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7

Cape Verde and Mozambique as Development Successes in West and Southern Africa

Jorge Braga de Macedo and Luís Brites Pereira

7.1 Introduction

The global financial crisis turned the risk of excluding African economies from globalization into the certainty that poverty would worsen in most of them. Prior to this crisis, however, Africa accompanied the trend of sustained growth evidenced by emerging economies. Primarily due to the implementation of adequate structural and macroeconomic policies, growth was the strongest in decades (African Economic Outlook [AEO], various issues; World Bank 2009). In sub-Saharan Africa, growth in the gross domestic product (GDP) increased from an average of 3.5 percent in 2000 to 5.7 percent by 2005 and Burkina Faso, Ethiopia, Mali, Mozambique, Tanzania, and Uganda, none of which is a major primary commodity producer, were able to post annual growth rates of over 5 percent in recent years (United Nations 2008).

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Indeed, the expansion, diversification, and deepening of trade and financial links between countries over several decades presented an unparalleled opportunity for some to raise their living standards and achieve the millennium development goals (MDG). Notwithstanding Africa's improved economic situation, absolute poverty was still widespread when unprecedented energy and food-price volatility brought worldwide expansion to a halt. Amid dire global economic prospects, growth-enhancing policies needed to be assessed against progress on MDG, including the global partnership on development and prospects for international cooperation.

The evidence suggests that development success under globalization is less a question of relative resource endowments or geographical location than in past waves of globalization. Market perception of the orientation and predictability of national economic policies, and the accompanying institutional arrangements, have proved to be decisive everywhere. The Asian crises of the mid-1990s showed that economic openness must be accompanied by good public- and private-sector governance in order for countries to take full advantage of globalization. Examples of the former include sound macroeconomic policies, unfailing transparency, stable and rational incentive frameworks, and robust financial systems coupled with effective supervisory and regulatory mechanisms.

Severe regulatory failures in developed countries, uncovered by the global crisis, confirmed that there is no universally applicable development model. Adequate governance responses to globalization thus become all the more important as globalization reduces national policy space and increases institutional and economic interdependence at various levels. At the same time, a more integrated global economic context necessarily demands greater policy and institutional coherence, as well the knowledge required to implement the associated reforms and monitor them through effective peer-review mechanisms.

To be sure, even among the highly integrated economies of the Eurozone, neither coherence nor knowledge were able to respond to the challenge posed by the global crisis. Nevertheless, regional economic cooperation remains a valid intermediate step toward the integration of developing countries into the world economy.[1] In addition to benefiting from regional economies of scale, their participation in reform programs within regional organizations also facilitates domestic authorities' work when implementing politically difficult measures. In the wake of the entry into force of the Lisbon treaty, the diverse perspectives of the twenty-seven European Union (EU) member states have at last found an institutional framework. Even though the financial challenges remain daunting for several highly indebted member states,

1. The implications of the financial crisis for international governance innovation and for the peer-review mechanism of the IMF for the G20 are contrasted with the Letter to Queen Elizabeth sent by the British Academy in Macedo (2011, 144, note 35; 2015).

especially those inside the Eurozone, alternatives to cooperative responses consistent with regional integration have not been found. Indeed, the success of the EU attests to the advantages among like-minded countries, where a combination of cultural proximity and mutual knowledge facilitated the deepening of the integration process from a free trade area to a single currency and the widening from the original six members through successive enlargements.

With respect to Africa, regional surveillance and peer pressure between the various partners have been set up and implemented over the last eight years: the African Peer Review Mechanism has involved thirty countries of which twelve have been examined.[2] Broader regional surveillance may help reduce the risks of macroeconomic slippage, resulting in a more stable, predictable environment—an essential factor for the private sector to flourish. Among French-speaking countries in West and central Africa (so-called CFA), particularly those pegged to the euro, surveillance has been a driving force of economic policy coordination and integration, even though in the 1980s enforcing the stability of the nominal exchange rate against the French franc led to unstable real effective exchange rates. The monetary allocation mechanism managed by the French Treasury kept the parity between the French franc and the CFA from 1948 until the devaluation of the latter in 1994, which led to a real depreciation in most members of the West African Monetary Union.[3] Their long experience with a monetary policy conducted by a strong institution that must preserve its independence vis-à-vis national governments has accustomed these countries to yielding some of their economic policy matters to a regional organization. In comparison to CFA-common institutions, those in the Economic Community of West African States ([ECOWAS], which includes Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, and Togo), and the Southern African Development Community ([SADC], which includes Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe) have not yet been effective constituencies for reform. If the ECOWAS and SADC secretariats (in Abuja, Nigeria, and Gabarone, Botswana, respectively) were to cooperate with the Commission

2. Macedo (2010) describes the implications of the crisis for international governance innovation and analyzes the peer-review mechanism of the IMF for the G20 drawing on Niels Thygesen's label on peer pressure by proxy at IMF and by commitment at EU. See also Macedo (2008). Five were examined from July 2002 to 2007, four in 2008, and AEO (2009, 75) expected six, but only three (including Mozambique) were carried out in 2009 (AEO 2010, 72) plus Mauritius in the 13th Forum in Kampala in late July. The effectiveness of mutual control devices reflects the extent to which cooperation overcomes collective action barriers and clears the ground for coherent reforms (Kanbur 2004).

3. Macedo (1986, 358) discusses the paradox of nominal stability and real instability in CFA countries.

for the African Union, or the local offices of global organizations such as the United Nations, the International Monetary Fund, and the World Bank, better interaction between globalization and governance would probably follow. With peer pressure, better information on the fifteen partners in each one of the subregions and beyond would probably be available, facilitating business development and a more active role for civil society.[4]

The idea of producing usable information from within a cooperative framework is what we mean by "mutual knowledge," a term used in a declaration on MDG approved at the 2006 summit of the Community of Portuguese-Speaking Countries (CPLP) held in Bissau.[5] Mutual knowledge is generally more limited and the data harder to compare outside of the Organisation for Economic Co-operation and Development (OECD), so that cooperation at the regional, subregional, and international levels may neither produce knowledge of effective policies or institutions nor create conditions for their implementation. In fact context adjusted, but also widely usable knowledge, only results from identifying an appropriate constituency for each set of related problems and challenges. Reaching the MDG in 2015, for example, presupposed sustained pro-poor economic growth in addition to better governance and more aid, but there were no immediately available recipes on how to bring about a positive interaction between globalization and governance.[6] In other words, alternatives to both the "one size fit all" and "each case is unique" development approaches are urgently needed in a context that cannot draw upon existing experiences of institutional cooperation that foster mutual trust and generate mutual knowledge. Under these circumstances, the quest for African development successes remains a policy as well as a research priority, especially acute in sub-Saharan Africa. In a nutshell, what is at stake for many African countries is how to ensure that current policy and institutional arrangements in the spheres of trade, finance, debt, investment, and technology mutually

4. Some of the group averages below exclude Nigeria and South Africa because their GDP weight is too large. The CPLP and NAFTA both have 1.4 members equivalent. See note 19 below.

5. Aside from five African countries (Angola, Cape Verde, Guinea-Bissau, Mozambique, and São Tomé e Príncipe), Brazil and Portugal are founding members, Timor Leste joined in 2001 and Equatorial Guinea in 2014, while Georgia, Japan, Mauritius, Senegal, and Turkey are associate members of CPLP (Macedo 2015). Macedo (2008) draws on a 2003 report for the OECD secretary general, using labels suggested by Niels Thygesen at an OECD Development Center seminar, such as peer pressure by proxy at IMF and by commitment at EU. Other useful references to work carried out along with the AEO report (produced since 2001) are in OECD (2003) and IICT (2007), the first comparative report on the 2006 Bissau declaration.

6. Bourguignon et al. (2008) underline the heterogeneity of country outcomes and the difficulty in finding patterns, even in fragile states. This heterogeneity is no surprise: to "develop a global partnership for development," the eighth MDG goal, reflects disappointment with the performance of developing countries that seemed to follow the policy recommendations of the "Washington consensus" during the 1990s. As governance improvements were not commensurate with the challenges of globalization, especially in what concerns financial markets, these countries faced recurrent financial crises that interrupted the long-term convergence process.

reinforce each other in support of equitable, rapid, and sustainable growth and development.

Against this background, we assess the extent to which Cape Verde and Mozambique may represent development successes in West and southern Africa. Specifically, we seek to identify lessons for successful governance based on meaningful regional comparisons of Cape Verde and Mozambique's development experience. These lessons will also be drawn from the study of the complementarity of economic policies and accompanying institutional arrangements bearing on trade, finance, and competitiveness. We realize the limitations that lack of data impose on this ambitious agenda but, in our view, identifying such lessons necessarily entails a broader scope of analysis than is usual. Moreover, by analyzing these countries in comparison with their neighbors we may also contribute toward greater mutual knowledge on economic development issues within CPLP and especially among the five Portuguese-Speaking African Countries (PALOP).

The emphasis on identifying the linkages between cultural, institutional, and economic factors that fostered growth and development remains in this chapter, organized as follows: Our interpretative framework, detailed in section 7.2, focuses on the interaction between globalization and governance, which may be positive or negative depending on the policies and accompanying institutional arrangements. Specifically, we hold that economic success under globalization entails, necessarily but not exclusively, positive market perceptions regarding outcomes such as export diversification and narrowing of the income gap with respect to the frontier. Success thus defined must, in turn, be underpinned by good governance and the freedoms that citizens and residents enjoy, which section 7.2 also discusses. Section 7.3, meanwhile, provides a historical and geographical perspective on Africa with comparisons in the subregion as well as PALOP. Section 7.4 estimates the factors that determine export diversification, measured by the number-equivalent Herfindahl index, and income-growth strategies in comparison to subregional averages. Section 7.5 offers a narrative of long-term development in Cape Verde and Mozambique with respect to foreign trade and economic growth and macroeconomic policy and financial reputation. Once again, policy and institutional reforms provide context for good governance indicators and progress toward the MDG in a separate subsection. The concluding section, 7.6, raises the issue of whether cooperative governance and peer-review mechanisms are capable of sustaining African development successes when due account is taken of the diversity of experiences evident from ECOWAS, SADC, and PALOP.

7.2 Interpreting How Globalization and Governance Interact with Convergence

Policy and institutional responses must necessarily change as the nature of globalization itself changes. Indeed, different waves of globalization

Table 7.1 **Range of variable**

Political rights and civil liberties	Economic freedom
7 = maximum political rights	10 = maximum economic freedom
1 = minimum political rights	0 = minimum economic freedom

(fifteenth, nineteenth, and twentieth centuries, including the past decade) have interacted with different forms of governance responses. The interaction of globalization and governance is always context specific, as defined by space (geography) and time (history). In the wave since the 1990s, the context is captured by convergence, often measured as the gap in per capita income relative to the frontier, and by democracy, often measured in terms of electoral competition and political participation, but best understood by its constituent political and economic elements.[7] To enhance the quality of the democracy measure, we look at the index of political rights and of civil liberties published by Freedom House and at the indexes of economic freedom published by the Fraser Institute and the Heritage Foundation. The Freedom House Index defines democracy as a concept with attributes of political rights and civil liberties. Political rights include the right to vote, fair and free competition for the office, the presence of multiple parties, and decentralized political power. Civil liberties refer to the existence of a free press, open public discussion, and freedom of speech and assembly. The indices are ranked in table 7.1.

Since political rights and civil liberties are highly correlated, we replace them with the average of both (labeled *prcl* in appendix A). This composite indicator performed better in estimation and, in addition, it also had the advantage of being interpretable as an index of political freedom, given that it captures its two main constituent components. We also note that these measures must be used and interpreted with caution due to well-known issues, most of which derive from the process of index construction itself, as pointed out by Oman and Arndt (2006) and Luiz (2009), and that Fedderke, de Kadt, and Luiz (2001) applied an improved method to South Africa. Below we draw on Luiz, Pereira, and Oliveira (2013), which have computed indexes of political and economic governance for Mozambique over the last 100 years.

These caveats should be borne in mind when reading some of our results. Countries are rated according to two seven-point scales, with 1 being the highest score for both scales. The sum of the points obtained in the scales

7. Przeworski et al. (2000) and Garoupa and Tavares (2009) show that higher income increases the survivability of democracy, but they label a country as democratic if its governments are designated through elections in which more than one party competes and the winning party is not always the same. Persson and Tabellini (2006) introduce quality considerations through the concept of democratic capital. The age of democracy is labeled *demage* below.

classifies the country as free (2–5), partly free (6–10), or not free (11–14). The Freedom House Index dates from 1995 and includes data on ten components: business freedom, trade freedom, fiscal freedom, government spending, monetary freedom, investment freedom, financial freedom, property rights, freedom from corruption, and labor freedom. Each component is measured by various indicators and is assigned a grade in a scale of 0 to 100. The ten component scores are then averaged to give an overall economic freedom score for each country. Although the definition of economic freedom is quite vague, and consequently measuring it lacks some precision, the index gains relevance worldwide as several studies reveal that there is an important relationship between economic freedom and positive social and economic values such as per capita income, economic growth rates, human development, democracy, the elimination of poverty, and environmental protection. Political rights are associated with free and fair elections for the executive and legislative branches of power, freedom to constitute political parties, freedom of association, independence from political, religion, and military authorities, real possibilities of the change of power, and other related aspects of the political system. Key elements of civil liberties include freedom of thought, religion, association, free press, and respect for the rights of minorities. The concept of economic freedom is more difficult to define as it may relate only to private ownership, prices being determined by market forces, de jure and de facto entry and exit, efficient rule of law, and official economic regulation guaranteeing competition or also include the financial freedom brought about by currency convertibility, stability of money value, central bank independence, and deep financial markets. Furthermore, the widely used indexes include low taxes, a small share of government spending in GDP, and flexible labor markets, and this appears to some as too extensive a definition of economic freedom. Once again the Luiz, Pereira, and Oliveira (2013) index for Mozambique avoids some of these pitfalls by distinguishing carefully between the rules of the game and their outcomes.

Macedo (2001) reports that trade openness reduces perceived corruption, even after correcting for its endogeneity, and claims that this is the way in which globalization improves governance, given highly significant historical control variables (e.g., Protestant tradition, de facto democracy, and OECD membership). Eichengreen and Leblang (2006) find a two-way interaction between democracy and globalization over the entire 1870–2000 period, distinguishing trade from financial openness but measuring democracy as a dichotomous variable. By introducing the extension of suffrage, for example, a negative interaction between democracy and debt default has been found for the period of the classical gold standard, with a more than proportional effect in capital-poor countries. At the time, parliamentary democracies were seen as sources of financial stability, to the extent that the checks and controls on the sovereign implied a greater ability to

tax.[8] This contradicts the widespread view that the repression of democracy facilitated the operation of the pre-1914 international monetary system by making external adjustment easier during the second wave of globalization. Over the period 1970–2004, the different types of freedom interact differently with the trade and financial globalization variables, and the interaction becomes more sensitive to regional context and to stages of national economic and institutional development.[9] Overall, allowing for the quality of democracy lowers the overall effect of globalization on democracy. One reason for this is the hypothesis that globalization's effects on democracy are mediated by slow-moving cultural values, which may, in turn, be associated with weaker constituencies for policy reform. This would imply that such variables might be accounted for by selecting groups of like-minded countries, like the OECD, for which the effect of globalization on freedoms would be stronger, but this would neglect the convergence dimension, more visible on a global scale. Eichengreen and Leblang (2006) also use a measure, "Age of Democracy" (labeled *demage* in appendix A), which counts for each country *i* at time *t* the number of uninterrupted years up to time *t* that country *i* has been democratic, that is, it measures the length of time a country has been a democracy, which is used in section 7.4. In addition, we employ data from the Political Regime Characteristics and Transitions (POLITY) project, which codes countries' level of democracy as a function of institutional rules.[10] This project is also the source of information on constitutional age. The POLITY project defines constitutional change as occurring either when there is a political transition or when the absolute value of the score changes by at least three points. This allows for constitutional changes in both democracies and dictatorships.

Given these measures, the mutual relationship between globalization, governance, and economic performance can be described along the following lines: a nation's resource endowments and its productivity determine how fast it can grow and the level of its economic well-being in terms of income per capita, both in absolute terms and relative to the income frontier. Feedbacks are possible: a richer country growing fast may invest more resources in scientific research and technology development and thus enjoy higher productivity levels than a poorer, slow-growing economy. Through trade, capital flows, or migration, globalization can influence the level of endowments available in an economy, or even, through international technology transfers, its productivity. Conversely a country's endowments of natural resources, labor, and capital, as well as its geographic location and efficiency of its production structures may determine how much it trades

8. Flandreau and Zummer (2004, 44) report an elasticity of 0.5 for the whole sample and of 1.3 for capital-poor countries.

9. Section 7.4 tests this result (reported in IICT 2007) on ECOWAS and SADC in the form of the diversification-convergence interaction.

10. See http://www.systemicpeace.org/polity/polity4.htm.

with the rest of the world in terms of goods, services, and assets. Similarly, a country with good governance, namely a democratic state with high-quality institutions, effective corruption-free accountable bureaucracies, and a flourishing civil society may likely increase the quality, if not the quantity, of its most important endowment: its own people. Once more, cause and effect can be swapped: well-endowed countries may evolve toward democratic forms of government more easily, or, at least, they may afford investing more resources to build well-functioning institutions.[11]

While these interactions have been at the core of economics, this has not been the case of the issue addressed in this section (how globalization and governance interact with convergence), perhaps because of the interdisciplinary nature of globalization waves and of governance innovation—even when the distance to frontier is not as fundamental as it is for Africa. With respect to the relative strengths of the links between the current wave of globalization, the benchmark measure of freedoms and convergence, the empirical findings of Macedo, Martins, and Pereira (2013) reveal that political rights and civil liberties had a significant impact in the run-up to the third wave of globalization, while feedbacks were somewhat weaker. As mentioned, further work is needed to understand the long-run dynamics and sustainability of this global system, in particular the mechanisms that could enforce or reinforce the expected positive effect of globalization on both convergence and freedoms. The particular interaction that involves democracy reflects historical, geographical, social, cultural, institutional, and economic factors and the method employed focuses on the economic aspect of this relationship. A complementary explanation of the interaction between globalization and governance can be based on the manner in which diversity, be it sociocultural or economic, is addressed by a given society.[12] This is taken up in the next section, with specific reference to the historical roots of CPLP in the first wave of globalization, associated with the Iberian maritime explorations of the fifteenth century.

The available empirical evidence regarding the relationship between economic growth and political regime is weak or inconclusive, as discussed in Kohli (1986), Remmer (1990), and Przeworski and Limongi (1993). In the case of Africa, it is not possible to establish a clear link between political regime and economic growth according to Young (1998), among others. However, the poor economic performance of many of its authoritarian

11. Bonaglia, Macedo, and Bussolo (2009). Transport technology also changes costs, sometimes dramatically, making them very different from distance, as documented by Feyrer (2009).

12. Indeed, one of the constants of human organization is the "absolute certainty that man will never be common, he will always de different, he will always give rise to diversity. And society, by managing this diversity, will manage prosperity and the creation of wealth" (Macedo 1996, 194). The same holds true, of course, for the case of political diversity and whether peace or conflict ensues. The distinct processes of colonization of the Americas is chosen to illustrate the importance of diversity and how it is managed as being a crucial determinant of the interaction between economic and political organization in Macedo et al. (2013).

regimes during the 1980s suggests that these failed to promote economic growth. Indeed, Maravall (1995) notes that "a strong case can be made that economic reforms are more likely to succeed in a democratic political context. Political pluralism generates more and better information to use in economic decision making; moreover, democratic institutions may reduce the transaction costs of economic reforms, as well as restrict predation of public resources." Looking at the Economic Freedom Index in sub-Saharan Africa, we see that it is not only the poorest but also the most economically repressed world region: no country belongs in the group of economically free countries, seven are listed in the mostly free group, twenty-eight in the mostly not free, and seven in the repressed group. More worrisomely, in the region, a decline in economic freedom is evident. Factors like corruption, excessive market regulation, or the size of the black market are among the reasons for such a poor result. Using the variables listed in appendix A, results presented in section 7.4 suggest that, in both West and southern Africa, economic convergence increases with political and economic freedom. Even though it warrants further investigation, the focus on the management of diversity as a determinant of positive interactions between globalization and governance pertaining to policy and institutional reform, is especially necessary in connection with Africa. In this case, the knowledge thereabout is certainly less "mutual" than with respect to other regions, even outside of the OECD.

7.3 History and Geography

7.3.1 World Regions

Three "regions" (North America, EU, ASEAN + China, Korea, Japan) each account for one-fourth of world GDP. Africa is in the "rest of the world," which includes over one-half of world population, with other significant actors (Brazil, Russia, India) and salient regions (Middle East). Taking a global view should foster governance innovation, as dominant players have different strengths (Nye 2002). Yet free-rider problems prevent cooperation among abstract regions, especially those where there are no peer-review mechanisms, let alone a culture of cross-cutting intergovernmental cooperation, as seemed to be the case in the rest of the world's significant actors and even in China, certainly before the creation of the Group of 20 (Macedo 2011). In addition, around seventy "fragile states," most of which are located in Africa, are very specific in their fragility (Bourguignon et al. 2008).

Looking at the rest of the world, the share of world GDP accounted for by Africa plus South America combined doubled from 1820 to 1950. The share remained constant at around 10 percent with North America and EU roughly equal to Asia (including Japan, Russia, and Turkey), shares that are comparable to those prevailing in 1820. In 1950, however, North America and the EU accounted for 60 percent and Asia for 30 percent. In terms of

Table 7.2 Statistics capacity index

Angola	34
Cape Verde	63
Egypt	83
Ethiopia	78
Guinea Bissau	39
Mauritius	74
Mozambique	62
São Tomé e Príncipe	55
South Africa	78
Tunisia	71

Source: AEO (2010, 47).

population, Africa and South America combined have more than doubled their combined world share from 10 percent in 1820 to 15 percent in 1950 to 22 percent in 2003, while Asia has dropped from three-fourths to one-half and then rose again to two-thirds. In terms of GDP per capita, the relative shares are one-half for Africa and South America combined and over two-thirds for Asia.

As emphasized in AEO (2010, box 2.2), strengthening the capacity of the national statistical systems is required for a results-based management framework, which in turn helps regional integration processes based on peer review.[13] The partnership known as PARIS21, hosted by the OECD, has been in operation since 1999 and on its tenth anniversary produced the Dakar Declaration on the Development of Statistics.[14] Table 7.2 presents a statistical capacity indicator of the five highest-ranking countries and the five PALOP, noting that only three of the former are in sub-Saharan Africa. Indeed, the data drawn from the impressive database of the late Angus Maddison underscores this lack of knowledge. In year 1 there are only estimates of GDP for the five North African countries (Algeria, Egypt, Libya, Morocco, and Tunisia), estimates of GDP for Ghana and South Africa begin in 1820, and for the remaining sub-Saharan African countries in 1950. The share of Africa in world GDP falls from over 4 percent to under 3 percent in 1000, 1 percent in 1500, and around .8 percent until 1820, when it begins to rise to about 1.2 percent in 1913. In 1950, when estimates for thirty-four new countries become available, the Africa share reaches under 4 percent

13. This objective also comprised part of the "capacity building" initiatives in Africa undertaken by the World Bank during the 1990s. These entailed promoting technical expertise and data base construction, for example, population census and socioeconomic surveys.

