer peasants within the villages were able to acquire land that was intended for communal use.

Thus by the time of liberalization a process of land accumulation, often involving illegal transfers of rights to powerful constituents at the village level was already under way. The new land laws that were enacted in 1999 were intended to address the competing pressures generated by the emergence of land markets on one hand and security of tenure for small-scale peasant farmers on the other. The debate over the future direction of land reform in Tanzania continuous to this day. The Presidential Commission on Land Reform under Professor Shivji provided strong recommendations for providing greater security for peasant land rights at the village level while the approach of the Ministry of Lands and numerous consultants was to strengthen the rights of new investors in land (Shivji 1998).

These contradictory pressures led to the failure of the state to clearly define a land policy that would achieve equity while at the same time promoting efficiency by allowing new more productive forms of land ownership to emerge. Efficiency in landholding also requires creating a minimum size of farm where the new owners are big enough to leverage the capital required to achieve high quality and productivity to compete in an increasingly globalized world. Far from achieving these ends, the actual implementation of ‘land reform’ is not occurring under the clear guidance of the state but rather through the actions of private individuals engaging in illegal non-market transfers. These are clearly a variant of the primitive accumulation described in Part A. As we described earlier, there are good theoretical reasons to expect these land transfers at early stages of development to have a large non-market component. The real question for countries like Tanzania is whether these transfers are likely to lead to the eventual emergence of a productive agricultural sector or not.

Corruption is inevitably associated with the mediatory role that political entrepreneurs play in processes of non-market land transfers. If the underlying land transfers lead to the emergence of relatively productive users of land, the associated corruption would be of Type 3 (in Figure 1). But if the non-market transfers led to grabbing by speculators or individuals who had no ability or incentive to raise productivity, we would classify these as predatory transfers and the associated corruption would also be predatory (Type 4). More evidence on the changing patterns of land use is needed before we can reach a conclusion on the trends evolving in Tanzania. Our examination of the Tanzanian state does suggest, however, that the institutions of the state dealing with land allocation are relatively weak, opening up the possibility of unproductive and therefore predatory non-market transfers of land. As described in the previous section, local elite groups appear to be tapping into the fragmented factions of the CCM to use local political influence to acquire land potentially for speculation rather than for productive use (Gibbon 1995, 1996). This is exacerbated by the fact that the potential growth of tourism and natural resource extraction, including mining, encourages the speculative acquisition of land by political entrepreneurs and 'business' interests associated with them.

The policy debate in Tanzania has been influenced by de Soto's argument that if property rights, particularly for the poor, are strengthened, an efficient market will re-allocate assets to maximize growth. In Part A and in our TSP review (Khan 2005a) we discuss a number of general reasons why this is an unattainable goal for developing countries. Given the very low productivity of peasant agriculture in Tanzania, the resources required for defining these rights effectively are simply not there. As a result, the realistic prospects are for a continuation of weak land rights and for land markets to have high transaction costs in the near future. In addition to the general reasons, in Tanzania the basic structure even of peasant land rights do not yet even in a weakly defined way. The policy implication of this is to strengthen the capability of the Ministry of Lands and the Tanzania Investment Centre, which manages the Tanzania Land Bank, to define national priorities in land allocation and then to carry out non-market land allocations (land reforms) according to these national priorities. Such a strategy will directly have an impact on the corruption associated with primitive accumulation by making the non-market land transfers transparent and following national priorities. It will still leave open the issue of accommodating powerful political factions at the local level, but this requires a political strategy as suggested at the end of our last section on political corruption in Tanzania.

The political problem in achieving growth-enhancing land reform is to ensure that CCM, working with the Ministry of Lands can override local interests to allocate land in line with developmental goals. This would involve strengthening the non-market, and often-informal land allocation mechanisms to improve the capacity of state agencies to override local interests when they conflict with productive land use. The current process of land allocation in China provides a useful contrast to Tanzania's land allocation process. The Chinese example suggests that land use and allocation can be developmental even when land allocation is partly through non-market mechanisms (see the discussion of primitive accumulation in Part A) provided the state agencies have the institutional and political capacity to oversee and implement the allocation of land.

iv) Natural resource rents

The management of natural resource rents has become a crucial issue for Tanzania since liberalization as mining and tourism have become the fastest growing sectors of the economy. Tanzania is exceptionally well endowed with mineral resources and particularly gold, with the second largest gold reserves in Africa, after South Africa. Large-scale gold mining has a history in Tanzania dating back to the colonial period yet after independence large scale mining disappeared due to low world prices and the restrictions on investment by South African mining companies during the apartheid period. The rapid growth in mining under liberalization relates to the introduction of particularly favourable legislation to encourage foreign investment in mining. The initial legal changes in 1987 and in 1992 set royalties at 3% of income, the required government stake at 10% and set normal income tax levels. Yet while these changes attracted foreign companies, they initially had only a limited impact on investment. The foreign mining companies that initially entered Tanzania did not in general bring in large scale capital and instead focussed on extraction in older mines with new smaller scale technology and mining remained a predominantly artisanal activity with 76% of mining undertaken by artisanal miners.