14. One year before, the *Lisbon Declaration on Science for Global Development* prepared by Jean-Pierre Contzen, adviser to the late Mariano Gago, then minister for science and technology, called for indicators from CGIAR (where IICT represented Portugal) and other organizations in the UN system. Papers presented then include Giovaninni et al. (2008) on statistics and good governance and Macedo (2008) on CPLP, drawing on IICT (2007) and work at OECD in note 5 above.

again, while sub-Saharan Africa remains just under 3 percent. Since then both shares have declined about 1 percentage point of world GDP. As for the share of SSA in Africa, it rose from around 20 percent to 34 percent in 1913 and more than doubled to three-fourths in 1950. Thereafter the sub-Saharan share of Africa GDP declined by more than 10 percentage points, but West (= ECOWAS) and southern (= SADC) shares in sub-Saharan Africa remain at 40 percent and 30 percent, respectively. The increase in population has been such that the relative stability in the share of world GDP implies a decline in GDP per capita of about 20 percentage points, from 42 percent of world GDP per capita in 1950 to 24 percent in 2003. The corresponding figure for sub-Saharan Africa is 18 percent, forecast by the International Monetary Fund (IMF) to rise to 21 percent in 2013.

The views of "development as self-discovery" (Hausman and Rodrik 2003) and the "ladder of competitiveness" (Causa and Cohen 2006) suggest measures of competitiveness that go beyond relative unit labor costs (Branson, Macedo, and Richardson 1987) and other refinements to the country narratives are presented below. The main point, once again, is that diversity must be taken into account. While the impressive database used in Maddison (2007) has been criticized, it allows a "millennial" perspective on world regions and helps to avoid the pitfalls of a purely geographic approach.[15] Regions may be historical rather than geographical, and interaction during the first wave of globalization and even the second did not involve nearly as many players as the current one. The complementarity between globalization and regional integration and the development paradigm based on mutual accountability first contained in the 2002 Monterrey declaration on MDG both suggest that in Africa interaction between globalization and governance has been weak. At the same time, there is evidence that complementary reforms are not a "luxury" for developing countries (Macedo et al. 2014).

7.3.2 Africa and Portuguese-Speaking Countries

The Common Historical Legacy

The combination of Africa and South America is more obvious when the Atlantic side is considered. In effect, Mozambique was ruled from Goa in India during the first wave of globalization and the influence remained after the forced union with the Spanish Crown (1580–1640), but India suffered the competition from Brazil during the 1700s.

Contrary to what is sometimes believed, there was a fair amount of decen-

15. Maddison (2001, 71–75) acknowledges the specificity of the Portuguese empire. Amaral (2009) revisits the Portuguese transition to democracy during the second wave of globalization. Macedo and Pereira (2007) were inspired to study the diversity of Portugal's and Portuguese-speaking countries' responses to globalization by drawing on the concept of "diferencialidade" due to Borges de Macedo and discussed in Macedo et al. (2009).

tralization in the Portuguese empire even before the departure of the Crown Regent to Brazil in the wake of the first Napoleonic invasion in 1807 that essentially moved the capital to the New World (Maxwell 2004). The Crown remained in Rio de Janeiro after the congress of Vienna and the liberal revolution of the 1820s. Brazil remained an empire until 1890 and was therefore the sole monarchy in the Americas during most of the nineteenth century. On the other side, the dispute between the two sons of the Regent led to the sole civil war in Portugal's history, which lasted from the independence of Brazil in the early 1820s until the defeat of the absolutist brother Miguel in 1834. In spite of a successful stabilization in the 1850s when it joined the gold standard, Portugal suffered from the 1890 crisis and the currency became inconvertible until 1992 (Macedo, Eichengreen, and Reis 1996). The transition of Brazil from empire to republic coincided with the financial crisis and the first default quickly followed the one of Portugal.

Similarly, the successive revolutions in 1910, 1918, 1926, and 1974 influenced the independence of the former African colonies, together with their own very diverse initial experiences with political and economic freedom. For example, the presumption that political freedom is incompatible with financial freedom instead of complementary damages financial reputations considerably because when political rights decrease the capacity to tax, countries become serial defaulters; but, Reinhart and Rogoff (2009) show that they are also capable of graduating.[16] More recently, the experience of Portugal with IMF adjustment programs may also be relevant to understand how countries like Cape Verde and Mozambique recovered their financial reputations.[17]

Our motivation for studying these countries reflects previous attempts to contribute toward greater mutual knowledge within the CPLP with respect to the MDG (IICT 2007; Macedo 2008). Indeed, the Declaration on MDG in CPLP (approved at the 2006 Bissau summit mentioned in the introduction) sees cooperative governance as capable of producing "mutual knowledge" among the eight member states based on the fact that the standards of appropriateness regarding policy and institutional reform may be less responsive to geography than to historical affinities. In spite of their geographical discontinuity, five Portuguese-speaking African countries formed the PALOP group in 1979, and held ten summits until 1992, when they signed the first Regional Indicative Program with the EU. With Timor-Leste

16. Tables 6.1–2, 4–6, 86–99, record one bankruptcy in Portugal from 1300 until 1812 (against seven in Spain and nine in France), and six are recorded until 1890 (against seven in Spain and zero in France and Brazil). Thus the share of years in default since independence or 1800 is similar in Brazil and Spain (table 10.2, 149), while France stands out for the share in a banking crisis.

17. Bliss and Macedo (1990) and Macedo (2009). Using Reinhart and Rogoff (2009) again, the change from 1979 to 2008 in the credit rating from *Institutional Investor* (table 17.2, 285) is 19 points in Spain and Greece, but 33 in Portugal, reaching 90, 85, and 81, respectively, in 2008 (table 17.2, 285).

joining in 2001, there are now six ACP Portuguese-speaking countries cooperating under the 10th European Development Fund. They signed a Memorandum of Understanding with the European Commission on the eve of the second Europe-Africa summit in late 2007, which extended to CPLP. Future activities, integrated into a multicountry approach, focus on democratic governance as a key determinant for poverty reduction.[18]

Moreover, it is widely recognized within the development community that both countries are actively seeking to overcome adverse developmental conditions, either due to geography (Cape Verde is a small island state devoid of natural resources) or history (Mozambique fought a protracted civil war following independence). Cape Verde, for example, signed a five-year contract in 2005 with the Millennium Challenge Corporation even though it was above the income per capita ceiling that determined eligibility. This was largely seen as an incentive for the country to continue its efforts on the development front. As expected, graduation to middle-income status occurred in late 2007 and, at the suggestion of Luxemburg and Portugal, Cape Verde also signed a special partnership with the EU. Mozambique, meanwhile, was eligible for the Millennium Challenge Corporation since its inception in 2004.

Given Africa's diversity, then, assessing development successes requires comparisons among partners in subregional organizations that include members with different cultural, historical, and strategic affinities. The ECOWAS was established in 1975 and SADC in 1980, and each now includes the fifteen countries listed above. The experience of Cape Verde and Mozambique is systematically compared to the ECOWAS and SADC average, but also to sub-Saharan Africa and PALOP. Table 7.3 summarizes the various sizes relevant to the comparisons in the next section, including comparisons between PALOP and CPLP and the share of both Africa and its sub-Saharan part in the world in terms of GDP, population, and GDP per capita.[19]

Common features in the five PALOP may reflect institutions preceding independence, in spite of very diverse experiences with political and economic freedom since then. Like Portugal during the first half of the nineteenth century and again after the 1890 bankruptcy, financial reputation suffers when political rights decrease the capacity to tax. Like Portugal since 1979, some PALOP have been able to improve their credit rating through appropriate policies. It is therefore useful to preface the estimation of diversification-convergence regimes in West and southern Africa with a reference to the contrasting political culture of Cape Verde and Mozambique.

The comparative evolution of GDP per capita in 1990 international

18. In relation to poverty reduction, see Paul Collier (2007), and especially Collier and Gunning (1999).

19. The weight of Brazil is, of course, overwhelming and the four microstates never rise above 25 basis points of GDP in 1990 international dollars, the number equivalent of NAFTA, as indicated in note 5 above.

dollars from 1950 until 2006 for PALOP and sub-Saharan Africa averages shows a more volatile growth pattern for the former group with more pronounced growth in the 1950s and the last decade (figure 7.1). This reflects civil wars following independence, especially in Angola and Mozambique, the two larger economies. In spite of the common colonial history, the pattern of each one of the five PALOP countries is very specific: figures 7.2A and 7.2B compare GDP per capita in Cape Verde and Mozambique to the

Table 7.3 **Relative sizes in 2003**

	GDP (%)	POP (%)	YCAP (%)
CPV/ECOW	0.3	0.2	168
ECOW/SSA	32	31	105
MOZ/SADC	9	11	88
SADC/SSA	41	25	166
SSA/AFR	64	86	74
AFR/WORLD	3	14	24
CPLP/WORLD	3	4	82
PALOP/CPLP	4	14	25

Source: Maddison database (2007). Available at: www.ggdc.net.

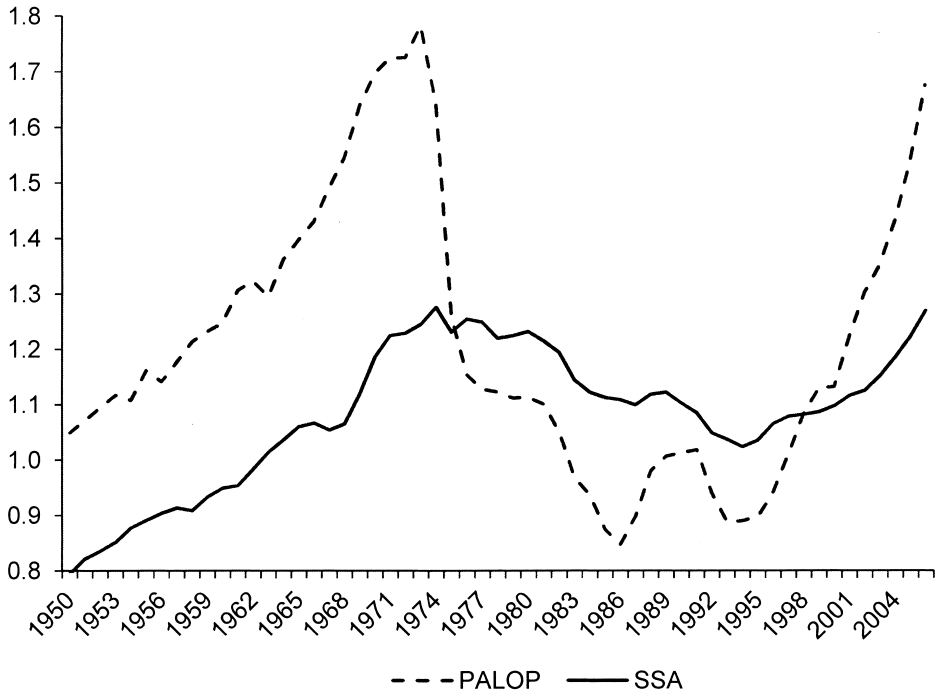

Fig. 7.1 The PALOP versus SSA (GDP per capita, 1990 international K$)

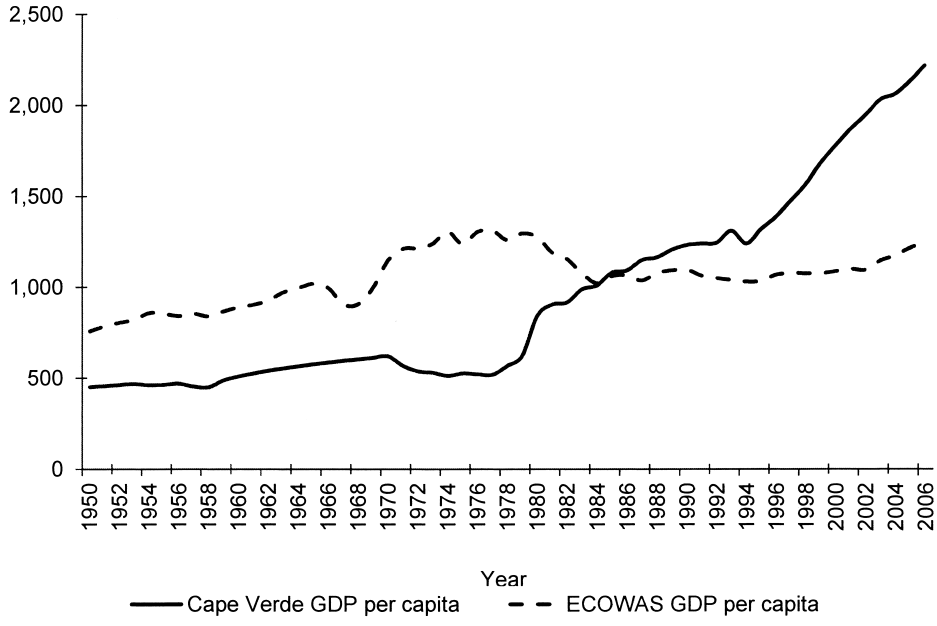

Fig. 7.2A Cape Verde and ECOWAS (GDP per capita in international $)

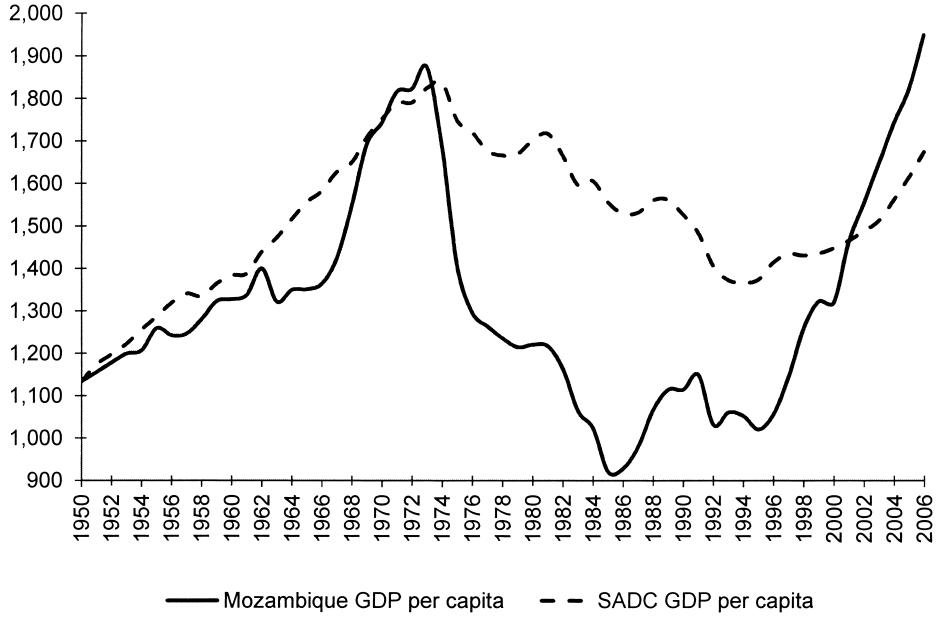

Fig. 7.2A Cape Verde and ECOWAS (GDP per capita in international $)

Table 7.4 Diversification index in PALOP

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	AVG
ANG	1	1	1	1	1	1	1	1	1	1	1	1	1
CV	15	10	6	8	9	6	15	14	9	11	15	6	10
GB	2	4	3	2	2	3	2	2	1	2	1	1	2
MZ	7	8	8	9	7	4	3	3	3	3	4	6	5
STP	3	3	5	4	7	3	3	6	4	5	5	2	4

Source: From 2004 AEO (2010); latest from previous issues.

Table 7.5 Economic freedom index in PALOP

	2010	2009	2008	2007	2006	2005	2004	2003
CV	62	61	58	57	59	58	58	56
MZ	56	56	57	56	53	56	57	59
A	48	47	47	45	44	—	—	—
GB	44	45	45	45	47	47	42	43

Source: AEO (2010, 75, from Heritage Foundation).

Table 7.6 Corruption perception index in PALOP

	Rank 2009	Index 2009	Rank 2008	Index 2008	Rank 2007	Index 2007	Year	Index
CV	46	5.1	47	5.5	53	4.7	—	—
STP	111	2.8	121	2.7	118	*2.7*	—	—
M	130	2.5	126	2.6	111	2.8	2003	2.7
GB	162	1.9	158	1.9	143	2.3	—	—
A	192	1.9	158	1.9	147	*2.2*	2002	1.7

Source: AEO from Transparency International (2010, 73, 274–75), previous issues.

respective subregional averages over six decades.[20] According to AEO, Cape Verde, São Tomé e Príncipe, Mozambique, Guinea-Bissau, and Angola is the ranking that applies to export diversification, political and economic freedom, as well as corruption perception in PALOP: Tables 7.4, 7.5, and 7.6 present the latest data available and will be detailed below for the first and third ranked.

In regional terms, current SADC countries showed greater export diversification than those of ECOWAS or the average for sub-Saharan Africa since 1960, as measured by the number-equivalent Herfindahl index. Export

20. The source is the Maddison database, which contains two outliers for GDP of Cape Verde in million GK$. The series is 1990: 430, 1991: 283, 1992: 231, 1993: 434, and the correction was interpolating the two outliers so that GDP per capita growth is smoothed during those years. Frankel (2010) presents governance rankings alongside GDP per capita figures consistent with the ranking in the text.

diversification in Mozambique and Cape Verde also tend to be higher than the sub-Saharan Africa average, but the number equivalent varies a great deal (table 7.7): data for Cape Verde begins in 1976, and in Mozambique recent large-scale investments determined both a strong increase in the exports and an increase in specialization. The decrease in export diversification in Mozambique followed a strong expansion of one single industrial product rather than from a decrease in the exports of other products. In all six governance indicators reported in table 7.8, Cape Verde scores higher than the ECOWAS average and Mozambique performs better than the SADC average in three of them, as detailed in section 7.5.2.

Comparing GDP growth rates of the both countries since 1950 shows a growth differential of almost 2 percent for Cape Verde relative to ECOWAS, whereas Mozambique growth is slightly below that of SADC. The decade averages show the greater volatility of Mozambique's output with two decades of negative growth, whereas in Cape Verde there was a negative differential of 4 percentage points in the 1970s. While this difference has roots in the colonial period, the pattern was reinforced after independence, as described next.

Cape Verde

After achieving independence in 1975, Cape Verde was governed under a one-party system that pursued an inward-looking, activist development program based on central planning and an economically dominant public sector, particularly in banking, transportation, insurance, and energy (IMF 1999). Motivated by the need to overcome the colonial legacy while minimizing the risk of possible political resistance, the new government adopted a protectionist trade regime and controlled the economy directly. As a consequence, there was limited scope for competitive export promotion and foreign direct investment was also discouraged: the resulting loss of competitiveness and the reduction of foreign direct investment became major constraints for sustainable long-run growth (Lourenço and Foy 2003). As of 1988, a wide-ranging program of reforms aimed at trade liberalization and privatization reduced the government's role to essentially that of building badly needed infrastructure, but the country was governed under a one-party system until 1990. Popular dissatisfaction led to free legislative and presidential elections and a constitutional amendment establishing a multiparty system in 1991. Economic reforms gathered further momentum after the country held free elections. The Movement for Democracy (MPD) took power away from the African Party for the Independence of Cape Verde (PAICV) that had led Cape Verde since independence and amended the 1980 constitution to allow for a multiparty democracy. The MPD government continued the economic reforms started by its predecessor, especially those pertaining to financial and foreign exchange markets. Since the adoption of this regime, there have been three legislative elections with results considered to be nonfraudulent and two orderly changes in government.

Table 7.7 **Annual change in number-equivalent Herfindahl index (Cape Verde versus ECOWAS, Mozambique versus SADC)**

	1961–1965	1966–1970	1971–1975	1976–1980	1981–1985	1986–1990	1991–1995	1996–2000	2001–2005	*1976–2005*
ECOWAS	0.11	–0.02	–0.02	0.05	0.04	**–0.01**	–0.12	0.21	**–0.03**	0.02
Cape Verde				**0.77**	**0.48**	–0.47	**0.19**	**0.27**	–0.16	**0.18**
SADC	–0.87	–0.32	–0.04	**0.29**	–0.11	**0.04**	**0.02**	–0.05	**–0.01**	–0.1
Mozambique	**0.75**	**0.1**	**0.14**	–0.17	**0.21**	–0.34	–0.62	–0.05	–0.48	**–0.07**

Source: Calculated from Cabral and Veiga (2010, graphs 7–8).

Table 7.8 World Bank Governance Indicators (1996–2007)

	CV	ECOWAS	MOZ	SADC
Rule of law	**0.48**	–0.75	–0.74	–0.44
Voice and accountability	**0.65**	–0.51	**–0.08**	–0.30
Political stability, absence of violence/terrorism	**0.96**	–0.49	**0.05**	–0.24
Government effectiveness	**0.11**	–0.77	**–0.33**	–0.38
Regulatory quality	**–0.25**	–0.65	–0.47	–0.45
Control of corruption	**0.33**	–0.66	–0.65	–0.39

Source: Updated from IICT (2007), same as Lopes and Santos (2010, tables 1a, b); note data are fitted to a normal distribution centered on zero.

Indeed, the fact that democratic governance has taken root is widely recognized by various governance indicators. The 2008 Ibrahim Index of African Governance (Gisselquist and Rotberg 2008) ranks Cape Verde second overall in a sample comprising forty-eight sub-Saharan countries. Cape Verde has good results in terms of safety and security, sustainable economic opportunity, participation, and human rights and human development when compared to its peers, with safety and security obtaining the highest score and sustainable economic opportunity the lowest. Data from the Freedom House Index also confirms the good results of Cape Verde in terms of political stability: Cape Verde is defined as free, obtaining the highest scores (1) for political rights and civil liberties. The presence of "creolisation/métissage" from the first settlers helped promote the view of peace and development. This "peace culture" has been reinforced by the absence of civil strife and by the impressive performance in terms of MDG, reflecting political stability, security, good governance, and functioning democratic institutions. The insular nation, without natural resources, has become an example of best practice: its neutrality in the region lead to its role of mediator—good reputation ("donors' darling"), leadership in United Nations (UN) reform, and using culture as a means of promoting tourism and development.[21]

Mozambique

Three different governance regimes can be identified: the preindependence period (1960–1974); the postindependence period, which was marked by

21. The argument in Santos (2010) is based on a PhD dissertation in peace studies a la Galtung (1996) where she analyzes the thought of Amilcar Cabral (1975, 1999) who led the liberation struggle of Cape Verde and Guinea-Bissau and influenced leaders of several other colonies, especially Angola (Cabral 1995, 1987; Andrade 1978). Surprisingly, she leaves out Cardoso (1986), which is seen as very influential. Another useful reference is the acceptance speech of an honorary doctorate from the Technical University of Lisbon on May 26 by the current head of state (Pires 2010). However, Lourenço and Foy (2003) claim that the resulting loss of competitiveness and the reduction of foreign direct investment became major constraints for sustainable long-run growth during this period.

civil war (1975–1992); and the post-peace-accord period (1993 onward).[22] Following independence, economic growth was stunted by a civil war estimated to have killed up to one million people. It is also affected by the Marxist-socialist ideology espoused by the governments in the immediate postindependence period. Prior to independence, there was significant public investment in infrastructure and also expenditures in health and education during the period 1960–1973, which contributed strongly to Mozambique's growth. In the agricultural sector, it was generally true that large private farms performed better than smaller ones, and therefore accounted for the bulk of agricultural output. However, the postindependence economy was very much government controlled. By 1984, for example, more than half of all registered firms were state owned. Not unexpectedly, the development of a market economy was severely hampered, which impacted negatively on growth. During the 1980s, Mozambique began gradually moving away from a centrally planned economy; for example, price controls on vegetables and fruits were removed. Another example is the enactment of the 1987 Economic Rehabilitation Program, which led to a strong shift toward market-based economic policies and the pursuit of structural reforms. These included the stabilization of the exchange rate, trade liberalization, extensive privatizations, and tariff and financial-sector reforms. However, it was only after the consolidation of peace that any significant improvements had the opportunity to occur. A contributing factor to a quick postconflict development was the UN-led program of exchanging guns for vouchers, which allowed an easier transition from war to peace. While it was soon discontinued because of difficulties in redeeming these vouchers, the program remains a success in confidence building. Following the signing of the 1992 Rome treaty, a new constitution was adopted that allowed for democratic elections and further progress toward a market economy. A prosperous transition after the peace accord allows Mozambique's economic performance to be compared to the best performers in the subregion, namely Mauritius and South Africa. Nevertheless, the rehabilitation and political transition took a few years, before megaprojects such as the MOZAL aluminum smelter plant and the Witbank highway (connecting Mozambique and South Africa) were implemented in 1996–1999, leading to the take off of growth after 2000. According to Tibana (2003), economic activity increased from 1991 until 1995, but slowed down during the preparation and implementation of the megaprojects that came to define the country's export behavior and high rates of economic growth. Over the past decade, Mozambique has again become one of the attractive economies in the subregion, as revealed by Luiz, Pereira, and Oliveira (2013), from where figure 7.3 is reproduced.

22. Tibana (2003) performs a trend and a business cycle analysis in the post-peace accord period, pointing out different growth behaviors within it. Such periods are: an immediate post-war recuperation (1992–1994), a period of slow growth and heavy infrastructure investment (1995–2000), and a strong growth period (2000–2002).

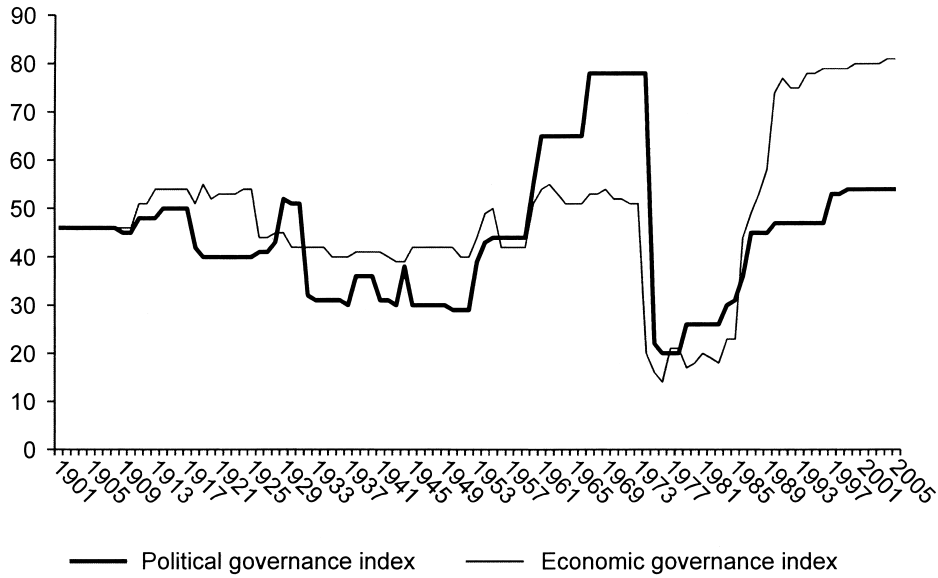

Fig. 7.3 Political and economic governance index in Mozambique

7.4 Analyzing the Convergence-Diversification Relationship

In this section, we study the two-way relationship between trade diversification and income convergence motivated by the insights provided by our interpretative framework and the empirical finding that economic development, measured by per capita income, entails more diversification. The general observation is that economies become more diversified as incomes increase before reaching a turning point, which Imbs and Wacziarg (2003) estimate to be around USD 9,000 per capita, beyond which they become less diversified, a stage not yet observed in the sub-Saharan Africa database used by Cabral and Veiga (2010), which includes data disaggregated at five different levels, according to the categories of the Standard International Trade Classification (SITC) trade data (Rev. 2).[23] In other words, development occurs when a country learns how to do new things and focuses on those that it already does well, such as producing new goods, choosing promising export markets, upgrading product quality, and moving into services exports. We note, in passing, that another strand of literature argues that diversification should focus on exporting more sophisticated products, as these entail higher productivity levels conducive to higher growth levels

23. Cabral and Veiga (2010) present mostly results with more disaggregated data, since the results tend to be stronger and more accurate than when the one- and two-digit categories are chosen. They add in note 12, page 15, that the results remain broadly similar, independent of the level of disaggregation used.

(e.g., Hausmann, Hwang, and Rodrik 2007). In this case, a country becomes what it exports, that is, countries converge to the level of income implied by their exports.[24] The common point in both approaches, however, is that product development is undoubtedly an important engine of growth for developing countries.

The study of how economic policy and institutional variables promote or limit the capability of countries to pursue successful export diversification and sophistication strategies serves as background for the identification of the factors that determined the success obtained by Cape Verde and Mozambique. Using regression analysis in a panel of forty-eight countries over forty-five years, Cabral and Veiga (2010) establish that the stage of development and the economy's size are positively correlated with export diversification, and that economies with larger GDPs or populations also have higher export sophistication levels. Moreover, both diversification and sophistication are promoted by trade integration, efforts to reduce transport costs, as well as improvements in institutional, political, and educational factors.

When used to explain export diversification, nineteen out of the twenty-six governance variables presented significant positive signs. The results were particularly robust for the variables reflecting government accountability, respect for the rule of law, political stability, effectiveness, and control of corruption (table 7.8). In export sophistication regressions, fifteen out of twenty-six variables are not statistically significant but "transparency," "accountability," "control of corruption in the public sector," "debt policy and fiscal policy rating, "economic management cluster average," and "policies for social inclusion" have a positive association.

Since 1960, the average of current SADC countries showed greater export diversification, as measured by the number-equivalent Herfindahl index, than ECOWAS or sub-Saharan Africa (Cabral and Veiga 2010, graph 8). It is seen that improving the education standards of the labor force (measured by the share of GDP spent in education or the World Bank index about "building human resources") is associated with export diversification. Moreover, lower levels of education are associated positively with diversification, while higher levels are associated with export sophistication. While equations in which diversification and sophistication were used to explain GDP growth suggested a positive but not robust relationship, higher diversification and sophistication were associated to lower variation in the rate of growth of both GDP and per capita income. The estimated coefficients suggest that a 10 percent increase in diversification leads to a 4.6 percent decrease in the variation of GDP growth and to a 4.4 percent reduction of income per capita variability. Similar results were obtained for sophistication, with country fixed effects models suggesting that increasing sophistication may have a

24. The issue of export sophistication is analyzed in Cabral and Veiga (2010, 16).

stronger marginal effect in decreasing economic instability than diversification in sub-Saharan Africa. In addition, higher diversification and sophistication are associated with lower infant mortality and higher life expectancy. The estimated coefficients are robust and the impact independent of that of diversification and sophistication on income per capita, which is all the more relevant as higher average income does not necessarily translate to better life for the majority of the population.

Export diversification in Mozambique and Cape Verde also tend to be higher than the sub-Saharan Africa average, but the number equivalent varies a great deal (Cabral and Veiga 2010, graph 9): data for Cape Verde begins in 1976, and in Mozambique recent large-scale investments determined both a strong increase in the exports and an increase in specialization. The decrease in export diversification in Mozambique followed a strong expansion of one single industrial product rather than from a decrease in the exports of other products. Figures 7.4 and 7.5, second panel, show the comparative pattern of the number equivalent for ECOWAS and SADC countries, respectively, while figures 7.6 and 7.7, third panel, compares Cape Verde and Mozambique to the group average.

Export diversification and sophistication in Cape Verde and Mozambique relative to the average in sub-Saharan Africa are shown in Cabral and Veiga (2010, graphs 9 and 10). With respect to diversification, Cape Verde ranks higher, whereas Mozambique has improved sophistication. In this regard, Cape Verde is close to 6,000 while ECOWAS is around 5,000, even though in the early nineties it decreases to 3,000 and 2,000, respectively. Mozambique, with a lower sophistication than SADC during the nineties, but its sophistication increased sharply since 2000, overcoming that of SADC. The average annual change in the number equivalent for five-year periods in Cape Verde and ECOWAS shows that, from 1976 to 2005, a new good was being exported by Cape Verde approximately every five and a half years (1/0.18 = 5.55). In Mozambique there was significant diversification up to the late seventies, while SADC was actually concentrating. However, from the eighties on, concentration was large, especially in the early nineties and between 2001 and 2005. During the latter period, on average, every two years a product stopped being exported (1/0.48).

With this in mind, in this section we seek to identify macrolevel policy and institutional combinations underpinning successful export diversification and economic convergence in ECOWAS and SADC. Just as important, we also expect to establish context-based objective metrics that will subsequently allow us to better assess the relative performance of Cape Verde and Mozambique on both counts in conjunction with evidence of a case-study nature. This indirect approach to study trade-related development success in these two countries is unavoidable as the severe lack of data prevents us from analyzing them empirically. Our study covers the period 1960–2004 and uses annual data obtained from various sources (see appendix A for

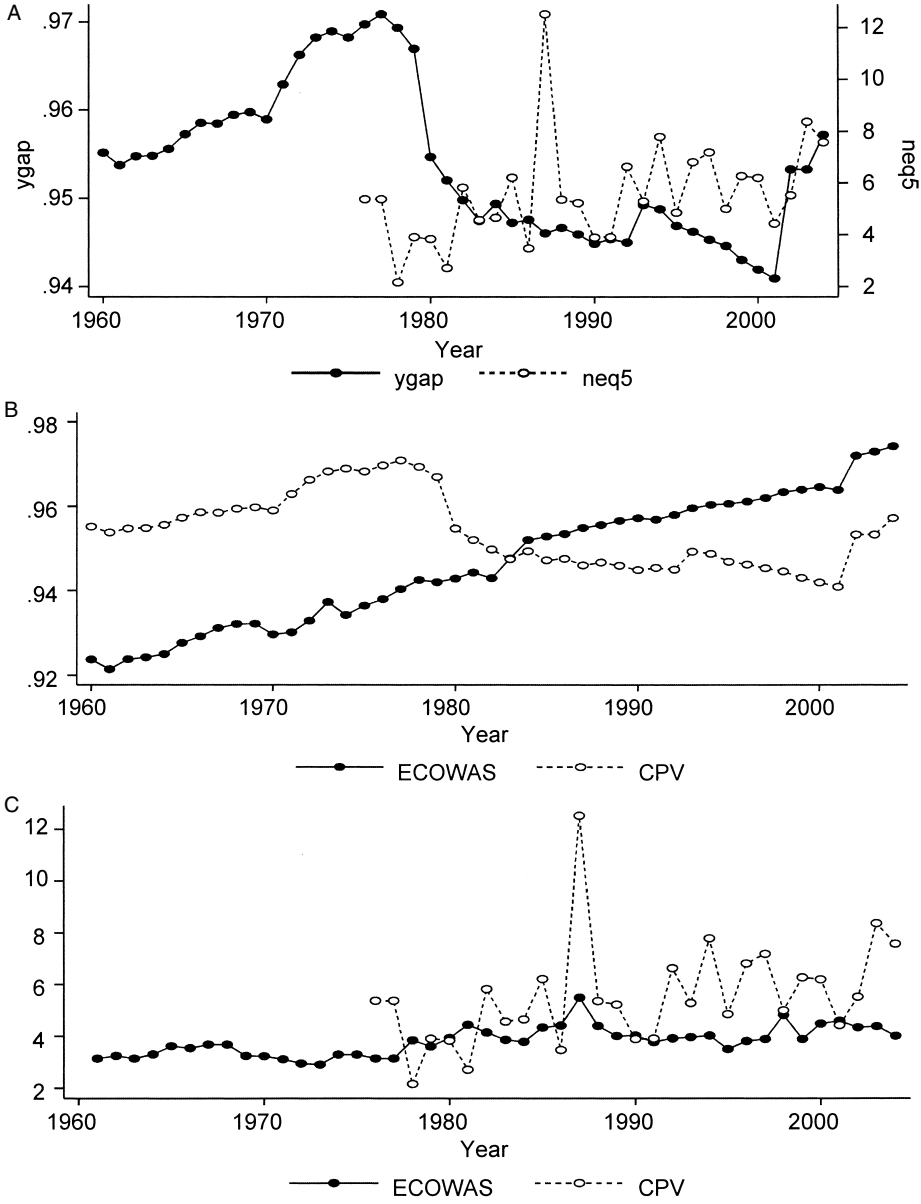

Fig. 7.4 Cape Verde: Relation between income gap and number equivalent

Note: Panel (a): Cape Verde, income gap to frontier and number equivalent; panel (b): Cape Verde versus ECOWAS, income gap to frontier; and panel (c): Cape Verde versus ECOWAS, number equivalent.

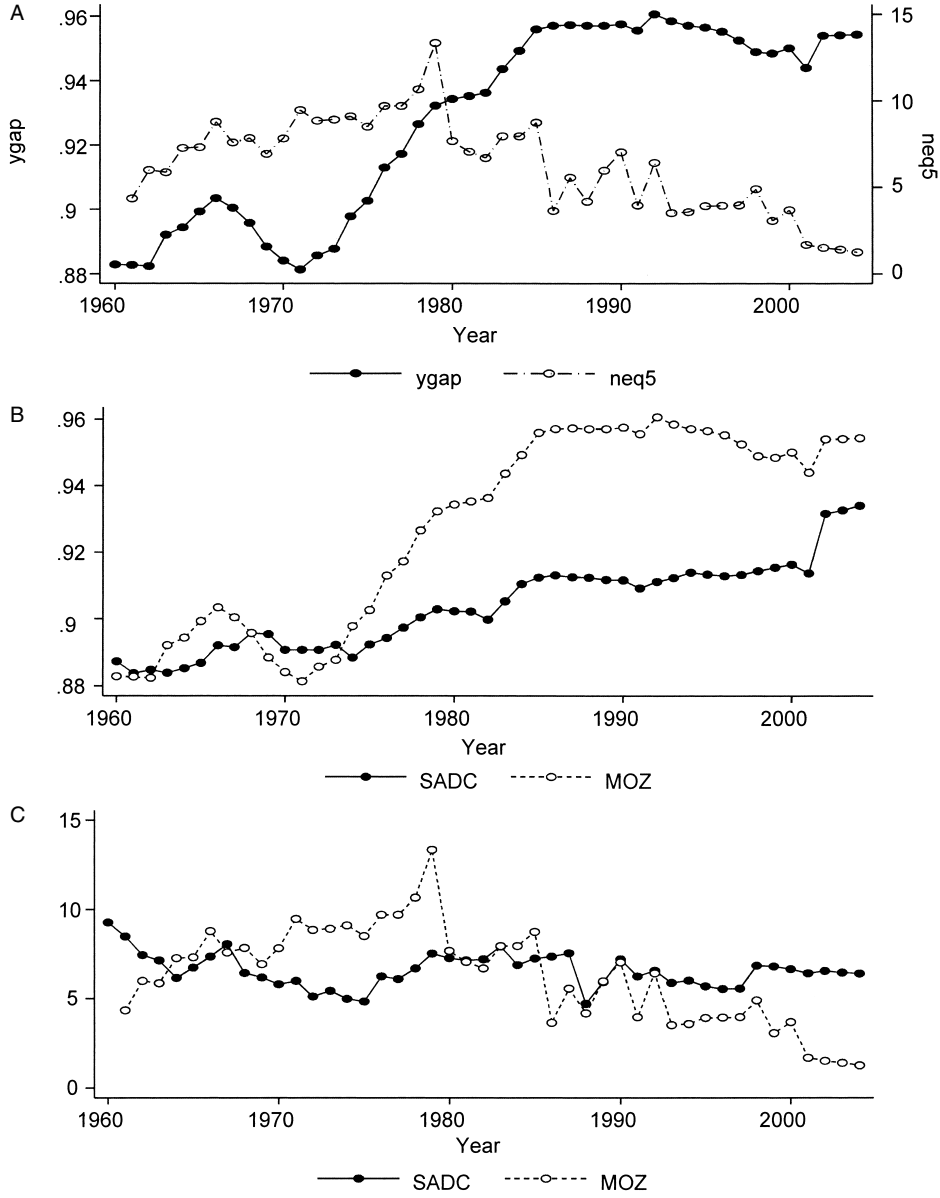

Fig. 7.5 Mozambique: Relation between income gap and number equivalent

Note: Panel (a): Mozambique, income gap to frontier and number equivalent; panel (b): Mozambique versus SADC, income gap; and panel (c): Mozambique versus SADC, number equivalent.

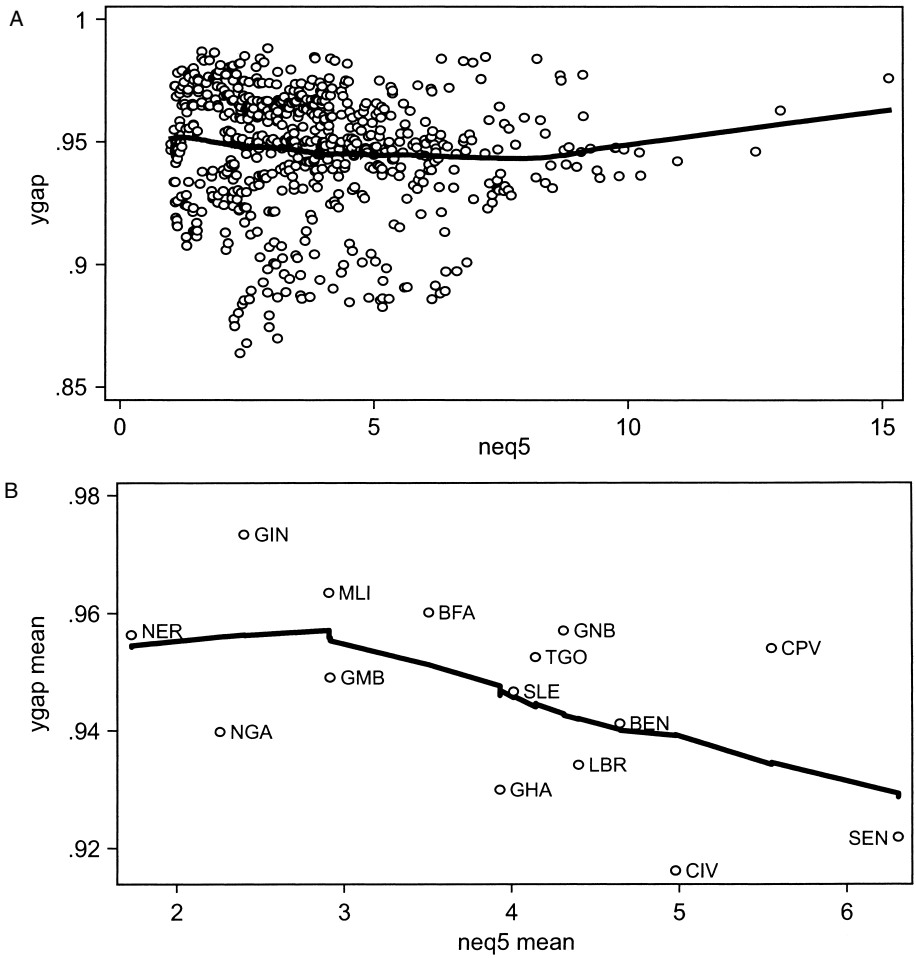

Fig. 7.6 Relation between income gap and number equivalent in ECOWAS

Note: Panel (a): ECOWAS, income gap to frontier versus number equivalent measure, Lowess smoothing, bandwidth = 0.8; and panel (b): ECOWAS, income gap versus number equivalent, country means, Lowess smoothing, bandwidth = 0.8.

full details, including summary statistics, on variables used in our estimations). Before presenting qualitative results from the econometric analysis, a snapshot of eight indicators used in the empirical analysis can be seen in appendix A, figures 7A.1, and 7A.2, for each one of the member countries in ECOWAS and SADC, respectively. Panels (a) through (h) report the following variables: panel (a), convergence: income gap to frontier, country and US GDP per capita, constant 2000 USD; panel (b), diversification: number

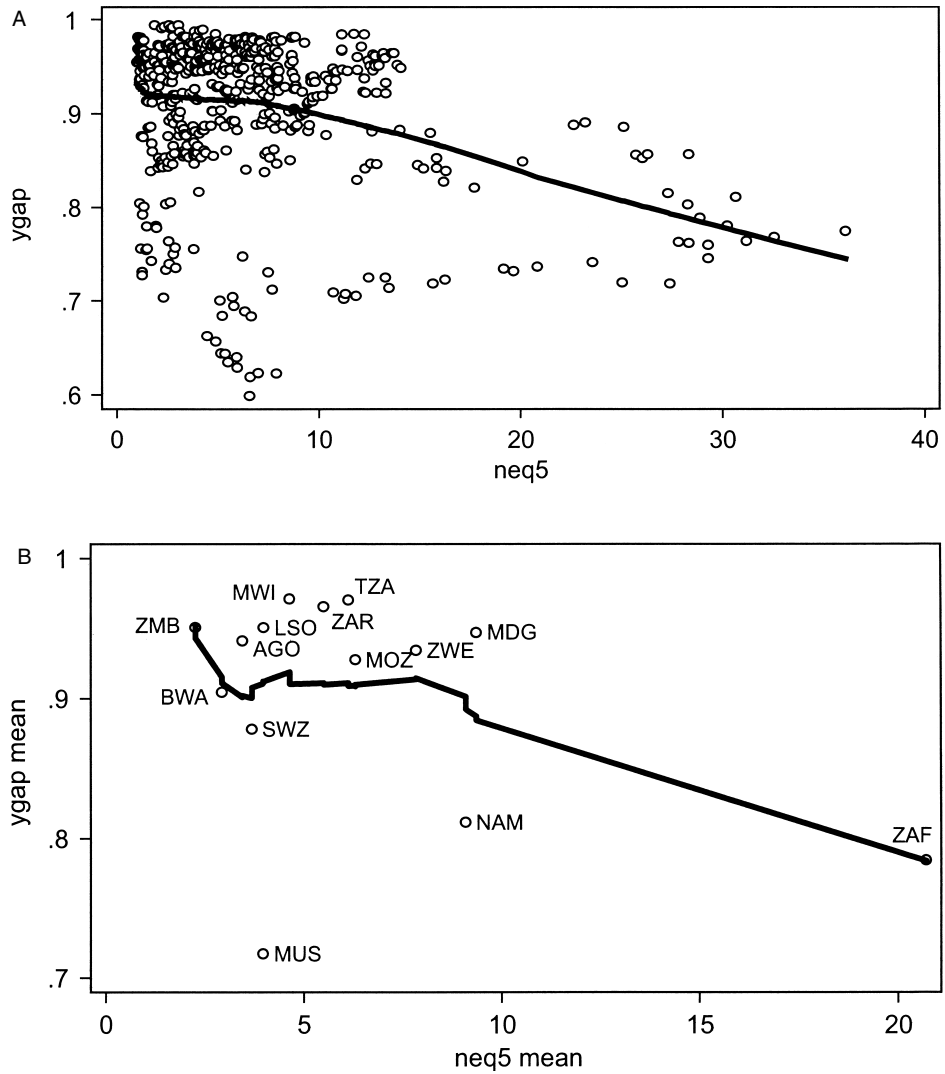

Fig. 7.7 Relation between income gap and number equivalent in SADC

Note: Panel (a): SADC, income gap versus number equivalent, Lowess smoothing, bandwidth = 0.8; panel (b): SADC, income gap versus number equivalent, country means, Lowess smoothing, bandwidth = 0.9; panel (c): SADC (excluding South Africa), income gap versus number equivalent, Lowess smoothing, bandwidth = 0.8; and panel (d): SADC (excluding South Africa), income gap versus number equivalent, country means, Lowess smoothing, bandwidth = 0.9.