The most significant increase in foreign direct investment into the mining sector occurred after the introduction of the new mining laws of 1998, which established the entitlement of private licence holders to use their mineral rights as collateral and to transfer mineral rights to banks or financial institutions without requiring ministerial approval or consent. This facilitated foreign financial institutions in acquiring mineral rights in Tanzania and led to a massive increase in investment into the mining sector, pushing Tanzania into the top three destinations for foreign direct investment in Africa.

Given the potential revenue that governments can earn by claiming their share of natural resource rents, this sector raises important questions of rent management capacity that are critical for accelerating economic development in countries like Tanzania. The most relevant rents the Government receives from the mining industry are in the form of royalties and corporate income tax. The 1998 Mining Act was extremely generous to investors, offering them a 3% royalty demand on gold (raised to 5% in the 2005/06 National Budget), 30% income tax and no additional profit tax as well as indefinite carry-forward of losses. Corporate income tax returns from the mining industry have been very low, mainly due to the generous concessions through capital deductions and additional capital allowances that have meant that companies are not currently liable for tax due to their recent heavy capital investments. The potential future tax resources that will be generated by the mining companies is uncertain as the significant concessions will allow foreign mining companies to avoid tax liability for a considerable period.

The weak capacity of the government to bargain for its share of Tanzania's natural resource rents explains why although mining is the fastest growing sector and accounts for around 60% of total exports from Tanzania, it contributes only 3% of GDP (Treichel 2005). There are clearly very strong incentives for politician and bureaucrats to engage in corruption in the allocation of mineral rights, though we did not come across documentary evidence of this. Since the allocation and taxation of mineral rights is a necessary state function, any corruption that compromised these functions would be state-constraining corruption (type 2 in the classification of Figure 1). Whether or not there is corruption in these state activities, weak state capacities are likely to lead to poor outcomes for countries like Tanzania in terms of extracting the best terms for a share of mineral rents. As we noted in Part A, if state capacities are strong and the regulatory agencies are able to identify the national interest, corruption would be a loss but would not upset the overall direction of natural resource policy. On the other hand, if state-constraining corruption was so severe that the allocation of licenses and the terms of allocation were significantly changed the result may be very damaging. This is particularly likely to happen in a context of weak state regulatory capacities, of factionalism within the state leading to short-term decision-making by factions in control of resource ministries. The policy response to this type of corruption and governance failure should be to strengthen state capacities to evaluate and pick the most efficient foreign investors and effectively impose productivity enhancing conditions upon them. The test of policy success would not necessarily be the absence of all corruption (which may be difficult to achieve in the short term) but rather the observation of an effective resource policy that allowed the government to extract a large share of natural resource rents for national development.

Donors are particularly concerned about the misuse of natural resource rents in developing countries and there is a considerable interest currently in international governance of multinational resource extraction companies. The hope is that if the limited transfers of royalties are made transparent African governments will be forced to use these for pro-poor redistribution. Such an expectation may be wrong for a number of reasons, not least that transparency alone does not confer effective power to the poor to claim these resources. Transparency could just as well result in more intense conflicts within intermediate class factions over resources rather than an allocation in favour of the poor. However, the problem for developing countries like Tanzania is even more serious, as they appear not to have states that can even ensure that a fair share of these natural resource rents revert to the country. In this context, economists like Amsden and Hikino (2005) have argued that African countries can learn a lot from the experience of OPEC and the state capacities that allowed oil-exporting countries to capture a fair share of the oil rents for redistribution within their own countries. Amsden and Hikino point out that while many OPEC countries can be criticized for not using their natural resource rents to accelerate sustainable industrialization, they were (with a few glaring exceptions) very effective in using natural resource rents to significantly reduce and in many cases remove poverty. African countries with natural resources should perhaps be looking to the more successful OPEC countries to learn how to form cartels and construct the institutional and political capacity to manage high levels of income from natural resource rents. This would not be very popular in the industrialized countries, but higher prices of many natural resources are an excellent way of conserving their use and promoting a shift to greener technologies in advanced countries as well.