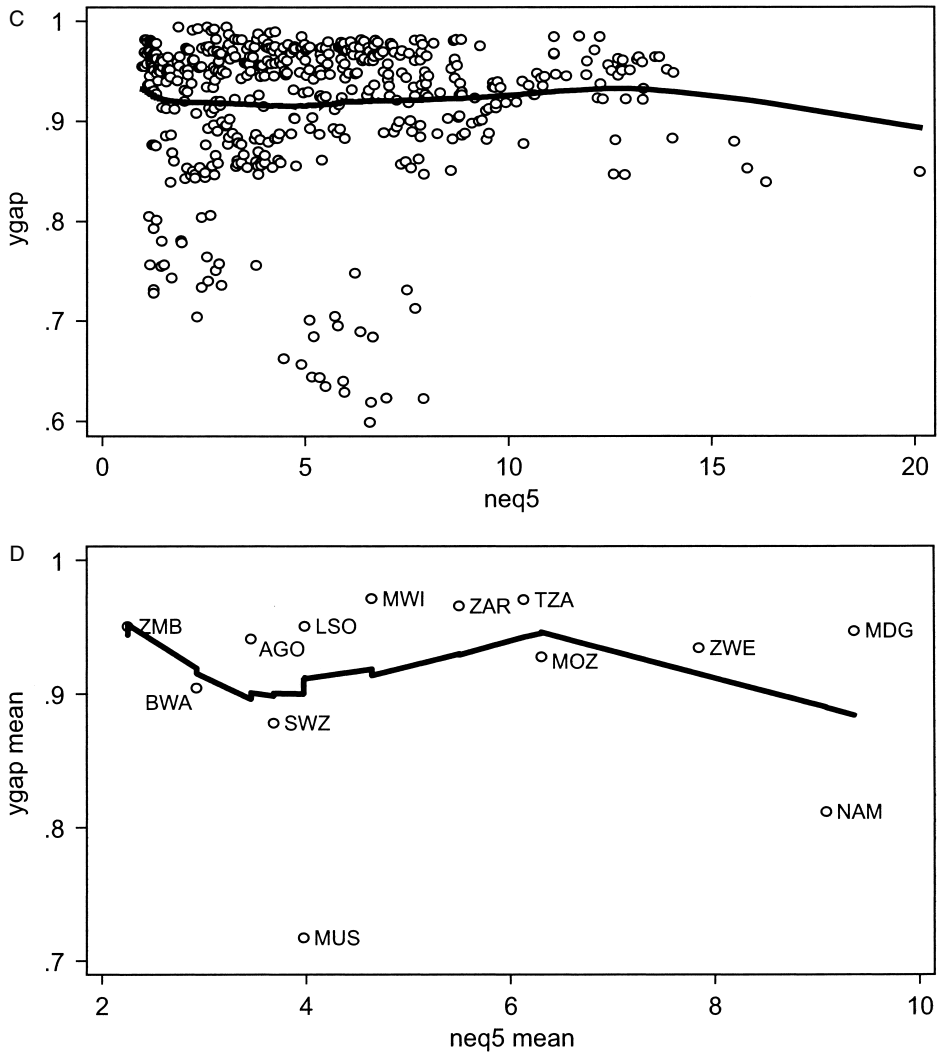

Fig. 7.7 (cont.)

equivalent index of exports at one-, two-, three-, four-, and five-digit SITC; panel (c), monetary stability: inflation in consumer prices; panel (d), fiscal sustainability: government surplus/deficit percent GDP; panel (e), trade openness: exports plus import percent GDP; panel (f), political freedom; panel (g), economic freedom; and panel (h), life expectancy at birth. We also depict the relation between diversification and convergence for Cape Verde and Mozambique over time and also with respect to their respective regional averages. Figures 7.4 and 7.5 compare convergence and diversification indi-

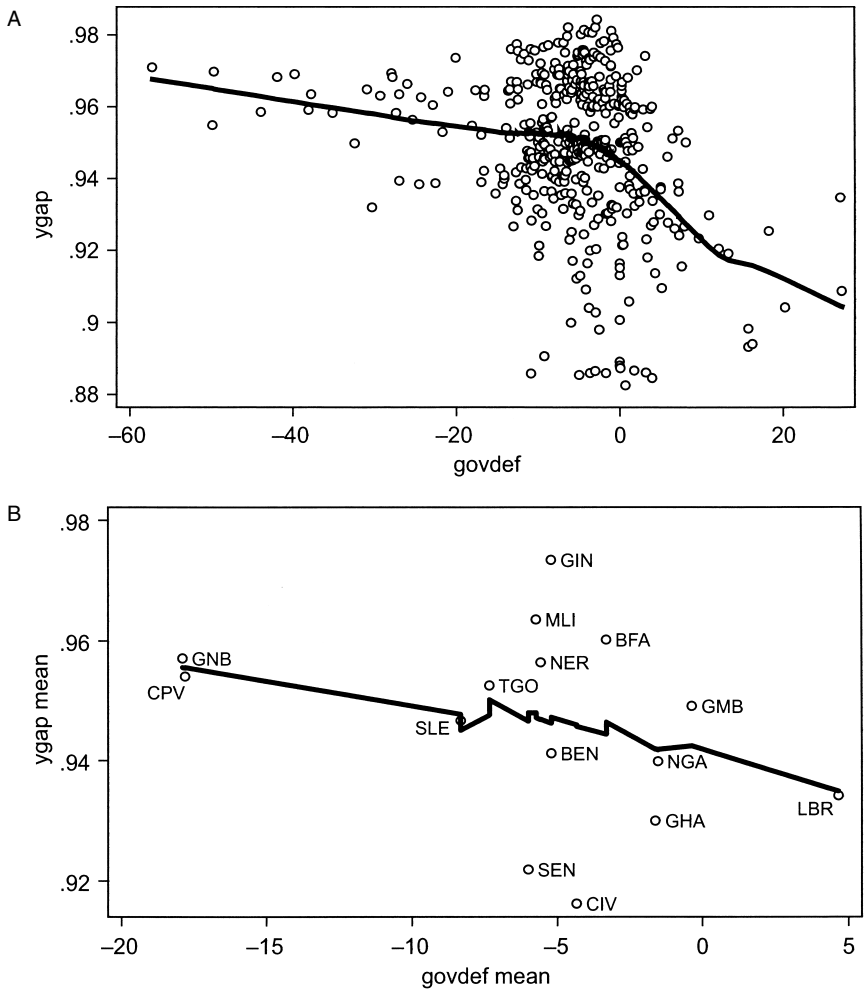

Fig. 7.8 Relation between income gap and government deficit in ECOWAS

Note: Panel (a): ECOWAS, income gap versus government deficit (percent of GDP), Lowess smoothing, bandwidth = 0.8; panel (b): ECOWAS, income gap versus government deficit, country means, Lowess smoothing, bandwidth = 0.8; and panel (c): ECOWAS, income gap versus government deficit, time means, Lowess smoothing, bandwidth = 0.8.

cators in panels (a) through (c) and show the time series of income gap and number equivalent for Cape Verde and ECOWAS, and Mozambique and SADC in panels (b) and (c), respectively. Figures 7.6, and 7.7 show the relation between same variables in terms of the raw data and country means in panels (a) and (b), respectively. The raw data, country means, and time means for the relation between income gap and government deficit is shown in figures 7.8, and 7.9, panels (a) through (c), and the relation between eco-

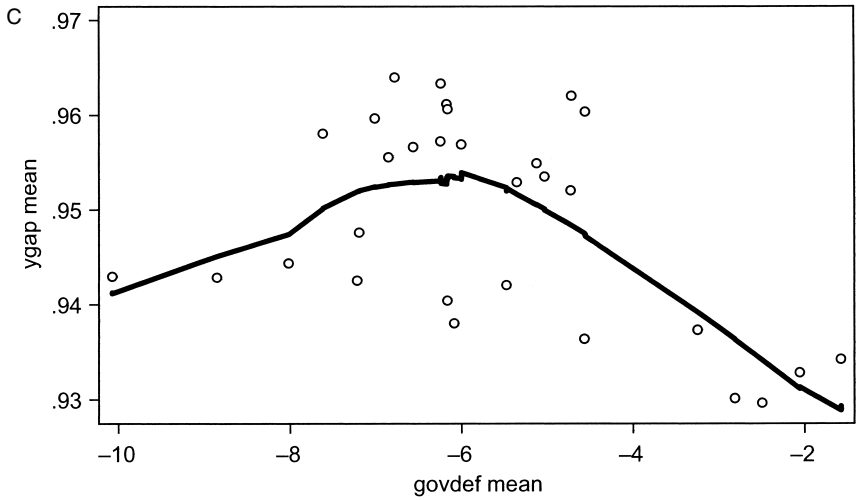

Fig. 7.8 (cont.)

nomic and political freedom in figures 7.10, and 7.11, panels (a) and (b). Account is taken of the different performances by defining "high" and "low" regimes in terms of the variables of interest, and figures 7.10 and 7.11, panel (c), compare the relation between economic and political freedom for the full sample and the two regimes. Figures 7.12 and 7.13, panels (a) through (c), present the indicators in appendix figures 7A.1 and 7A.2, panels (b) through (g), while growth in GDP per capita replaces the distance to frontier in figures 7.12 and 7.13, panel (a). The insights obtained from these graphs, as well those from the Lowess plots (figures 7.6 to 7.11) will help us to better understand and interpret our results, especially with respect to variables identified as being highly significant in our econometric analysis.[25]

The first Lowess plot clearly depicts the expected (negative) relation between diversification and convergence when using the country means, that is, mean ygap and mean neq5 for each country (figures 7.6 and 7.7). When all observations are taken into account, the same is true for SADC, but there is no discernible relation between the two variables for ECOWAS. It is also clear that the strong negative relation exhibited by SADC is largely attributable to South Africa's high level of diversification. Once we exclude

25. Lowess, or locally weighted scatter plot smoothing, is a method that fits simple regression models to localized subsets of the data. The objective is to build up a function that describes, point by point, the deterministic part of the data's variability. For further details, see Cleveland's (1979) seminal contribution and also subsequent developments by Cleveland and Devlin (1988). Note that we only present those Lowess plots in which there is clear and interpretable relationship between the variables under consideration. The others are available from the authors upon request.

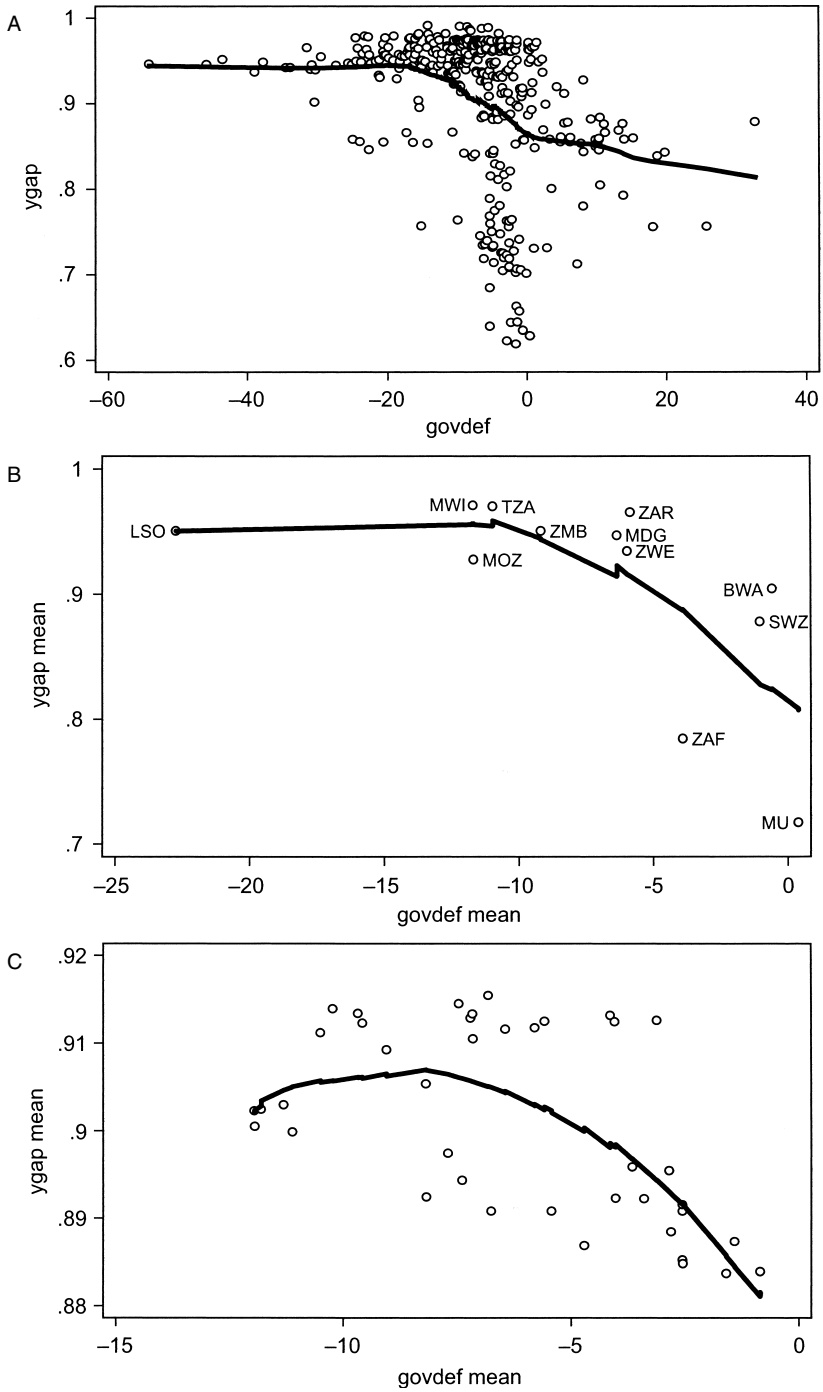

Fig. 7.9 Relation between income gap and government deficit in SADC

Note: Panel (a): SADC, income gap versus government deficit (percent of GDP), Lowess smoothing, bandwidth = 0.8; panel (b): SADC, income gap versus government deficit, country means, Lowess smoothing, bandwidth = 0.8; and panel (c): SADC, income gap versus government deficit, time means, Lowess smoothing, bandwidth = 0.8.

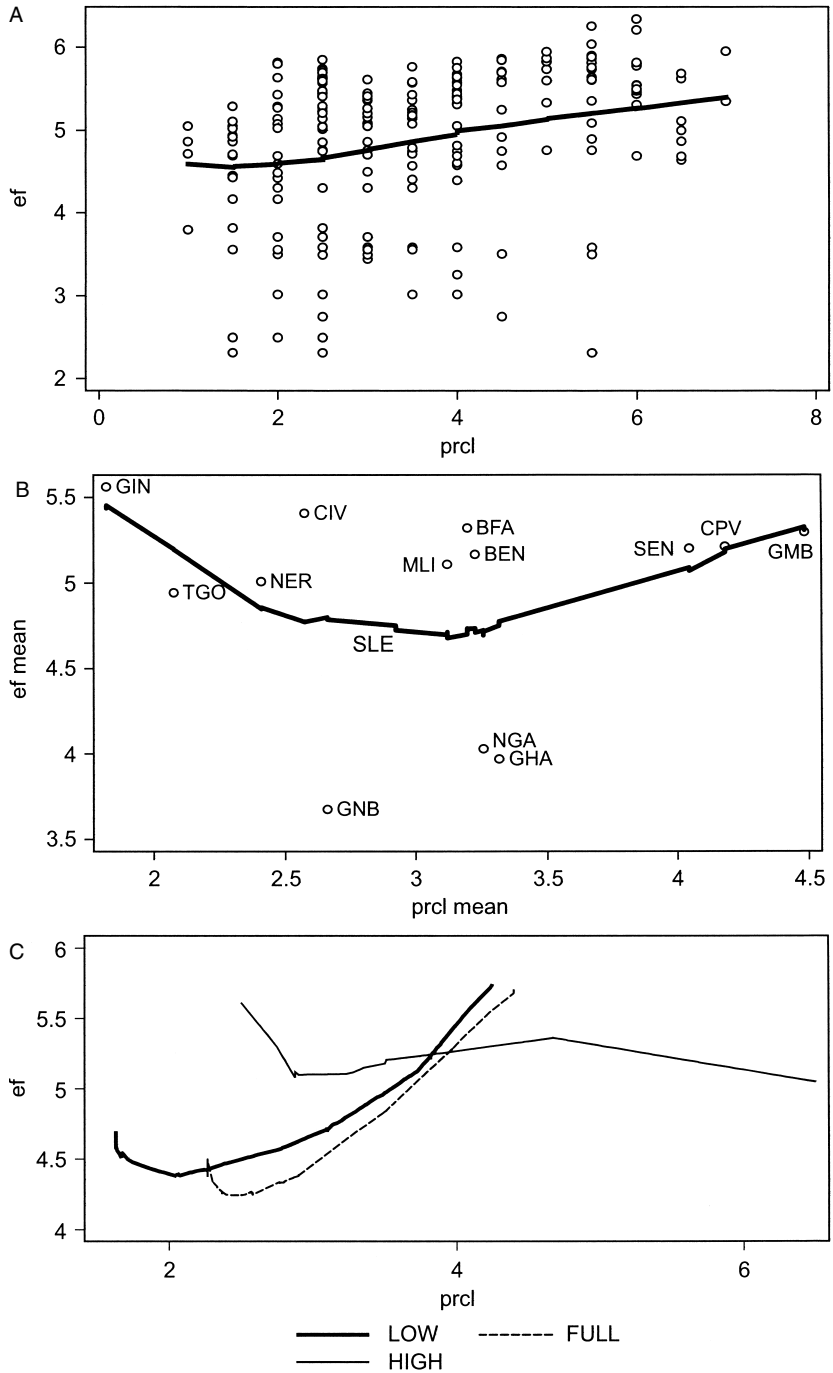

Fig. 7.10 Relation between economic and political freedoms in ECOWAS

Note: Panel (a): ECOWAS, economic freedom versus political freedom, Lowess smoothing, bandwidth = 0.8; panel (b): ECOWAS, economic versus political freedom, country means, Lowess smoothing, bandwidth = 0.8; and panel (c): ECOWAS, economic versus political freedom, Lowess smoothing, bandwidth = 0.8.

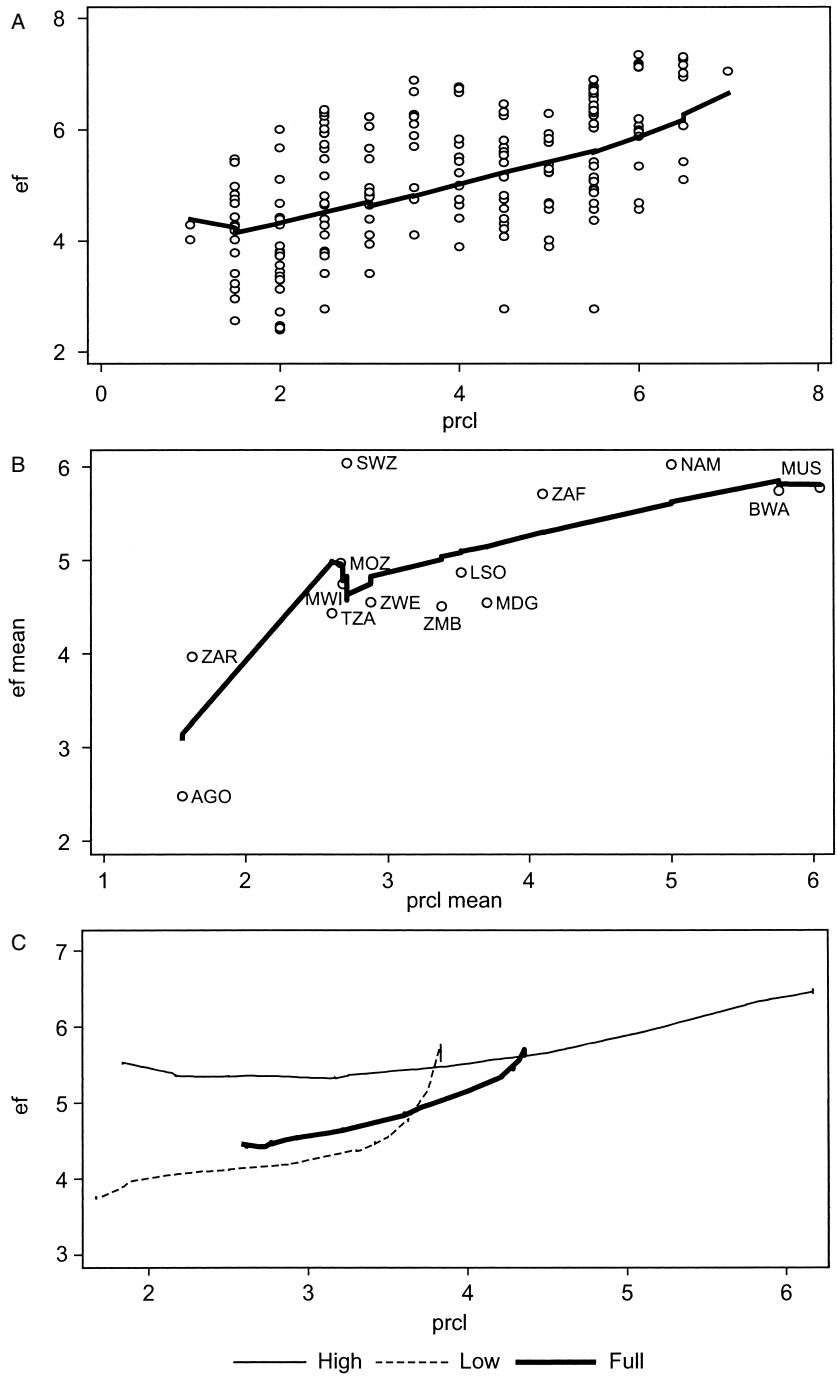

Fig. 7.11 Relation between economic and political freedoms in SADC

Note: Panel (a): SADC, economic freedom versus political freedom, Lowess smoothing, bandwidth = 0.9; panel (b): SADC, economic versus political freedom, country means, Lowess smoothing, bandwidth = 0.8; and panel (c): SADC, economic versus political freedom.

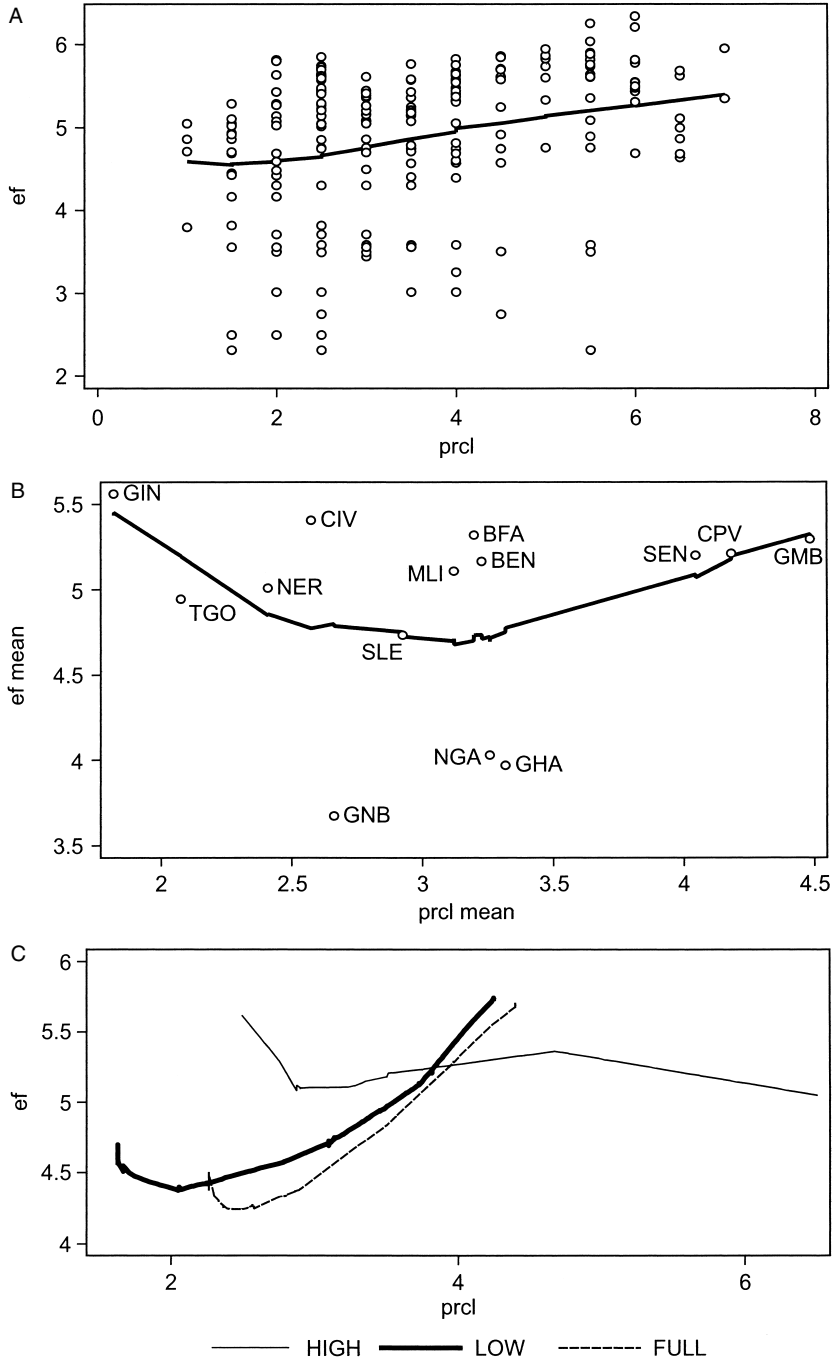

Fig. 7.12 Relation between economic and political freedoms in ECOWAS

Note: Panel (a): ECOWAS, economic freedom versus political freedom, Lowess smoothing, bandwidth = 0.8; panel (b): ECOWAS, economic versus political freedom (country means), Lowess smoothing, bandwidth = 0.8; and panel (c): ECOWAS, economic versus political freedom, Lowess smoothing, bandwidth = 0.8.

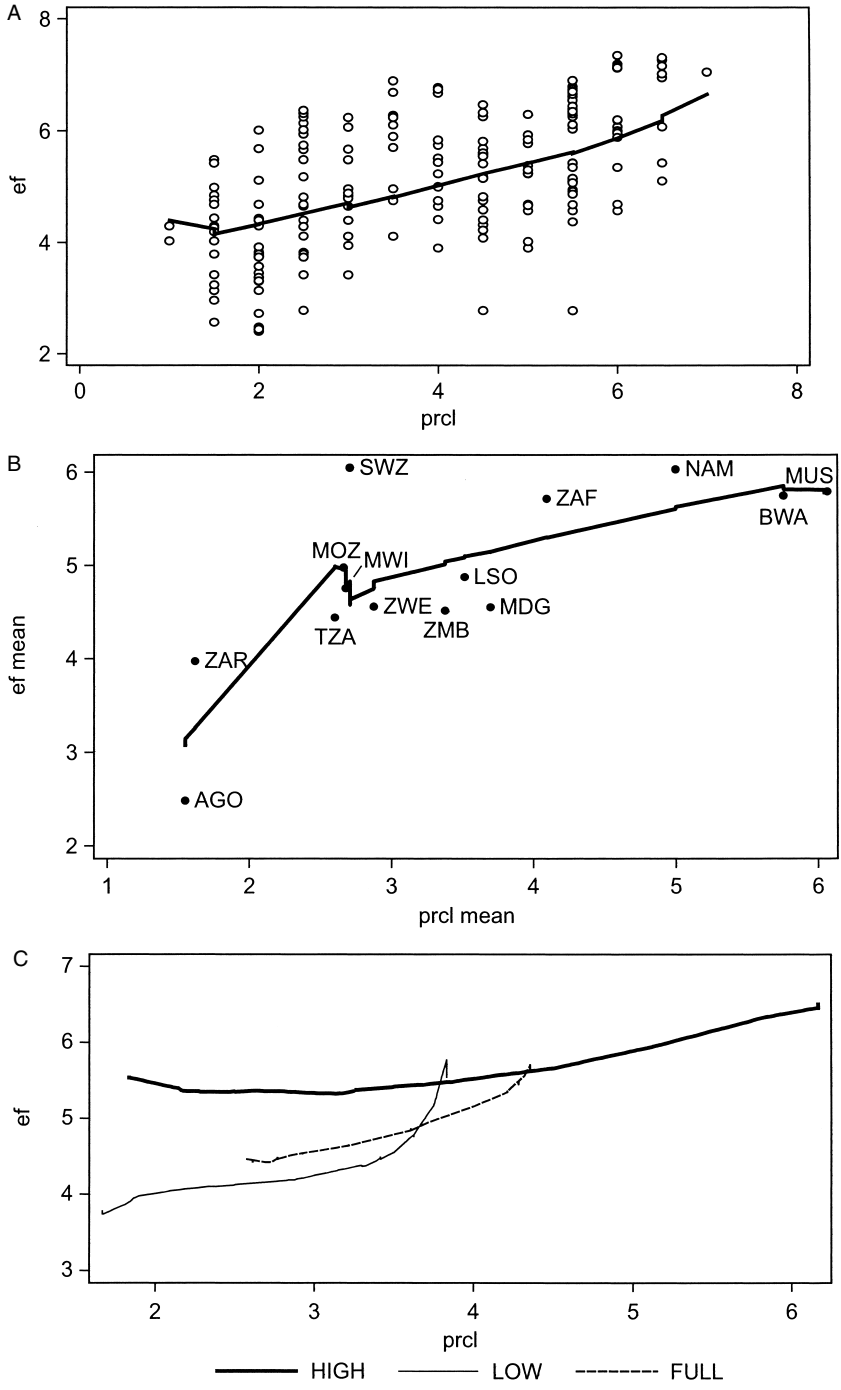

Fig. 7.13 Relation between economic and political freedoms in SADC

Note: Panel (a): SADC, economic freedom versus political freedom, Lowess smoothing, bandwidth = 0.9; panel (b): SADC, economic versus political freedom (country means), Lowess smoothing, bandwidth = 0.8; and panel (c): SADC, economic versus political freedom.

South Africa from the sample, we observe that the relation is now ambiguous and not dissimilar to that of ECOWAS. Regarding government deficits, we observe that lower budget deficits are associated with increased convergence, especially when they are less than 6 percent of GDP for ECOWAS and around 8 percent for SADC (figures 7.8 and 7.9). As for the relation between political and economic freedoms, it is clearly positive in both regions, but more so for SADC based on the visual inspection of the Lowess plot obtained using all observations (figures 7.10 and 7.11). When one uses country averages instead, we see that there is an unequivocal positive relation between freedoms in SADC (figure 7.11, panel [b]), while it is somewhat "U-shaped" in ECOWAS (figure 7.10, panel [b]), which possibly reflects the fact that the region aggregates countries with dissimilar characteristics on this score.

Turning to our empirical analysis, we adopt a system equation approach mainly because we believe that it is better suited to model interdependence between variables. We also seek to address the problem of endogeneity due to simultaneity bias and so make use of the standard three-stage least square method (3SLS). This method incorporates uses all the information provided by the exogenous right-hand-side (RHS) variables to instrument the endogenous (LHS) left-hand-side variables. As such, it avoids the potential pitfall of having to find "good" instruments within a single equation context. Notwithstanding this advantage, we recognize that 3SLS may be more sensitive to the existence of spurious correlations or multi-collinearities among the regressors in one equation, thereby "contaminating" the remaining equations. In our sample, this does not seem to be an issue, however. In order to assess the robustness of our method, we also estimated the diversification-convergence relation using alternative estimation techniques, namely ordinary least squares (OLS) and two-stage least squares (2SLS). Since the results obtained are broadly consistent, tables 7.9A and 7.9B present the 3SLS results while the others are in appendix B.

As for our dependent variables, we measure the distance of a country's GDP per capita (ypc_{it}) compared to that of the United States ($ypc_{\mathrm{USA},t}$) in order to capture economic convergence. Specifically, the income gap is calculated as $ygap_{it} = 1 - (ypc_{it}/ypc_{\mathrm{USA},t})$, which implies that the income gap narrows as ypc_{it} increases. We measure export diversification using the number-equivalent index ($\mathrm{neq5}_{it}$), which is calculated as the inverse of the Herfindahl index (five-digits, SITC, Rev. 2). Together with additional control variables, we expect these two variables to be a meaningful characterization of each country's diversification-convergence regime, which will be affected by the interaction between policy and institutional variables. Accordingly, we specify the following two-equation simultaneous system for our analysis:

$$(1)\quad ygap_{it} = \alpha_1.\mathrm{neq5}_{it} + \delta_1.(\mathrm{Policy}_{it}) + \beta_1.(\mathrm{Institutions}_{it}) + \gamma_1.Z_{1it} + \varepsilon_{1\cdot it}$$

$$(2)\quad \mathrm{neq5}_{it} = \alpha_2.\, ygap_{it} + \delta_2.(\mathrm{Policy}_{it}) + \beta_2.(\mathrm{Institutions}_{it}) + \gamma_2.Z_{2it} + \varepsilon_{2\cdot it}$$

Table 7.9A **ECOWAS, 3SLS estimation results**

		Low-regime subsample		Full sample		High-regime subsample	
Variable type	Variable	lnygap	lnneq5	lnygap	lnneq5	lnygap	lnneq5
Policy	lnygap		–0.569***		–0.398***		–0.751***
			(–3.326)		(–3.812)		(–4.000)
	lnneq5	–0.0972		0.189**		–0.646***	
		(–1.139)		(2.409)		(–3.798)	
	inflation1	–0.0344**	0.0530*	–0.0368***			
		(–2.491)	(1.799)	(–3.400)			
	govdef	0.000174	0.0457***			–0.00618	–0.0153**
		(0.0435)	(4.744)			(–1.407)	(–2.291)
	lnopen1					–0.185**	–0.229**
						(–2.112)	(–2.156)
Institutional	lnprcl	–0.0147	–0.157	–0.172***	0.0620	–0.0477	0.299**
		(–0.339)	(–1.646)	(–2.723)	(0.579)	(–0.395)	(2.157)
	lnef	0.114	0.399*	–0.497***	0.840***	0.201	1.610***
		(1.487)	(1.888)	(–2.606)	(2.710)	(0.456)	(2.923)
	demage	–0.0319***		–0.0312***	–0.0444*		
		(–3.498)		(–2.963)	(–1.879)		
	demtot			0.00804***			
				(11.12)			
	dictrans		–0.179**				
			(–2.459)				

Control	lnk	–0.107***		–0.0879***			
		(–4.441)		(–3.290)			
	lnltotal					0.961***	
						(4.396)	
	lnpopdens				0.191***		
					(3.293)		
Dummies	capcont		0.666***		0.552***		
			(5.132)		(3.193)		
	landlock	0.345***		0.322***	0.322***		
		(7.128)		(4.163)	(4.163)		
	oil			–0.427***	–0.427***	–3.601***	
				(–7.158)	(–7.158)	(–4.657)	
	cpv			–0.299***	0.438**		
				(–3.267)	(2.346)		
	sen			–0.370***	0.504***	–2.827***	0.473***
				(–6.040)	(4.982)	(–3.871)	(6.759)
	legaleng			–0.108**		–2.418***	
				(–2.347)		(–4.918)	
	Constant	6.254***	2.790***	5.469***	0.904	–5.875**	2.334*
		(14.00)	(3.268)	(11.34)	(1.426)	(–2.359)	(1.828)
Model diagnostics	Observations	40	40	99	99	32	32
	R-squared	0.860	0.703	0.876	0.604	0.866	0.688
	F-test	30.87	13.95	62.61	18.63	44.60	14.27
	Prob. > F	0	0	0	0	0	0

Note: The *t*-statistics are in parentheses.
***Significant at the 1 percent level.
**Significant at the 5 percent level.
*Significant at the 10 percent level.

Table 7.9B **SADC, 3SLS estimation results**

		Low-regime subsample		Full sample		High-regime subsample	
Variable type	Variable	lnygap	lnneq5	lnygap	lnneq5	lnygap	lnneq5
	lnygap		1.340***		–0.782***		–1.067***
			(6.654)		(–9.407)		(–6.012)
	lnneq5	0.617***		–0.276**		–0.659***	
		(6.624)		(–2.571)		(–5.961)	
Policy	inflation1	0.0533***	–0.0765**				
		(2.662)	(–2.532)				
	govdef			–0.0399***	–0.0517***	0.0259	0.0649***
				(–6.492)	(–4.202)	(1.322)	(2.836)
	lnopen1	0.779***	–1.160***	–0.276	–0.691***		
		(6.829)	(–7.293)	(–1.622)	(–2.813)		
Institutional	lnprcl	–0.812***	1.070***	–0.147**	–0.182**	–0.396***	–0.323**
		(–10.64)	(5.112)	(–2.458)	(–1.969)	(–4.609)	(–2.028)
	lnef	–1.171***	1.751***	0.766***	1.526***	–2.386***	–2.306***
		(–6.261)	(6.795)	(4.175)	(6.154)	(–6.059)	(–2.991)
	constage				0.00610**		
					(2.537)		
	demage	0.121***	–0.169***		–0.0179*		
		(5.235)	(–4.294)		(–1.686)		
	demtot	0.0127***	–0.0160***				
		(8.015)	(–3.998)				

Control	lnk			–0.412***			
				(–9.979)			
	lnltotal			0.379***	0.419***		
				(6.551)	(4.502)		
Dummies	landlock			0.152*	0.859***		
				(1.806)	(4.352)		
	mus			–0.833***		–0.972***	–1.578***
				(–5.429)		(–4.263)	(–9.644)
	moz			–0.728***	–1.313***		
				(–4.403)	(–4.507)		
	legaleng				–0.750***		
					(–3.485)		
	Constant	1.856***	–2.137**	6.939***	–1.130	9.409***	10.55***
		(3.672)	(–2.285)	(5.027)	(–0.488)	(12.76)	(5.822)
Model diagnostics	Observations	39	39	156	156	51	51
	R-squared	0.850	0.645	0.893	0.530	0.847	0.745
	F-test	48.47	19.68	150.1	30.28	76.55	38.08
	Prob. > F	0	0	0	0	0	0

Note: The *t*-statistics are in parentheses.
***Significant at the 1 percent level.
**Significant at the 5 percent level.
*Significant at the 10 percent level.

where $i = 1, \ldots, N$ countries and $t = 1960–2004$. For each country, Policy_{it} and Institutions_{it}. respectively, represent economic policy variables (inflation, government deficit, and degree of openness) and institutional ones (political and economic freedom, age of constitution, age of democracy, and number of prior transitions to dictatorship, among others). The $\{Z_i\}$ denotes a set of control variables (see appendix A) where the economic variables (such as capital and labor endowments) are used together with geographic variables (such as distance or landlockedness). Our initial estimation process revealed that the inclusion of certain key variables of interest, such as the real effective exchange rate and measures of exchange market pressure (EMP), dramatically reduced the number of observations that were available to be used in our models. We subsequently dropped these variables from our analysis, but evidence on conditional EMP is presented in the next section.

Regarding our estimation strategy, we first estimate the log-log equivalent of equations (1) and (2) for each region in order to identify the determinants of diversification and convergence at the regional level. Then, we reestimate these two equations for regional subsamples that capture two different diversification-convergence scenarios. The first subsample, denoted as the high regime, comprises countries that simultaneously exhibit high diversification and high convergence while the second, the low regime, comprises those that exhibit the opposite combination. We expect that this strategy will allow us to highlight differences and commonalities in performance across regimes and regions.

We identify the criteria used to divide the sample from the visual inspection of the partial relation between income gap and number-equivalent index averages (see figures 7.8 and 7.9, panel [b]). We define high regime as those observations satisfying the condition $\{ygap < 0.945 \;\&\; neq5 > 4.5\}$ and low regime as those where $\{ygap >= 0.945 \;\&\; neq5 <= 4.5\}$ in the case of ECOWAS. In effect, we are isolating the upper-left and bottom-right quadrants for further analysis. Moreover, we identify Senegal as a potential regional benchmark with which to compare Cape Verde, given its high intraregional diversification-convergence combination. We adopt the same conditions for SADC to facilitate interregional comparisons and identify Mauritius and South Africa as potential benchmarks. Estimation results are given in tables 7.9A and 7.9B, which includes both the full sample and two subsamples for ease of comparison.

With respect to ECOWAS, we find a two-way relationship between convergence and diversification, but only under the high regime. Moreover, the estimated coefficient of the impact of diversification on convergence is relatively and highly significant (–0.646 at 1 percent level). Under the low regime, the relation is only 1-way, as more convergence always increases diversification, but not the other way around. For the region as whole diversification increases with more convergence, but more diversification actually leads to *less* convergence. This result is unexpected but plausible given the ambigu-

ous relationship between these two variables in ECOWAS, as depicted in figure 7.8 (panel [a]), and nonlinearities that characterize many of the partial relations between variables. The impact of convergence on diversification is also weaker when compared to the high regime, as the estimated coefficient is about half as large (–0.398 vs. –0.751). Together, these results appear to indicate that a critical level of diversification is needed before one observes a two-way relationship, ceteris paribus.

For SADC, the two-way relationship between convergence and diversification occurs under the high regime and, significantly, also for the full sample. These findings contrast with the one obtained for ECOWAS, where only the high regime exhibited such behavior. It is probably due to the influence that highly diversified countries such as South Africa and, perhaps to a lesser extent, Mauritius, exert on the region.[26] It may also be due to the fact that SADC is almost 70 percent more diversified than ECOWAS (6.47 vs. 3.83 mean neq5 as reported in table 7A.2). In contrast, the two-way relation is *positive* under the low regime: more diversification leads to *less* convergence and less convergence leads to more diversification. This result implies that SADC countries experiencing low levels of diversification may well need to specialize in order to ensure more convergence. This could be the rationale for Mozambique's move toward lower diversification, albeit accompanied by higher GDP per capita growth rates, as discussed below.

In order to better interpret our empirical findings, as well as to highlight possible differences and commonalities in performance, we also look at how key model variables differ across high and low regimes for each country (see figures 7B.1 and 7B.2). Note that we use each country's GDP per capita growth rate in lieu of its rate of convergence to the income frontier, as the latter measure would also reflect changes in the United States' GDP per capita. Interestingly, almost all of the highly diversified countries in ECOWAS register *negative* GDP per capita growth rates, with the exception of Cape Verde. Indeed, it is striking that Cape Verde exhibits not only the highest GDP per capita growth rate in ECOWAS, but also one that is fairly consistent across both regimes. This finding accords with our findings in section 7.3 and is also reflected in our estimates, as the Cape Verde dummy contributes toward more convergence under the full sample. Moreover, its effect for the Cape Verde dummy is almost on par as that of the benchmark. Note also that while Cape Verde is not as diversified as Senegal, it has increased its number equivalent appreciably between regimes as a result of its positive diversification trend over time.

For SADC, GDP per capita growth rates are positive under the high regime with the exception of Madagascar, Mozambique, and Zimbabwe.

26. Indeed, our initial OLS and 2SLS scoping estimations indicated that the determinants of diversification and convergence are broadly similar for ECOWAS and SADC when South Africa is excluded from the latter sample. These results are available from the authors upon request.

In the case of Mozambique, however, the move toward less diversification is accompanied by positive GDP per capita growth, which appears to be a notable reversal of fortune. Indeed, Mozambique's growth under the low regime compares very favorably with that of Mauritius, which is highly diversified and so has no observations falling in the low-regime subsample (see figure 7.13).

Turning to the other policy variables, we find that more inflation leads to more convergence under the full sample and low regime. In the case of the latter more inflation also leads to diversification, as does a higher budget deficit. This result could mean that increased diversification is associated with less macroeconomic stability, but this intuition needs to be confirmed. For the high regime we find no relation between inflation and diversification, while increased budget deficits lead to *less* diversification and have no effect on convergence. A greater degree of openness leads to less diversification and more convergence under this regime and has no impact whatsoever on the others. Our reading of figure 7.12 reinforces these findings: inflation is generally lower under the high regime for countries experiencing both regimes (with the exception of Ivory Coast), while government deficits are higher, but only moderately so in most cases, and always less than 10 percent of GDP. For Cape Verde, the result of government deficit consolidation as diversification increased is very clear, as is the dramatic lowering of its inflation rate. Diversification coupled with convergence also appears to go hand in hand with an average degree of openness in the range of 60–80 percent of GDP based on Ivory Coast, Cape Verde, and Senegal's performance on this score.

The results obtained for policy variables in SADC differ from those in ECOWAS when compared on a sample-by-sample basis. We find that more inflation leads to *less* convergence and *less* diversification under the low regime, as does greater openness. Greater openness is also associated with *less* diversification in the full sample. Increased government deficits lead to more convergence and *less* diversification for the same sample, but increase diversification under the high regime. Our reading of figure 7.13 is that more inflation, larger budget deficits, and being less open are a greater concern for countries under the low regime. Regarding Mozambique the shift toward less diversification is accompanied by lower inflation, but also higher deficits, and it appears that there is scope for it to increase its degree of openness. With the exception of the sole effect mentioned above, we note that the effect of policy variables is not as pronounced under the high regime as in the others, which we take to be a sign of policy credibility.

As for the institutional variables, convergence increases as political and economic freedom increases in ECOWAS. Also, there is more convergence as the age of democracy increases, and this holds true for the low regime. However, an increase in the number of democracies in the system unexpect-

edly reduces convergence. Under the high regime, diversification increases with more political and more economic freedom. In the other two cases, diversification is associated with more economic freedom only. Indeed, we observe that the effect of economic freedom is pervasive across all samples and its effect is largest precisely under the high regime. In the full sample, being an older democracy also leads to less diversification, as do a larger number of prior transitions to dictatorship in the low regime. There is also more convergence under an English legal tradition. While these results are interesting, they clearly need to be further explored.[27]

For now, we take away the insight that a positive relation must exist between economic and political freedoms, which may have to exceed some critical threshold in order for there to be an environment conducive to convergence (full sample). In addition, economic freedom may be a necessary, but not sufficient, condition to underpin successful diversification in ECOWAS. The insight applies to SADC: an increase in both political *and* economic freedoms increases convergence in both the low and high regimes. This does not happen in the full sample, possibly because of a composition effect (we have the combined effect of two opposing effects associated with more economic freedom, which leads to more diversification under the low sample and less under the high). Moreover, an increase in both freedoms increases diversification under the low regime but has the opposite effect under the high. Here again, the full sample exhibits mixed results. Even though this is not the main focus of analysis in this section, most control variables display the expected signs.[28] Additional insights against which to interpret both countries' performance with respect to political and economic governance and the convergence-diversification relationship relative to their subregional partners is provided in the next section.

7.5 Comparative Description of Cape Verde and Mozambique

We seek to embed the insights from the estimation of diversification-convergence regimes to successful development experiences in Cape Verde and Mozambique into a comparative description of the broad dimensions of economic growth and foreign trade on the one hand and macroeconomic policy and financial reputation on the other. Going back to the interaction between globalization and governance in Africa, section 7.5.3 presents progress on the MDG and other governance indicators.

27. This task requires a better understanding of how freedoms interact with one another and how they relate to alternative legal, political, and constitutional arrangements, as discussed in Macedo et al. (2013).

28. For example, more capital and more oil both lead to more convergence, while landlockedness has the opposite effect in ECOWAS. On the other hand, total labor force and population density have unexpected signs.