It is important for development partners to plan for the fact that the scramble for natural resources is likely to intensify in the coming decades, with Chinese and eventually Indian resource companies entering Africa as major players and adding to the already great competitive pressures and political compromises involved in natural resource extraction. Realistically, the international governance of resource companies is unlikely to achieve significant results in this context. A rapid development of state capacities to use natural resource rents for national development is required in African countries like Tanzania if these resources are not to be squandered.

There is also evidence that the losses resulting from the weak regulation and rent-sharing imposed on mining companies are compounded by leakages at a lower level through extensive smuggling and tax evasion (Chachage 1995). These effects of corruption are quite different and this corruption is predatory (type 4) corruption. These types of corruption follow from the inability of the state to discipline its workers effectively. We discussed the appropriate policy responses to this type of governance failure in section B.3.i above.

v) Industrial Policy

Industrial policy has a poor reputation in Tanzania particularly as the ujamaa industrialization process, which led to the creation of the largest parastatal sector in Africa, was ineffective and costly. It is important to remember however that the industrialization efforts of the 1960s and 1970s led to a rapid accumulation of productive capacity some of which still survives following the extensive de-industrialization of the 1980s. The unsuccessful industrial policy in Tanzania was due not only to poor policy design and to the deliberate exclusion of the private sector for reasons specific to the African and particularly Tanzanian experience. The failures also had a lot to do with weak institutional and political capacities of the state to discipline firms and managers receiving rents to accelerate technological learning and development. The corruption that was involved in these processes was a serious variant of state-constraining corruption. Instead of abandoning all attempts at promoting industrial development, policy-makers in Tanzania should have learnt from that experience to use the private sector more extensively, even if it means assisting the emergence of a new black African capitalist class. In addition, the institutional and political weaknesses that prevented the state disciplining rent recipients during Nyerere's time (and even today as in the IPTL example discussed above) needs to be addressed. The Asian experience suggests that this can be achieved even in the context of patron-client politics and political corruption by creating a few ring-fenced institutions that can make allocations of resources that are critical for accelerating national development. Paradoxically, the weakness of the state in removing subsidies even affects the capacity of the state to carry out liberalization regardless of the potential of liberalization to achieve rapid development in Tanzania. Thus, even after committing to the liberalization programme under the auspices of the IMF in 1985, the parastatal sector continued to expand and direct subsidies to parastatals increased to 11% of total government expenditure during the late 1980s.

The new approach to industrial policy is to focus on market-constraining (Type 1) corruption and to attempt to reduce market-constraining state interventions with the intention of unleashing market-led investment and growth. It has been argued that Tanzania's regulatory framework is one of the most extensive, time-consuming to work around and least transparent in Africa (URT, 2003). Since liberalization there has been a significant scaling down of government involvement in industrialization, mainly with the withdrawal of government from the financial system, extensive privatization of parastatals as well as a reduction and rationalization of the tax system for the private sector.

These reforms have seen a return to industrial growth after 1995 driven by a number of privatized firms in the food and beverages sector as well as by cement, steel and tobacco. But other privatized industries including chemicals, petroleum, rubber, plastics, paper and wood products have demonstrated negative growth, with weak growth in textiles and garments. It is important to note here that the privatized manufacturing firms that have done well have a large domestic market and a relatively low scale of technology in production. Tanzania has done relatively very poorly in exports where quality and productivity are more important, performing relatively poorly even in low technology export industries like garments. The problem of efficient technology acquisition and technological learning for manufacturing has received a much lower priority in the market-led growth strategy. The technological support institutions such as the Small Scale Industries Development Organization, the Tanzania Industrial Research and Development Organization (TIRDO) and the Tanzania Bureau of Standards (TBS) still exist but their performance has always been weak and there has not been sufficient investment or co-ordination to promote their effectiveness. The failure to learn how Asian countries used national agencies to attract high productivity foreign technologies and create incentives for local producers to start using these technologies remains a big gap in Tanzania's new economic strategy.