7.5.1 Economic Growth and Foreign Trade

Cape Verde

During the 1970s, the growth rate of GDP was positive (0.18 percent) but below the ECOWAS average (1.18 percent). In contrast it averaged 6.85 percent during the 1980s, while ECOWAS reported a decline of –0.64 percent. The reversal of fortunes continued during the 1990s, with a growth rate above the ECOWAS average (3.89 percent vs. –0.20 percent) and over the 2000–2006 period (1.04 percent vs. 0.86 percent). Although the causal study of growth is beyond the scope of our research, Cape Verde's improved growth performance follows the policy and institutional reforms described above. Describing their impact on exports, these were derived mainly from a relatively limited natural resource base. During 1988–1997, exports consisted mainly of primary-sector products, namely fish and crustacean, and so were neither diversified nor high value added. The 1976 decision to join ECOWAS was possibly one of the few exceptions to the otherwise protectionist trade policy. In practice, ECOWAS trade is of reduced importance, as ECOWAS members produce similar manufactured products. Clearly of greater importance was the decision to diversify production during 1992–1996, which went hand in hand with greater trade openness and a market-orientated policy stance. As a result, exports grew substantially. After a dramatic decline of over 40 percent in 1993, exports surged to almost 4 percent in 1997 (IMF 1998). The destination of exports also changed, as these were now directed mainly toward the European Union, particularly Portugal and Spain. Most of the export growth, however, has been in tourism, notwithstanding the cyclical efforts to diversify the fishing and industrial sectors since the 1990s.

When the government shifted away from a policy of state control to a free market one in 1988, tourism also began to develop substantially. In line with this policy change, Werlin (1996) observes that this sector's development entailed the synchronization of public and private investment in infrastructure. Legislation was also passed to encourage tourism, which included streamlining approval of qualified projects, allowing for a gaming industry, and setting up a regulatory and enforcement framework. Furthermore, a standard service fee was levied on the users, as opposed to service providers, which helped finance tourism. Direct public investment in infrastructure construction, such as hotels and transportations, was also pursued. Tourism's contribution to GDP increased from approximately 2 percent in 1995 to 5 percent in 2000 and 10 percent in 2005 (Mitchell 2008). As noted in IMF (2008a), the balance of payments changed from being very dependent on international aid and emigrants' remittances to being based on tourism and tourism-related foreign direct investment. In 2001, services exports and foreign direct investment surpassed transfers for the first time as a percentage of GDP. Indeed, Cape Verde became the fastest-growing market within

the group of tourism-based economies whose travel exports have exceeded 10 percent of GDP for at least one year during 1998–2007, reporting an average annual growth rate of tourism services around 30 percent during 2000–2006. During the same period Croatia registered an average annual growth rate of 20 percent, the second highest. Tourism is highly procyclical, however, so an excessive reliance on it increases output volatility unless exports of goods and services are sufficiently diversified. Unfortunately, tourism is absent from the OECD database used in our empirical work.

When it returned to power in 2001, PAICV pursued growth-orientated policies while rationalizing and reducing import taxes and seeking to rein in the budget deficit. It also promoted trade integration through increased access to preferential markets, such as the United States (African Growth and Opportunity Act [AGOA]), and European Union (Cotonou agreement). Joining the World Trade Organization in 2008 required a transparent and predictable trade and foreign investment environment, which accelerated Cape Verde's global integration. Although recently graduated to middle-income status, it still benefits from preferential market access for least developed countries. Recent governments have continued the reform process, including those of relevance to financial and exchange markets. Growth has been sustained by the service sector, namely transports, hotel, and restaurants and communications, and also due to increased spending on education and improved governance. Indeed, the importance of the service sector, largely in tourism, was evident as early as 1980. Its continued success depends on further improving required infrastructure, namely good communications and a liberalized air transport market (Lourenço and Foy 2003). Cape Verde's business cycles have thus become more synchronized with developed economies following increasing trade and financial integration into the world economy: Ribeiro, Loureiro, and Martins (2008) make this an argument for "euroization" and the stability of a real effective exchange rate where the euro and dollar shares are equal to one-half (table 7.10) and could be used in supporting such policy recommendation. On the other side, the labor market is relatively rigid and administered prices still exist, for example, in the energy sector. Thus structural problems persist and they make adjustment to external shocks more difficult.

Regarding foreign financing sources, emigrant's remittances accounted for 12 percent of GDP in 2006, and their low volatility has allowed for consumption smoothing in response to external shocks. However, remittances have become more procyclical in recent years; for example, the correlation between (detrended) GDP and remittances was around 65 percent for the period 1980–2006. This fact may be associated with investment-driven flows rather than traditional consumption-smoothing behavior. Since financial flows are far more volatile and less prone to act as a buffer in times of crisis, this is another challenge to Cape Verde: reforms are a necessary but not sufficient condition for success. Adequate implementation and control is also

Table 7.10 Nominal and real effective exchange rates based on consumer prices

	CVP NEX	CVP R CPI	MOZ NEX	MOZ R CPI
1990	85	100	8	70
1991	86	95	13	84
1992	83	93	23	107
1993	94	103	33	114
1994	96	104	52	113
1995	95	98	81	117
1996	100	100	100	100
1997	107	100	97	92
1998	112	102	99	94
1999	115	102	104	97
2000	124	116	115	99
2001	125	117	154	124
2002	122	114	181	127
2003	112	105	199	126
2004	106	104	198	114
2005	106	107	202	112
2006	106	104	224	112
2007	101	97	238	113
2008	98	91	232	103
2009	100	91	244	105
2010	91	81	243	96
2011	91	80	243	94

required to ensure that increased foreign direct investment translates into higher growth and employment.

Industrial policy in the 1980s was characterized by less state intervention and more privatization, which led to the creation of a vibrant private sector that contributed positively to growth. On this score, the literature shows a clear link between private ownership and economic growth. According to Plane (1997), privatizations are a means to reduce government loans, equity, subsidies, and explicit or implicit government guarantees for borrowing, which contributes toward competitiveness and a more efficient market economy.

In terms of competitiveness, the relative stability of Cape Verde's real effective exchange rate since 1992 has already been mentioned. This is largely attributable to the Cape Verde escudo's peg, first to a basket of currencies during 1977–1998 and to the euro thereafter (table 7.10). Thus, exchange rate changes have not played a major role in engineering gains in competitiveness. Moreover, the low volatility reflects the control of inflation over the 1990s.

Mozambique

The GDP data show a similar, though slightly worse, comparative performance in the preindependence period, where the country grows at an

average rate of 4.6 percent, while the SADC average was close to 5 percent, then the period of social and political unrest, where we watch a general regional slowdown and a severe recession in Mozambique (an average rate of –1.6 percent while SADC average growth rate equals 1.7 percent), and finally, in the postwar period, Mozambique grows at a fast rate (averaging about 8.5 percent per annum [p. a.]), while the region grows at a considerably slower rate of 3.4 percent, less than half of Mozambique's. The civil war is characterized by both a regional slowdown and a significant decrease in Mozambique's GDP per capita. While SADC still manages to grow at a rate of less than 1 percent per year, Mozambique's GDP per capita falls, on average, 3 percent per year. After the severe recession of the late 1970s and 1980s, when Mozambique fell back in comparison to its neighbors, Mozambique more than doubles its GDP per capita and starts to close the gap relative to the SADC average.

Export specialization has gone hand in hand with GDP growth, possibly due to the megaproject-related exports, which increased appreciably since 2000. Products such as aluminum and electrical energy now dominate exports, while prawns and cashews lost significance. The average trade share of world exports more than doubled in the 2001–2006 period relative to 1991–2000, but remains lower than in comparator groups in Africa and Asia.[29] While most Mozambican exports are directed to OECD countries, SADC is also a preferred destination, making up over 20 percent of the 2007 total, of which sixteen is accounted for by South Africa. This increase is due almost exclusively to megaproject-related exports, rather than a diversified performance associated with extensive competitiveness gain. Mozambique's revealed comparative advantages are in the production of aluminum, gas, electrical energy, and wood articles, reflected in terms of trade that improved significantly more than in comparator groups in Africa and Asia. As aluminum prices rose, the terms of trade improved by 7 percent in 2001–2006 as opposed to 0.5 percent during 1991–2000. These industrial exports are directed mainly to developed countries, whose share in the share in total exports toward those countries are from 40.1 percent in 1991–2001 to 63.9 percent in 2002–2005 (Lledó, Peiris, and Kvintradze 2007, 61). Considering traditional exports, Mozambique's main agricultural exports are cashew nuts, sugar cane, cotton fiber, and timber. Other products include sisal, tobacco, and fruits such as bananas, citrus, and mango. The main fisheries product, prawns (shrimp), continues to be among the country's top exports (and the largest agricultural export in 2007). Unlike the typical cases of export specialization, in Mozambique these grew by an annual

29. Lledó, Peiris, and Kvintradze (2007) compare Mozambique with sub-Saharan Africa (SSA) and Indonesia, Malaysia, the Philippines, and Thailand (ASEAN4) instead of SADC average. It rose from 0.01 to 0.02, whereas SSA rose from 1.5 to 1.6 and ASEAN4 remained constant. Since the early 1990s, exports have expanded at an average rate of 10 percent per year. According to the 2007 WTO Trade Policy Review, exports reached over $2.4 billion.

average rate of 4 percent, whereas the growth of megaproject-related exports was over 10 percent yearly, on average (additional evidence in Easterly and Resheff 2010).

In terms of competitiveness, Mozambique's real effective exchange rate (shown in table 7.10, with euro and dollar shares equal to one-half) has tracked the SADC average since the mid-1990s, whereas before it was clearly less competitive than the subregion. Nevertheless, both Mozambique and SADC are less competitive than South Africa, especially in recent years. Based on our reading of the 2006 and 2007 World Bank Enterprises surveys in section 7.5.3, trade liberalization has yet to yield substantial improvements in firm-level competitiveness. While Mozambique has better infrastructures (particularly on water, electricity, and Internet), less corruption, and a generally better regulatory environment than SADC, PALOP, and sub-Saharan Africa, it has less developed financial markets, a state where rule of law grounded less export-oriented firms, and less technology licensed to foreigners than the benchmarks (additional evidence in La Porta and Schleifer [2010]).

Notwithstanding the progress achieved thus far, Mozambique also faces a number of challenges. As it depends on foreign aid, revenue and administration reform, as well as a stronger fiscal regime toward mineral and oil resources, will be required for the government to enforce an "exit strategy" that enables it to raise revenue for its own, to finance at least current expenditure as soon as the MDGs are achieved (Lledó, Peiris, and Kvintradze 2007). While it is true that Mozambique has a strong export record when one considers its share of world exports over the last few years, this achievement has been primarily due to specific megaprojects, most noticeably in the aluminum sector. Moreover, its trade pattern is sometimes the result of protectionist policies, such as tax exemptions and qualification as export-processing zones that allow companies to import goods duty free and benefit from tax incentives. Two examples are the sugar and cashew industries. In the late 1990s, an import tax on sugar led to increased domestic sugar production, and an export tax on raw cashew nuts penalized small exporters while encouraging small- and medium-sized cashew processing. In this case, the pattern of specialization is clearly linked not only to comparative advantage, but also to trade policy.

That said, Mozambique's trade regime is not too restrictive. In 2006, the average tariff was in line with the rest of SADC, there were no significant nontariff barriers according to the IMF, and the process of tariff disarmament will likely continue. As a result, the maximum tariff has declined from 35 percent in 1999 to 20 percent in 2006. Mozambique's business environment is still relatively weak. The *Ease of Doing Business* indicators for 2006 suggest that custom procedures, business registration, and contract enforcement still perform poorly against other SADC members. Mozambique was one of the countries that benefited most from the Heavily Indebted Poor

Countries and Multilateral Debt Relief Initiatives (IMF 2008b). Coupled with a cautious macroeconomic stance, debt relief has allowed for increased spending, especially in the health and education sectors. However, long-term fiscal sustainability hinges crucially on the widening of the tax base and on economic growth underpinned by high-quality structural investments.

7.5.2 Macroeconomic Policy and Financial Reputation

Exchange Market Pressure

The empirical results in section 7.4 did not use EMP and real effective exchange rate indices due to database incompatibilities, but they did establish that lower budget deficits (less than 7 percent of GDP) are associated with convergence for both ECOWAS and SADC. Not unrelated, Cape Verde and Mozambique also compare favorably to respective subregional averages in financial reputation. As discussed in Macedo, Pereira, and Reis (2009), this can be proxied by EMP, a weighted sum of the nominal depreciation rate, changes in foreign reserves (excluding gold), and changes in the interest-rate differential,[30] that is,

$$EMP_t = \Delta e_t + \eta_r \Delta r_t + \eta_i \Delta (i_t - i_t^*).$$

The weights for reserves and for the interest rate differential are given by the standard deviation of depreciation relative to the respective variable, to avoid that the most volatile components of EMP dominates the others. As mentioned, according to the governance indicators reported in table 7.8, Cape Verde compares well to the ECOWAS average. Lopes and Santos (2010) note, however, that this institutional portrait misses the "financial credibility factor" that they analyze through EMP using monthly data from 1990 to 2005, both in a descriptive sense and in a model-dependent framework. Mozambique's mixed record compared to the SADC average is shown in table 7.8. Yet, it behaves well in terms of political stability and voice and accountability.[31]

Lopes and Santos (2010) distinguish between fixers and floaters as follows: The seven franc CFA countries (Benin, Burkina Faso, Côte d'Ivoire, Mali, Niger, Senegal, and Togo) and Guinea-Bissau peg to the euro in ECOWAS, while Seychelles and Zimbabwe peg to the dollar in SADC.[32] Ghana, Nigeria, Sierra Leone, and Gambia are floaters in ECOWAS and Zambia, Tanzania, Mauritius, Malawi, Madagascar, and South Africa are floaters in

30. From *International Financial Statistics* and central banks' websites.

31. Figure 1 in Lopes and Santos (2010) shows the tremendous improvements in Mozambique as soon as the war is over, compared to SADC and Great Britain. Again it misses the "financial credibility" factor.

32. Botswana, Lesotho, Namibia, and Swaziland peg to the rand, so they float relative to the dollar. Lopes and Santos (2010) acknowledge that this makes them effectively neither fixers nor floaters, but a third category.

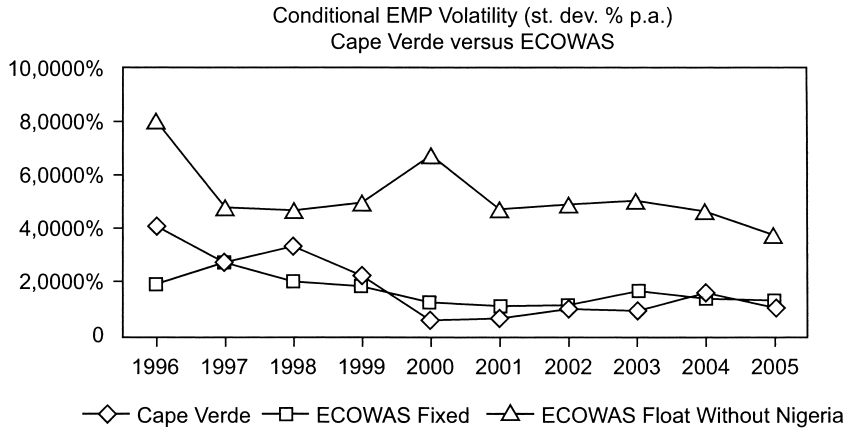

Fig. 7.14A Conditional volatility of EMP Cape Verde versus ECOWAS
Source: Lopes and Santos (2010).

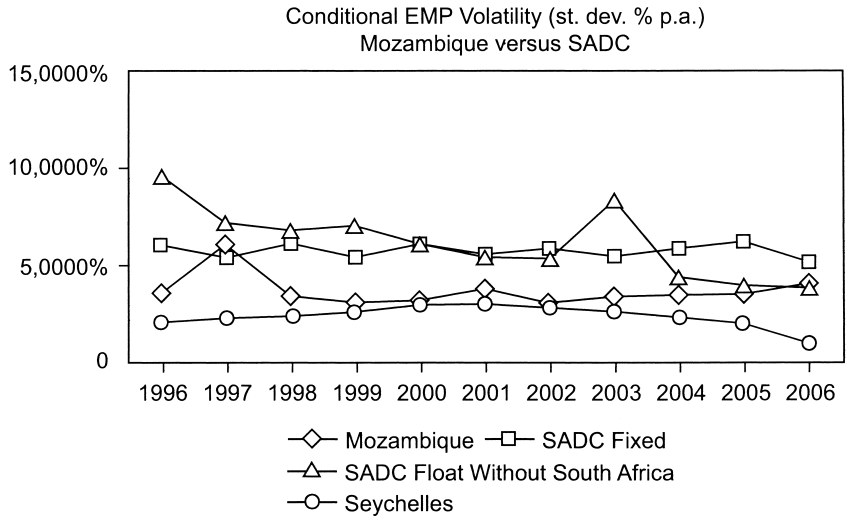

Fig. 7.14B Conditional volatility of EMP Mozambique versus SADC
Source: Lopes and Santos (2010).

SADC. They also find that real exchange rate depreciation improves financial reputation in Cape Verde while doing the opposite in Benin, where it increases EMP mean and volatility.

If financial reputation is defined as low EMP with low volatility, then fixers behave better than floaters both in ECOWAS and SADC. Conditional volatility and mean EMP, reported in figures 7.14A, 7.14B, 7.15A and 7.15B for ECOWAS (without Nigeria) and SADC (without South Africa), strengthen

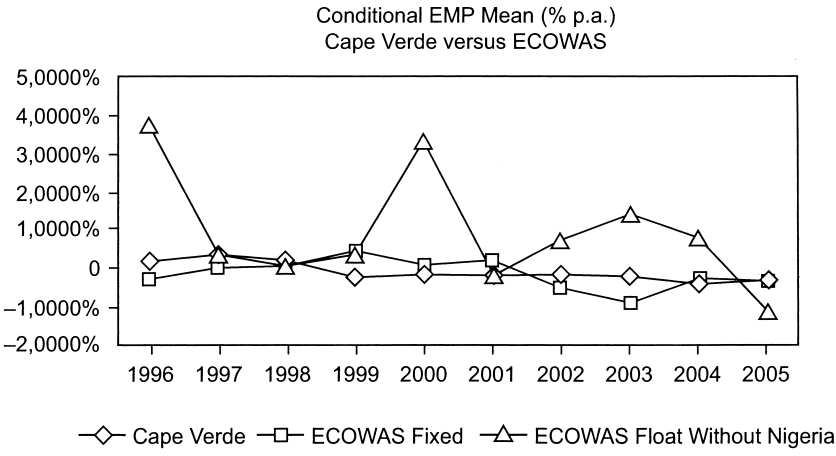

Fig. 7.15A Conditional mean of EMP Cape Verde versus ECOWAS
Source: Lopes and Santos (2010).

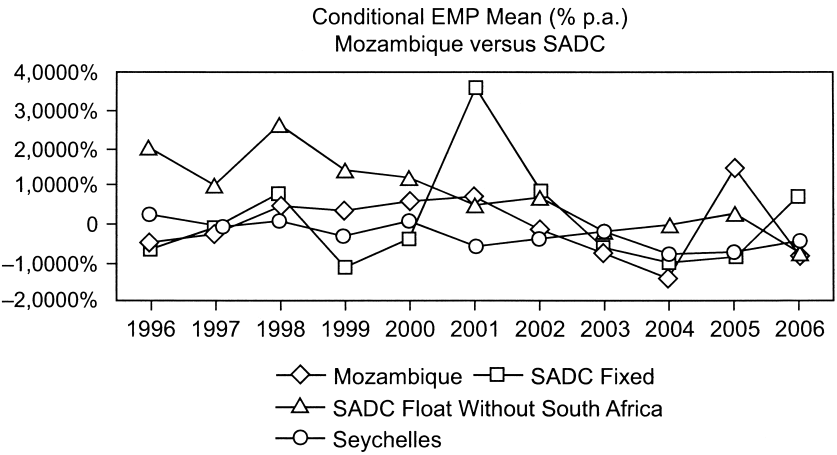

Fig. 7.15B Conditional mean of EMP Mozambique versus SADC
Source: Lopes and Santos (2010).

conclusions from the unconditional volatility and mean EMP. Comparing Mozambique's EMP performance to SADC, except South Africa (which dominates the weighted average), Botswana, Lesotho, Namibia, and Swaziland because they are pegged to the rand, and Zimbabwe because of the huge devaluations in 1998 and 2000, the standard deviation of Mozambique's EMP has converged to that of Seychelles. The fixers, taken as a whole, behave very similarly to South Africa, given that Lesotho and Namibia

are pegged to the rand and Botswana is pegged to a basket of currencies where the South African rand has an overwhelming weight. From 1994 to 2008, Mozambique's EMP mean has behaved similarly to the one of South Africa but, from 1999 on, its volatility has converged more sharply toward the one of Seychelles. Mozambique also has a few EMP "crises" (taken to be extreme values of EMP), none of which are severe, behaving better on this account than several economies in the region, such as Tanzania, Mauritius, and Malawi. In SADC, the gap between fixers and floaters is not as wide as in ECOWAS.

For the impact of domestic credit in EMP variance, Mozambique appears with a positive relationship that indicates the opposite of Cape Verde. It seems that these countries did not avoid the volatility and uncertainty on EMP with monetary expansions through domestic credit. But if we complement this result with the one obtained for the coefficient of domestic credit variation in the mean equation for Mozambique, then volatility is not as harmful given that Mozambique was able to reduce its mean EMP when credit was expanded, although they did not behave so well in controlling the volatility. In Mozambique, moreover, the initial real depreciation is followed by nominal depreciations, which increase EMP and incite speculation.

In the SADC floaters group, Mauritius and South Africa display the most credible results on our key indicators, as well as other coefficients. However, Mozambique also has some positive conclusions, as the risk-return relationship or the domestic credit effect on the EMP mean. Cape Verde has had a remarkable degree of credibility and sophistication of its exchange markets, undoubtedly due to the quality of the institutional framework. Due to its natural focus on political freedom and accountability, the governance indicators presented in table 7.8 and below overlook the effect of financial expectations. Mozambique, too, despite lagging behind Cape Verde, also has some good results, very much in line with other floaters in the region, and better in some accounts (namely, the absence of any severe crises, a conditional volatility close to a fixer's, and a risk-return effect pointing the right way, unlike many other countries in the region). While Mozambique's financial reputation is weaker than Cape Verde's, it seems to be heading the right way. We now described the foreign exchange market in greater detail for each of the two countries.

Cape Verde

On this score, Cape Verde's track record improved substantially given that, following independence, high budget deficits were the order of the day. The reason for expansionary fiscal policy was the relatively large expenditures required to improve living conditions, run the state-controlled industrial sector, and pay for the high level of imports. The deficit was also high due to interest payments on domestic and foreign debt, leading to a loss of foreign exchange reserves and financial reputation. It was only in the

late 1990s that the deficit was reduced. This change was accompanied by measures to control inflation and strengthen the financial sector. In 1997, a program was adopted that did away with domestic bank financing to be substituted by that obtained from foreign sources. As a result, the 1998 budget deficit was financed entirely by foreign creditors, whereas domestic creditors had accounted for 10 percent of GDP and foreign ones almost 1 percent in 1997. The peg to the euro, which allowed for low inflation rates and increased financial reputation, was crucial in obtaining the needed international finance. The government also speeded up the privatization process, improved tax collection, and increased the recovery of debt obligations from public enterprises. Current primary expenditure was curtailed to offset higher interest revenue and the government abstained from prefinancing, donor-supported investment projects. The composition of the expenditures was also modified while maintaining their level. With these measures, the budgetary position changed from a deficit 15.1 percent of GDP in 1997 to a surplus of 0.5 percent in 2000.

The 2001 elections brought about some fiscal slippage, but the newly elected PAICV government then sought to reduce the deficit, as well as domestic and external public debt, without overly increasing the tax burden. More recent reforms have streamlined and rationalized taxes on imports, accompanied by a general reduction of customs duties and excises. At the same time, public spending was redirected toward education, health, and other priority areas, in accordance with the government's poverty-reduction strategy. Transfers and subsidies were also reduced substantially, notably subsidies to large public enterprises. As a consequence, current revenues increased from approximately 21 percent of GDP in 2001 to 23 percent of GDP in 2004, while current public expenditures were kept constant at around 21–22 percent of GDP during the same period. The adoption of an IMF mid-term program in 2006, supported by a new nonfinancial instrument—Policy Support Instrument (PSI)—confirmed Cape Verde's commitment to maintain the pace of reforms and close dialogue on macroeconomic policy. The program, which will be completed in 2010, will assist Cape Verde in reducing fiscal risks and minimize the impact of external shocks on its economy by promoting the necessary structural reforms under IMF advice and supervision. While AEO (2010) maintains a positive assessment on financing, the threats to the EU financial system are bound to have a negative effect going forward.

In 1976, Banco de Cabo Verde started operations, succeeding Banco Nacional Ultramarino (the former issuing bank) and Banco de Fomento Nacional (a state-owned development bank). The currency was pegged to the escudo but in 1977, following Portugal's devaluation, the peg shifted to a basket of currencies. During the eighties, several reforms were put in place, namely through the use of information and communication technologies in the central administration and a network of bank offices spreading

through the archipelago: A newly created investment department managed programs supporting productive activities. From 1988 on, a vast program of reforms began promoting trade liberalization and privatizations while the government remained responsible for infrastructures. Successive governments continued these reforms, accompanied by an increasing concern with the role of education and good governance. High growth in transports, hotels, restaurants, and communications was associated with these reforms, making Cape Verde largely dependent on services by 1980.

In 1990 monetary and exchange rate policies, as well as the supervisory and lender of last resort roles of the central bank, were reinforced by new by-rules but commercial and development activities continued until September 1993. Starting April 1, 1998, the Cape Verde escudo was pegged to the euro in the framework of an agreement with Portugal. Ribeiro, Loureiro, and Martins (2008) describe the agreement, while Macedo and Pereira (2006) associate it with a substantial reduction in EMP and lower inflation, as described above. In 2002, deficit financing by the central bank was also formally prohibited. In practice, the government has not needed to rely on this type of financing due to the receipt of donor aid and the sale of treasury bonds with medium-term maturities. Fiscal policy has also been prudent with a medium-term fiscal strategy for 2008–2010 approved by the IMF. Fiscal reforms were accompanied by an increase in tax effort, particularly of income tax, as corporate tax rates are still relatively low. Together, this environment of fiscal responsibility has allowed debt sustainability analysis to classify Cape Verde's debt risk as low. The external position continues to depend on transfers, mostly migrants' remittances. The decreasing role of transfers and the increasing role of portfolio and direct investment from abroad erodes remittances' role as a buffer for households. It is likely that second and third generation emigrants will be less inclined to send remittances and will only invest in Cape Verde when it is profitable to do so. The government will have to take cognizance of this fact when designing and implementing its medium-term development strategy.

Mozambique

Mozambique's economic recovery in recent years has clearly entailed a more effective and prudent fiscal policy. After the 1992 peace accord, there was a significant reduction of current expenditures (from 20 percent in 1992 to 10 percent three years later). In fact, except during 2000–2002, revenues have exceeded current expenditure since 1995, while investment expenditure (mainly on megaproject-related investments) has been paid with grants. Such a strategy, in combination with a sound monetary policy (particularly since 1996–1997) and significant trade liberalization (as discussed above), has allowed for higher growth rates, private investment, and lower inflation. We also observe a shift in the utilization of public resources, with new emphasis being given to sectors such as health, education, and agriculture,

along a poverty-reduction strategy undertaken principally since 1998.[33] At present, it seems that budget equilibrium is not a goal for the Mozambican policymakers. Moreover, the tax effort is still very low, although it has increased recently. As such, it is important for government to increase taxes on big projects and to create procedures that increase compliance in order to widen the future tax base.

Mozambique's currency, the metical, was created on June 16, 1980, by Law 2/80 and the colonial administration's banknotes ceased to circulate. The first credit conceded by the International Development Association, though, was only granted in 1985; the second was in 1987 and successive agreements were signed in the following years. Mozambique has benefited widely from the support of the IDA, either financially or through its technical expertise. The main accomplishments, as reported in IDA (2007), involve the liberalization of trade, financial sector reform (with a separation between the commercial and central banking, with competition in commercial banking), improved health conditions, good investment climate, and privatizations in several sectors. On January, 31, 1987, the metical was pegged to the US dollar instead of being pegged to a basket of six currencies reflecting shares in goods and services transactions, but authorities reverted to a basket of ten currencies in April 1988.

In the late eighties/early nineties, policymakers started aiming at transforming Mozambique into a market economy. Throughout 1989, several capital account liberalization measures were pursued: agencies of the bank were allowed to conduct foreign operations (April) and private financial firms were given more freedom to conduct foreign exchange operations (July). On November 30, finally, the new Constitution declared that Mozambique would aim at being a market economy.

In May 1993, interest rates were semiliberalized and left to the free market, with the central bank determining maximum and minimum bounds. In June, exchange rates from the Secondary and Official Exchange Markets were unified. By 1994, the interest rates were completely liberalized. Through the following years, several liberalizing measures were undertaken and the legal foundations of the exchange market were perfected.

In June 1999, in a move that was very important for Mozambique's development, external debt in the amount of $3.7 billion is erased by the Heavily Indebted Poor Countries Initiative of the IMF. In 2000, a reinforced initiative was put in place to the favor of Mozambique. In 2003, further measures were taken to ease capital operations by nonresidents in the stock exchange. In fact, AEO (2008) claims that debt relief early in the twenty-first century was a condition for most of the development Mozambique is experiencing today. In 2005, Banco de Moçambique started intervening in the Interbank

33. For instance, according to official budget figures from 1998 to 2000, health and education accounted for 26–28 percent of central governmental spending.

Foreign Exchange Market through weekly auctions of foreign exchange and a Multilateral Debt Relief Initiative was launched.

Mozambique's inflation rate has been under control for some time now and it now ranks among the lowest in the SADC. Indeed, the control of inflation has been the main objective of monetary policy since 1987, upon the approval of an economic recuperation plan, and even more so since the early 1990s. The data show that Mozambique managed to control inflation since 1991, averaging consistently below its SADC counterparts, particularly Angola. The inflation rate has been about half of the average in SADC since the nineties. This accomplishment is significant if we consider that in this period Mozambique experienced a transition from a central-planned, public-owned economy to a free-market economy, which is known to create an upward pressure on inflation.[34] More recently, Banco de Moçambique has also adopted several important measures, namely, daily liquidity forecasting and sterilization of changes in the monetary base, which improved the conduct of monetary policy.

This relative stability in inflation has been accompanied from the 1990s onward by a steady depreciation of the Mozambican metical's exchange rate against the US dollar, which is in line with other depreciation rates of SADC currencies. Regarding its external position, Mozambique has experienced trade deficits and negative factor incomes balances, which have been partially compensated by transfers (with the exception of 2006, where transfers were in excess of the shortfalls). The trade balance improved up till 2006 due to high aluminum prices and export growth of cashew nuts, sugar, prawns, and tobacco. However, the increase in the oil price and a decrease in traditional exports in 2007 deteriorated the trade balance. Indeed, financing a current account deficit, which reached 22 percent of GDP in 1999, required debt relief.

7.5.3 Millennium Development Goals and Governance Indicators

The information on MDG is drawn from a report prepared at the request of the Guinean presidency of CPLP (IICT 2007) and from AEO: the percentage of satisfactory outcomes in PALOP is 31 percent according to the first source, but 26 percent according to the second, as shown in table 7.11. The corresponding percentage for the whole AEO sample of fifty-three countries is 31 percent in 2007 and 41 percent in 2009 and 2010. Fewer entries with missing data appear in AEO (2009, 2010) than in previous issues, at least for PALOP, and the criteria used seem to have stabilized together with the percentage. The ranking found in the first source remains that found in tables 7.4 through 7.6, Cape Verde followed closely by Sao Tome, and Mozambique only marginally above Guinea Bissau and Angola, whereas the Sao Tome and Mozambique have the same average AEO score. Table

34. See Andersson and Sjöö (2002) for the structural adjustment's impact on inflation.

Table 7.11 The MDGs in PALOP before and after crisis

No. Indic.	1 pov.	2 schl.	3 rat.	4 < 5 m	5 mm	6 dis.	7 wat.	No. sat.
A	S	R	S	R	R	R	C	1
CV	A	R	A	A	A		A	5
GB	R	S	S	R	R	R	A	1
M	S	C	S	S	S	R	S	1
STP	R	A	A	S	R		A	3
No. percent sat.	1	2	2	1	1	0	4	31
2007								
A	C							1
CV		C	C	C				3
GB								0
M	C							1
STP	C	C		C		C		4
No. percent sat.	3	2	1	2	0	1	0	26
2009								
A	R	S	S	S	S	R	S	0
CV	R	A	A	S	A		C	4
GB	S	A	A	S	S	S	A	3
M	S	C	C	S	S		S	2
STP	R	R	S	S	R	S		0
No. percent sat.	0	3	3	0	1	0	2	26
2010								
A	S	S	R	S	R	S	S	0
CV	A	R	S	A	S	S	A	3
GB	R	S	S	S	R	S	S	0
M	S	C	S	C	A	R	S	3
STP	R	A	A	S	R		C	3
No. percent sat.	1	2	1	2	1	0	2	26

Source: First panel, Macedo, Martins, and Pereira (2007); others AEO of year indicated.
Note: A = achieved/early achiever; C = on course/on track; S = slow progress/off track; and R = regress satisfactory (A + C).

7.12 provides more detail on the quantified MDG presented in table 7.11 and compares Cape Verde and Mozambique to the ECOWAS and SADC average as before.

On the eradication of poverty, Cape Verde has one of the lowest shares of the poorest quintile in national consumption. Using the data available, we see that it is slightly worse than the average ECOWAS member. Angel-Urdinola and Wodon (2007) argue that relative poverty increased between the 1988/89 and 2001 surveys, based on the increase in the Gini coefficient from 50.2 percent to 53.83 percent), while absolute poverty measures decreased dramatically. Mozambique, meanwhile, has a slightly larger share (5.4 percent) of consumption of poor people when compared to the SADC average. Although the United States has a comparable figure, its definition of poverty is a relative and not absolute one. In view of Mozambique's recent

Table 7.12 Millennium development goals

1. Share of poorest quintile in national consumption (%)					
Cape Verde	4.4	1990–2003			
ECOWAS	5.3				
Mozambique	5.5	1991–2004			
SADC	5.0				
2. Net enrollment ratio in primary education					
	1991–2006	**1991–1999**	**2000–2006**	**90s–00s (%)**	
Cape Verde	942	953	938	–1.5	
ECOWAS[a]	575	508	602	9.5	
Mozambique	614	470	663	19.3	
SADC[b]	808	720	835	11.5	
3. Ratio of girls to boys in primary education					
Cape Verde	95	95	96	0.6	
ECOWAS	80	75	81	7.8	
Mozambique	79	74	81	9.0	
SADC	91	92	91	–1.4	
4. Children under five mortality rate per 1,000 live births					
	1990	**1995**	**2000**	**2005**	**2006**
Cape Verde	60	50	42	35	34
ECOWAS	213	207	190	181	179
		90s	**00s**	**90s–00s (%)**	
Mozambique		224	154	–7.0	
SADC		155	143	–1.2	
5. Maternal mortality ratio per 100,000 live births 2005					
Cape Verde	210				
ECOWAS	1,027				
Mozambique	520				
SADC	819				
6. Tuberculosis incidence rate per year per 100,000 population					
		90s	**00s**	**90s–00s (%)**	
Cape Verde		1,642	1,672	0.0	
ECOWAS		2,076	2,817	0.7	
Mozambique		2,854	4,330	1.5	
SADC		3,066	4,708	1.6	
7. Proportion of population using an improved drinking water source					
Cape Verde		79	80	1.0	
ECOWAS		52	57	4.2	
		1995	**2000**	**2006**	
Mozambique		39	41	42	
SADC		57	60	63	
8. Debt service as a percentage of exports of goods and services					
	1990–1994	**1995–1999**	**2000–2006**		
Cape Verde	136	118	82		
ECOWAS	171	179	102		
Mozambique	238	252	33		
SADC[c]	132	121	71		

Source: Same as table 7.8.

[a]Except Sierra Leone.

[b]Excluding Angola and DR Congo due to insufficient data.

[c]Except Zimbabwe, Zambia, and DR Congo.

evolution, the IMF considered it likely that this goal will be attained by 2015, and the 2009 and 2010 AEO percentages of satisfactory performance are uniformly better than in 2007. In fact, they are higher in 2010 than in 2009, so that they do not yet show any effect of the crisis—except for objectives 5 and 7, maternal mortality, and access to water, which fall to one-half of the previous value.

On MDG 2, net enrollment in primary education, Cape Verde has actually decreased slightly. However, the enrolment level is very high, even by the developed world's standards. Notably, Cape Verde is well ahead of its ECOWAS partners, which reflects its focus on education and the quality thereof. For Mozambique, the net enrollment in primary education has increased significantly since the 1990s, especially during 2000–2006. Indeed, Mozambique has improved remarkably when compared to most SADC countries, but stills lags behind them. The same can be said for its level of literacy. On MDG 3, gender parity, Cape Verde is better placed than its ECOWAS partners, but some of them are now catching up fast. Gender parity in Mozambique is one of the poorest in SADC but, at the same time, it registers a sustained and strong improvement. With respect to child mortality, MDG 4, Cape Verde's is by far the lowest in ECOWAS, but still far short of the level in developed countries. Even so, it has decreased significantly. On this score, Mozambique is improving rapidly, as its child mortality rate has decreased to 153.67 per thousand, which is much better than the SADC average. The IMF foresees that this MDG will probably be reached by 2015. For maternal health, MDG 5 (for which there is only one observation, and a higher percentage of satisfactory performance was reached in 2009 than in 2010), Cape Verde is the best in ECOWAS. Mozambique's maternal mortality rate was below the SADC average in 2005, which is in line with the improvement in child mortality and in public health as a whole. The MDG 6, the incidence, prevalence, and death rates associated with tuberculosis, show much lower figures in Cape Verde than for ECOWAS. There is no data on HIV prevalence in Cape Verde as far as we are aware. The prevalence and death rate of tuberculosis grew more in Mozambique than in SADC members, while HIV/AIDS statistics show a worrying increase in infection rates among young people.

The goal of sustainable development is often proxied by the proportion of the population having access to safe drinking water sources. It is much higher in Cape Verde than in ECOWAS. Similarly, the proportion of the urban population is also higher in Cape Verde, but a significant catching up is noticeable in ECOWAS member states. In Mozambique, the proportion of population having access to improved sanitation facilities has increased from 22 percent to 31 percent between 1995 and 2006: it lags behind other SADC partners but is quickly narrowing the gap. The same can be said of the proportion of the population living in slums, which has fallen drastically since 2001 (whereas in the SADC partners the reduction has been modest).

The weak spot of this MDG lies in the water quality since the improvement in the proportion of population having access to an improved drinking water source has been negligible, while the proportion of the urban population has actually decreased from 83 percent to 71 percent when comparing 1995 to 2006. This is again a case where the percentage of satisfactory performance reached in 2009 was about double that reported in 2010, under 30 percent as opposed to slightly over 60 percent.

The global partnership for development is often illustrated by debt service as a percentage of exports of goods and services, as done in table 7.12. This has been historically lower in Cape Verde when compared to ECOWAS and has decreased over time, but ECOWAS decreased more markedly when looking at the year-by-year numbers. Mozambique's debt service has fallen markedly and the period of high growth coincides with that of the donor community's relief of debt, as discussed in the previous subsection.

Coming back to the comparison of governance and freedom indicators appearing in tables 7.5, 7.6, and 7.8, Cape Verde's Economic Freedom Index has improved since 1996, when it obtained 49.7 points. However, trade freedom (45), government spending (30.9), financial freedom (10), and freedom from corruption (30) were below average. The lack of financial freedom was due to commercial banks' weak independence, and excessive government spending was due to weak industrial policies in the transition to independences. Financial freedom only ranked higher in 2002 (50 points), when a law that gave more independence to the central bank was approved. As for government spending, this category reached similar values to current ones in 2004 (around 70 points) because political measures aimed at controlling the budget deficit started to be effective. In the years following 1996, the country's score has been improving when compared on a year-to-year basis, except during 1997, 2003, 2005, and 2007. In 2010, Cape Verde reached its maximum score (61.8) and is classified as the 78th freest economy in the world. Above average items include business freedom (63.3), trade freedom (65.5), fiscal freedom (65.6), government spending (65.3), monetary freedom (74.5), and property rights (65). Freedoms in need of improvement were investment freedom (69), financial freedom (60), freedom from corruption (51), and labor freedom (48.1). In comparative terms, Cape Verde ranked seventh out of forty-six countries in sub-Saharan Africa, with a regional score much higher than the average.[35] Luiz, Pereira, and Oliveira (2013) present a set of institutional indicators for Mozambique for the period 1900 through to 2005, reproduced in figure 7.3. The first tracks political freedoms

35. This happens not only due to relatively good performances in the above-mentioned categories, but also due to the fact that its regional partners perform even worse in those categories where Cape Verde performs poorly. For example, Cape Verde ranks 47th out of 179 countries in Transparency International's 2008 Corruption Perceptions Index regarding the "freedom from corruption" indicator. However, Cape Verde ranks third when looking at only African countries, coming in after South Africa (first) and Botswana.

and is unique in its duration and complexity, even though it correlates highly with the Freedom House combined index of political and civil liberties. The second index constructs a property rights measure, which has not existed previously, but also reveals a fairly strong correlation with the other index. They explain this as follows: "The Portuguese government during several phases of its colonial administration went to great lengths to develop a more formal system of property rights even whilst politically suppressing the participation of the vast majority of its population and this drives down the correlation between these two indices to 0.46 under colonialism. If we focus on the post 1975 period the correlation shoots up to 0.93 which indicates that a deterioration in political freedom from independence onwards is associated with a lack of economic freedom and security, whilst an improvement sees a rise in economic freedoms as well."

The IICT (2007) includes the following six governance indicators from the World Bank Institute: freedom and accountability (FREE), stability and absence of violence (STAB), government efficiency (EF GV), quality of regulation (Q REG), quality of justice (JUST), and control of corruption (CORR), which were reported in table 7.8. Good governance has been one of the main features of Cape Verde's development. Rule of law and accountability stem from the fact that democracy is well established and that free elections take place regularly with the results not being disputed. The only aspect that fares worse is regulatory quality, but this indicator still fares better than most ECOWAS member states. Education is a major concern for Cape Verde governments: between 1970 and 1990, the number of children leaving school with secondary education increased dramatically. In 1990, half of the children in rural areas attended secondary school and 60 percent of girls received secondary education in urban areas (see Goujon and Wils 1996). The literacy rate in the people between fifteen and twenty-four years old is the highest in all ECOWAS. With respect to Mozambique, no significant evolution is noticeable between 1996 and 2006 for most indicators, and then it improves gradually. The exception is the indicator of political stability and the absence of violence/terrorism, which has improved markedly.

The twenty-eight indicators in the 2006 and 2007 World Bank Enterprise Surveys, for which both Cape Verde and Mozambique report at least ten answers, are in table 7.13, panels (a) through (e). The indicators for regional groupings and sub-Saharan Africa are simple averages of the countries, some of which are missing (two out of fifteen from ECOWAS and SADC, twelve in sub-Saharan Africa). Relative to the average of their comparator countries (in parentheses), then Cape Verde has more developed financial markets, greater macroeconomic stability, less corruption, and a state where rule of law is more grounded than ECOWAS, PALOP, and sub-Saharan Africa, but less export-oriented firms, less technology licensed to foreigners, higher taxes, and a heavier regulatory framework than the benchmarks. Mozambique has better infrastructures (water, electricity, and Internet)

Table 7.13 World Bank Enterprise Survey

A. International trade (= 5, best/**worst**)

Country/comparator	CV	MZ	SSA	SAD	ECW	LOP	Code
Exporting firms	**4**	6	13	16	11	5	%
Time imports	11	11	11	10	10	**17**	Day
Import license days	06	13	18	**21**	16	15	Day
Foreign technology	**2**	33	11	16	8	12	%
Foreign shareholder	**10**	20	19	25	12	14	%

B. Infrastructure (= 5, best/**worst**)

Country/comparator	CV	MZ	SSA	SAD	ECW	LOP	Code
No. electricity outages	**21**	3	14	12	16	10	No./mo.
No. Internet outages	4	3	46	32	**86**	3	No./mo.
No. water outages	**13**	4	8	6	9	7	No./mo.
Transportation	36	37	44	35	**49**	40	Percent bad
Access to land	19	26	34	31	**36**	28	Percent bad

C. Finance, competition, and education (best/**worst**)

Country/comparator	CV	MZ	SSA	SAD	ECW	LOP	Code
Credit line	47	**13**	24	24	20	17	Percent good
Investment own funds	**51**	88	77	74	80	78	Percent good
Access to finance	48	62	60	51	**68**	64	Percent bad
Number competitors	4	3	4	4	4	4	No.
Education workers	**43**	33	34	37	28	32	Percent bad

D. Institutions: stability, corruption, and rule of law (best/**worst**)

Country/comparator	CV	MZ	SSA	SAD	ECW	LOP	Code (%)
STAB crime theft and disorder	47	**50**	41	49	35	45	Bad
CORR corruption	25	37	46	43	**48**	42	Bad
CORR informal payments	0	2	**5**	3	5	2	Bad
JUST sales on credit	30	19	29	**36**	25	19	Bad
JUST government predictability	**59**	21	49	50	47	29	Good
JUST court impartiality	**62**	15	44	46	44	30	Good
JUST legal conflict resolution	**29**	14	23	21	25	27	Bad

E. Quality of regulation (best/**worst**)

Country/comparator	CV	MZ	SSA	SAD	ECW	LOP	Code (%)
Time senior mgt. regulations	**14**	4	7	8	8	7	Bad
Tax administration	41	31	46	36	**48**	36	Bad
Tax rates	**74**	53	59	51	61	57	Bad
Licensing permits	29	30	33	29	33	**37**	Bad
Labor regulations	**28**	17	20	21	16	18	Bad
Customs & trade regulations	**38**	26	33	28	30	33	Bad

Source: World Bank Enterprise Survey, courtesy of Francisco Queiró.

and less corruption than SADC, PALOP, and sub-Saharan Africa, but less developed financial markets, a state where rule of law is less grounded, less export-oriented firms, and less technology licensed to foreigners than the benchmarks.

7.6 Conclusions

The expansion, diversification, and deepening of trade and financial links between countries over several decades presented an unparalleled opportunity to raise living standards and achieve the MDG. Development success under globalization, meanwhile, is less a question of relative resource endowments or geographical location than in past waves of globalization. Moreover, adequate development responses to globalization become all the more important as globalization increasingly affects political and economic governance, mainly by reducing national policy space and increasing institutional and economic interdependence at various levels. Under these conditions, interactions between globalization and governance can be either positive or negative, depending on the orientation and predictability of economic policies and the accompanying institutional arrangements, but also on linkages between cultural, institutional, and economic factors.

Against this background, we want to determine whether the interaction between globalization and governance is positive or not in Cape Verde and Mozambique so as to assess the extent to which they represent development successes in West and southern Africa. Specifically, we attempt to identify lessons for successful governance based on meaningful national and regional comparisons of Cape Verde and Mozambique's development experience. Economic success under globalization for these countries entails necessarily, but not exclusively, positive market perceptions regarding outcomes such as trade diversification and narrowing of the income gap relative to the frontier. This aspect of success has to be, in turn, sustained by good governance and a level of political and economic freedom that their citizens and residents enjoy. As such, policy and institutional reforms provide the context against which to interpret governance indicators and progress toward the MDG.