As in most developing countries, trade policy has become the central focus of industrialization. Liberal economic theory argues that rents hamper exports. For instance, rents for selling in domestic markets created by tariffs create disincentives to export. Even targeted and specific incentives for exporters such as targeted infrastructure or technology licensing strategies can featherbed inefficiency. But in fact, the benchmark level playing field that these economic theories assume does not exist. Every country including the most advanced has complex national systems of subsidies and support for producers ranging from public education systems, health systems and infrastructure that developing countries cannot replicate. By definition, any attempt to compete with more advanced countries will involve targeted assistance because developing countries do not have the public resources to achieve education, health and infrastructure provision at a high level through non-targeted approaches. Apart from that there are specific problems to do with learning new technologies that we have briefly discussed earlier in our discussion of state-constraining corruption (see also Khan 2000a). The real problem why many developing countries have fared very poorly with catching-up strategies is not that the strategies were irrational and irrelevant but rather because they lacked the institutional and political conditions for managing these rents. For example, the duty draw-back scheme in Tanzania is designed to encourage export promotion through refund of import taxes on imported inputs that go towards production for exports. However the scheme is hardly operational as there is lack of capacity for timely technical verification on the value of inputs consumed by exports resulting in delays in effecting duty refunds (URT 2003). No doubt, there is corruption associated with its implementation as well. The failure of this scheme can be used as an argument to get rid of it. However, that will not necessarily achieve faster export growth. The conclusion we would draw is to spend a small amount of time and resources in improving the capacity of the public institutions to implement the strategy (or to design an alternative strategy that is cheaper to implement).

Another example from contemporary Tanzania is the Export Processing Zone established in 2001 that has the aim of providing subsidized infrastructure for export-oriented manufacturing firms. By 2004 only 35% of the space had been rented (URT 2004) and significant problems of effective service delivery from the utilities have hampered further expansion (personal communication 2005). The performance of the firms located within the EPZ has also been disappointing (Financial Times 2005) and one of the most successful companies exporting under AGOA from the EPZ, Star Apparels, closed in 2005 apparently due to an inability to abide by its contractual obligations (Tancotton 2005). We do not see in this experience a justification for closing down the EPZ but rather to strengthen institutional and political structures to provide targeted infrastructure and utilities more efficiently. Success in these types of industrial policy clearly depends on tackling the type of political fragmentation and damaging political corruption that resulted in Tanzania achieving one of the highest electricity tariffs in Africa.

While a shift to a full-fledged Asian style of industrial policy in Tanzania is unrealistic, the establishment of the EPZ as well as the adoption of a Mini-Tiger Plan in December 2004 to promote a more active industrialization are significant steps in the right direction. Donor policy needs to concentrate on how to support these initiatives and improve rent management capacities, starting in relatively uncontroversial areas such as agricultural extension, developing effective EPZs and technology licensing for moving up the value added chain. In doing these, the priority is to address state-constraining corruption in critical agencies that will need to be developed, keeping in mind the danger of not attempting to deal with state-constraining corruption by closing down much of the state.

Appendix 1: List of Interviewees/Discussants Tanzania

Barkan, Joel	Political Scientist, University of Iowa
Bwana, Justice Stephen	Head, Commercial Court
Morin, Denyse	Senior Public Sector Adviser, Tanzania and Uganda, World Bank
Mueller, Helga	Head, Public Sector Group, Africa Region, World Bank
Mukandala, Prof. Rwekaza	Professor, Political Science, University of Dar es Salaam
Okoh, Kwasi	Managing Director, Unilever Tanzania
Titsworth, Jack	Governance Adviser, DFID
Kobb, Dan	M & E Adviser, President’s Office Public Service Management
Mushi, Richard	Professor of Business, UDsm
Rajani, Rakesh	Head, HakiElimu
Rutashobya, Lettice	Professor of Business, UDsm
Sundet, Geir	Political Scientist, REPOA
Titsworth, Jack	Governance Adviser, DFID
Wangwe, Sam	Public Service Reform – check
Mmuya, Max	Professor, Political Science, University of Dar es Salaam
Tax, Stergomena	Head, BEST Programme, Presidents Office Planning and Privatization
Mr Keruzi	Head of Research, Tanzania Investment Centre
Mayaya, Robert	Head of Good Governance Coordination Unit, Presidents Office
Shivji, Issa	Professor, Faculty of Law, University of Dar es Salaam

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[i] The previous policy of the British had been to settle new white farmers on land which had belonged to Germans, avoiding some of the contentions over Tanganyika's trust status and reducing direct conflict with African farmers (Coulson; 1979). The farmers threatened with dispossession organized themselves into the Meru Citizens Union to fight evictions. Through fundraising efforts and organizational support of the African Association (the predecessor to TANU) the Union lobbied the visiting mission of the Trusteeship Committee before the evictions actually took place and they sent representation to the Trusteeship Committee in New York. The issue was taken to the Security Council in 1952 and the British agreed to change their policy, causing the British to adopt a cautious non-confrontational approach with regards to expropriation of land until the end of the colonial period.