To identify macrolevel policy and institutional combinations underpinning successful export diversification and economic convergence in ECOWAS and SADC, the empirical analysis establishes context-based objective metrics that assess the relative performance of Cape Verde and Mozambique in conjunction with evidence of a case-study nature. Given the severe lack of data over the period 1960–2004, this indirect approach to study trade-related development success in these two countries is unavoidable. We apply three-stage least squares and other estimation techniques, with broadly consistent results, to two main variables: the distance of a country's GDP per capita compared to that of the United States in order to capture economic convergence (ygap), and the inverse of the Herfindahl

index (neq5) as a measure of export diversification. Together with additional control variables, these two variables are a meaningful characterization of each country's diversification convergence, which will be affected by the interaction between policy and institutional variables.

We first identify the determinants of diversification and convergence at the regional level. Then, we reestimate the model for subsamples that capture two different diversification-convergence scenarios in each subregion. The first subsample, denoted as the high regime, comprises countries that simultaneously exhibit high diversification and high convergence {ygap < 0.945 & neq5 > 4.5} while the second, the low regime, comprises those that exhibit the opposite combination{ygap > = 0.945 & neq5 < = 4.5}. This strategy allows us to highlight differences and commonalities in performance across regimes and regions including regional benchmarks, namely, Senegal for ECOWAS and Mauritius and South Africa for SADC.

The principal differences are that ECOWAS high-regime countries are becoming more diversified, while those of SADC are becoming less diversified. Opening up to trade is also an important driver of both convergence and diversification for the former, especially in the range of 45–75 percent of GDP, but not for the latter. In SADC high-regime countries, economic and political freedom drive convergence, suggesting effective institutional arrangements. As for the commonalities or lessons present in the high regimes, we find that: (a) the expected two-way relationship always exists; (b) convergence always entails macroeconomic stability (inflation < 9 percent, budget deficits < 7 percent of GDP); (c) political and economic freedoms are always greater, on average, when compared to the other cases; and (d) freedoms always affect diversification policy as do government deficits, albeit in different directions across both subregions. However, increasing deficits always counteract prevailing diversification stance in both subregions, which we take to be a sign of regime credibility. The comparison across subregions, meanwhile, serves to highlight the importance of institutions irrespective of the sample chosen: economic freedom always affects diversification in ECOWAS, while both freedoms affect it in SADC, where they affect convergence too. Efforts at monitoring the MDGs complement the context for export diversification across sub-Saharan Africa (Cabral and Veiga 2010) and for financial reputation in PALOP, ECOWAS, and SADC (Lopes and Santos 2010).

The estimated impact that Cape Verde and Mozambique have on their respective subregions, which accords with the intuition and implications of the posited two-way relationship, confirms the narrative of their long-term development. Based on our reading of this narrative, we identify the following common drivers of macrolevel policy and institutional combinations as being associated with the (different) two-way relationship of both countries: moving toward a market economy; opening up to regional and global

trade; increasing economic and political freedom; pursing macroeconomic stability and financial reputation; ensuring policy continuity (especially in trade and industrial sectors), and focusing on human development (especially poverty reduction and education). These two case studies of positive G&G interaction reflect on the potential for cooperative governance and peer-review mechanisms outside of its usual domain among OECD and EU member countries. For Cape Verde, in particular, the effects of the "culture of peace" should be stressed again, as it helped sustain the move toward a market economy, through greater trade integration, especially with the European Union and the United States, culminating in membership in the World Trade Organization. Multiparty democracy and greater political freedom and civil liberties allowed policy continuity across the political divide and improved human development. This is not to say that human development is sustainable in the face of the current global crisis. In effect, macroeconomic stability was threatened from outside, but also through an insufficient attention to public and external deficits. If not appropriately monitored, this could threaten the positive interaction attained between globalization and governance.

Appendix A

The acronyms of the different variables used in the regressions are given above. The data are annual and cover the period 1960–2004, but some variables have shorter spans (e.g., data on political and civil liberties, economic freedom) as these only became available later. Capital controls are measured in the manner of the Annual Report on Exchange Arrangements and Exchange Restrictions of IMF, which seeks to capture whether there are explicit legal restrictions on capital transitions (supplemented with historical sources introduced by Eichengreen and Leblang [2006]). For data on the real effective exchange rate, the International Financial Statistics gives an index based on 2005 = 100, where an increase reflects an appreciation. A real effective exchange rate index represents a nominal effective exchange rate index adjusted for relative movements in national price or cost indicators of the home country and selected countries. A nominal effective exchange rate index, meanwhile, represents the ratio (expressed on the base 2005 = 100) of an index of a currency's period-average exchange rate to a weighted geometric average of exchange rates for the currencies of selected countries.

Table 7A.2 reports summary statistics for the ECOWAS and SADC averages of all the variables and table 7A.3 reports correlations for both samples of the final model variables.

Table 7A.1 Data description

Variable type	Variable	Description	Source
Policy	ygap	Income gap to frontier (country and US GDP per capita, constant 2000 USD)—see text for definition	World Bank & own calculations
	ypc	GDP per capita (constant 2000 USD)	World Bank
	neq 1, 2, 3, 4, 5	Number equivalent index (1-, 2-, 3-, 4-, 5-digit SITC rev. 2)	OECD
	inflation1	Inflation, consumer prices (annual %)	World Bank
	govdef	Government surplus/deficit (% GDP)	World Bank
	open1	Exports plus import (% of GDP)	World Bank
	reer	Real effective exchange rate (% change)	IMF-IFS
	emp	Exchange market pressure (% change)	Own calculations
Institutions	pr	Index of political rights	Freedom House
	cl	Index of civil liberties	Freedom House
	ef	Index of economic freedom	Fraser Institute
	constage	Constitutional age	Polity
	demage	Age of democracy	Eichengreen and Leblang (2006)
	demtot	Number of other democracies in system	Polity
	dictrans	Number of prior transitions to dictatorship	Polity
Controls	k	Gross capital formation (constant 2000 USD)	World Bank
Economic	ltotal	Labor force, total	World Bank
Geographic	land	Land (sq. km)	World Bank
	landagri	Agricultural land (% of land area)	World Bank
	landarbl	Arable land (% of land area)	World Bank
	disteur	Minimum distance to the European Union	CEPII
Demographic	poptotal	Population, total	World Bank
	popdens	Population density (people per	World Bank
	popurban	Urban dwellers (% population)	World Bank
	life	Life expectancy at birth, total (years)	World Bank
Dummies	landlock	Landlocked countries	United Nations
Economic	oil	Net oil exporter	United Nations
	capcont	Capital controls	IMF-EAER
	legaleng	British legal origin	Polity
	cpv	Cape Verde	IFS country codes
	gha	Ghana	IFS country codes
	mus	Mauritius	IFS country codes
	moz	Mozambique	IFS country codes
	sen	Senegal	IFS country codes
	zaf	South Africa	IFS country codes

Table 7A.2 Summary statistics (all variables)

Variable	Obs.	Mean	Median	Std. dev.	Minimum	Maximum
			ECOWAS			
ygap	675	0.95	0.95	0.02	0.86	0.99
ypc	612	356.70	284.39	217.94	56.47	1,266.81
ypcgrowth	597	0.23	0.66	7.32	–50.49	90.47
neq5	637	3.83	3.46	2.09	1.00	15.12
inflation1	574	12.83	6.89	20.09	–34.40	178.70
govdef	450	–5.70	–4.65	9.19	–57.26	27.17
open1	592	59.01	54.58	26.57	6.32	140.86
reer	144	–0.04	–0.01	0.26	–1.88	0.79
averageempusd	106	0	0	0.04	–0.13	0.21
pr	490	2.87	2.00	1.78	1.00	7.00
cl	490	3.23	3.00	1.34	1.00	7.00
prcl	490	3.05	2.50	1.50	1.00	7.00
ef	295	4.81	5.05	0.90	2.31	6.34
constage	596	13.11	7.00	19.98	0.00	105.00
demage	660	0.72	0.00	2.16	0.00	14.00
demtot	660	64.72	54.50	26.48	36.00	110.00
dictrans	626	0.39	0.00	0.73	0.00	3.00
k	415	4.35e + 08	3.00e + 08	5.04e + 08	4.90e + 06	3.60e + 09
ltotal	375	4.97e + 06	2.66e + 06	8.95e + 06	88,445.88	5.00e + 07
disteur	675	4,889.93	5,020.85	302.59	4,244.89	5,283.33
landagri	660	42.49	41.81	17.32	13.04	81.40
land	660	335,343.33	192,530.00	415,989.64	4,030.00	1.27e + 06
landarbl	660	12.39	9.43	9.89	1.34	46.15
poptotal	675	1.01e + 07	4.49e + 06	2.06e + 07	196,351.00	1.38e + 08
popdens	660	42.83	35.96	31.32	2.49	157.07
popurban	576	0.11	0.10	0.08	0.00	0.39
life	240	47.50	46.90	7.75	32.28	69.84
			SADC			
ygap	630	0.9	0.94	0.08	0.6	0.99
ypc	507	945.54	459.1	1,040.85	81.01	4,264.32
ypcgrowth	493	1.13	1.07	5.69	–27.14	23.75
neq5	554	6.47	4.96	5.75	1	36.09
inflation1	495	109.59	12.14	1,114.9	–9.62	23,773.13
govdef	370	–7.37	–6.15	10.29	–54.09	32.68
open1	502	80.63	68.23	40.54	14.33	198.91
reer	129	–0.02	–0.02	0.2	–0.91	1
averageempusd	106	0.01	0.00	0.04	–0.08	0.18
pr	441	3.38	3	1.85	1	7
cl	441	3.41	3	1.56	1	7
prcl	441	3.4	3	1.65	1	7
ef	316	4.91	4.84	1.10	2.39	7.35
constage	509	13.06	8	16.35	0	81
demage	600	1.76	0	5.53	0	37
demtot	600	65.02	55.5	26.72	35	110
dictrans	572	0.15	0	0.36	0	1
k	466	2.03E + 09	4.35E + 08	4.85E + 09	2.26E + 06	2.79E + 10
ltotal	350	5.60E + 06	4.28E + 06	5.69E + 06	170,025.2	2.28E + 07
disteur	630	8,253.78	8,491.14	978.51	6,257.08	9,571.16
landagri	616	50.26	46.94	20.09	9.68	87.97
land	616	688,990	662,465	596,625.63	2,030	2.27E + 06
landarbl	616	9.62	6.77	11.76	0.61	49.26
poptotal	630	1.02E + 07	6.74E + 06	1.14E + 07	326,000	5.69E + 07
popdens	616	55.93	18.2	121.74	0.75	607.58
popurban	497	0.14	0.13	0.13	0	0.78
life	237	50.9	49.25	8.69	33.19	71.97

Table 7A.3 **Correlations (final model variables only)**

	lnygap	lnneq5	inflation1	govdef	lnopen1	lnprcl	lnef	constage	demage	demtot	dictrans	lnk	lnpopdens
lnygap	1												
lnneq5	–0.126	1											
inflation1	0.08	–0.012	1										
govdef	–0.128	–0.043	–0.011	1									
lnopen1	–0.396	–0.027	–0.016	–0.017	1								
lnprcl	–0.242	0.18	–0.042	0.035	0.212	1							
lnef	–0.264	0.296	–0.09	0.069	0.321	0.362	1						
constage	–0.225	0.176	–0.038	0.102	0.246	0.022	0.148	1					
demage	–0.189	0.073	–0.013	0.009	0.143	0.376	0.282	0.008	1				
demtot	0.244	0.064	0.044	–0.148	0.162	0.26	0.282	–0.01	0.24	1			
dictrans	0.042	0.003	–0.018	–0.04	–0.183	0.202	–0.046	–0.121	0.266	0.241	1		
lnk	–0.392	0.335	–0.035	0.15	–0.084	0.096	0.221	0.427	0.031	0.123	0.243	1	
lnpopdens	0.107	0.144	–0.013	–0.129	–0.104	0.24	0.074	–0.046	0.283	0.246	0.19	–0.029	1

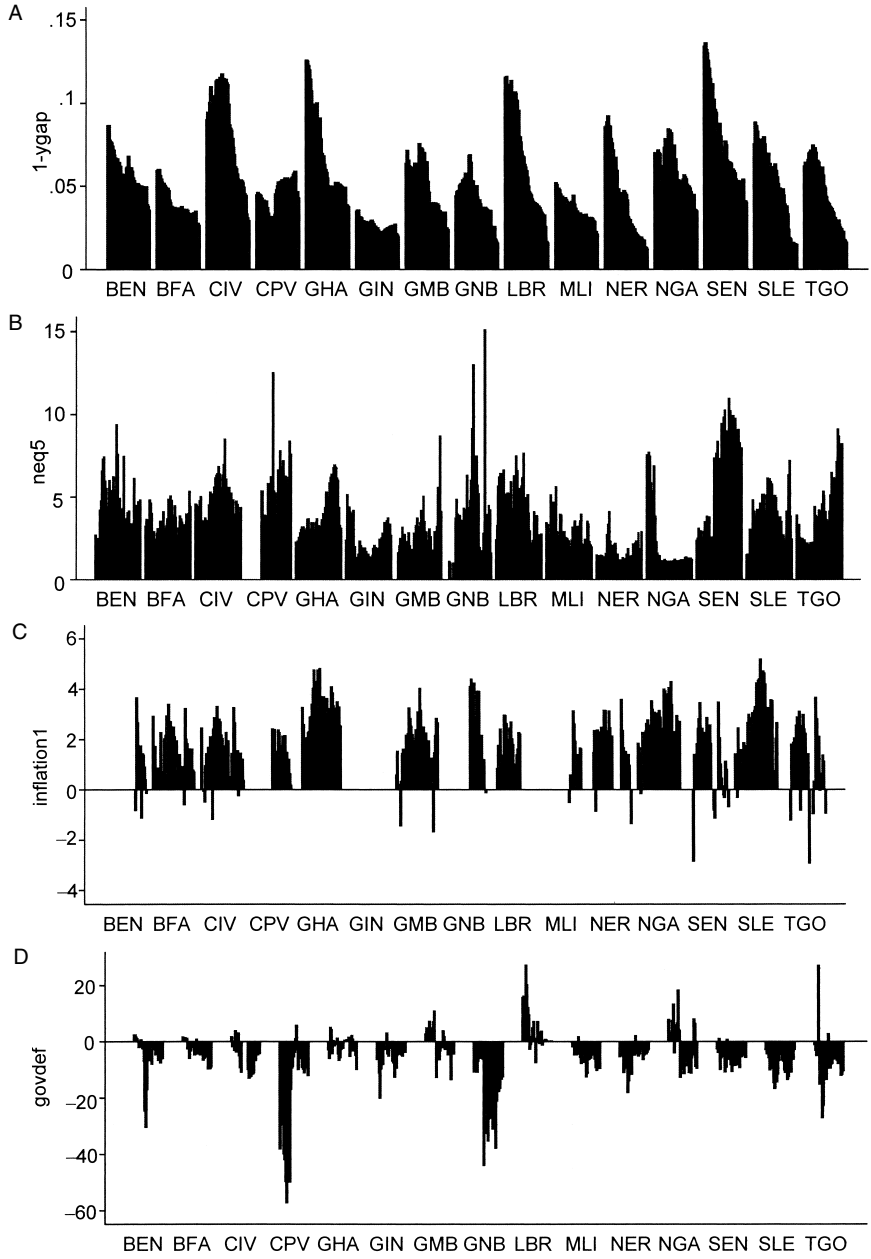

Fig. 7A.1 Description of ECOWAS

Note: Panel (a): ECOWAS, income gap (reverse scale) 1960–2004, read from left to right; panel (b): ECOWAS, number equivalent, 1960–2004, read from left to right; panel (c): ECOWAS, inflation (consumer prices, annual percentage, log), 1960–2004, read from left to right; panel (d): ECOWAS, government deficit (percentage of GDP) 1960–2004, read from left to right.

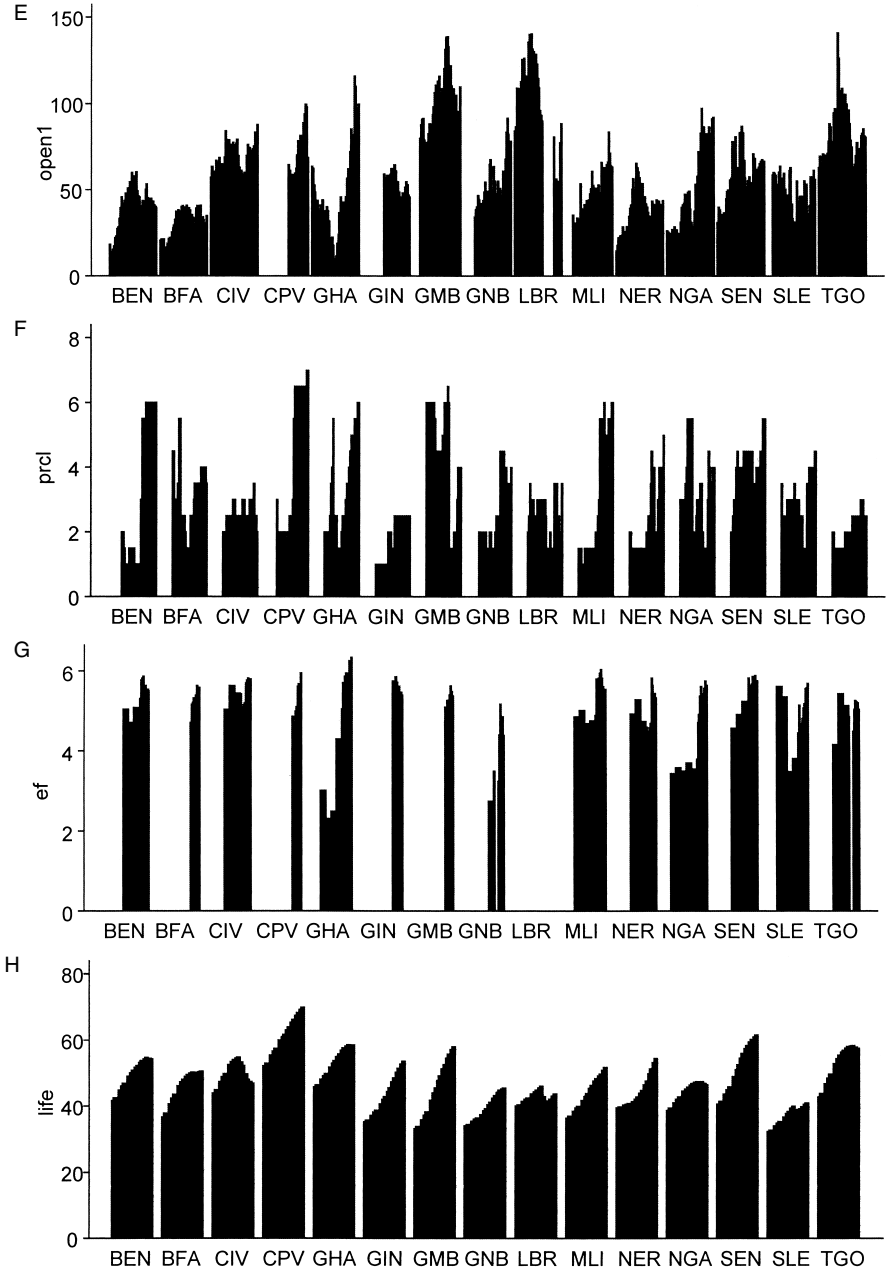

Fig. 7A.1 (cont.)

Note: Panel (e): ECOWAS, openness (X + M/GDP), 1960–2004, read from left to right; panel (f): ECOWAS, composite index of political and civil freedoms, 1960–2004, read from left to right; panel (g): ECOWAS, index of economic freedom, 1960–2004, read from left to right; and panel (h): ECOWAS, life expectancy at birth, 1960–2004, read from left to right.

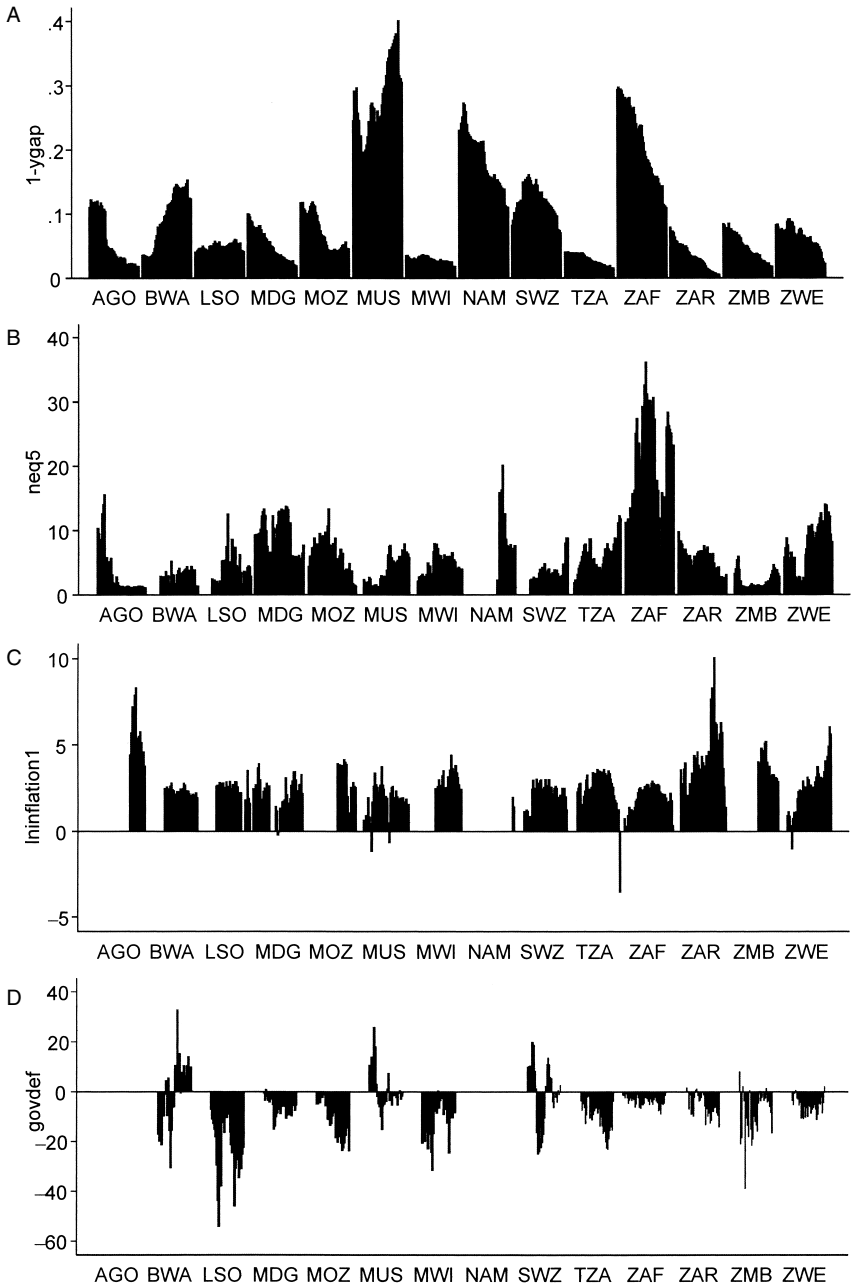

Fig. 7A.2 Description of SADC

Note: Panel (a): SADC, income gap (reverse scale), 1960–2004, read from left to right; panel (b): SADC, number equivalent, 1960–2004, read from left to right; panel (c): SADC, inflation (consumer prices, annual percentage, log), 1960–2004, read from left to right; panel (d): SADC, government deficit (percentage of GDP), 1960–2004, read from left to right.

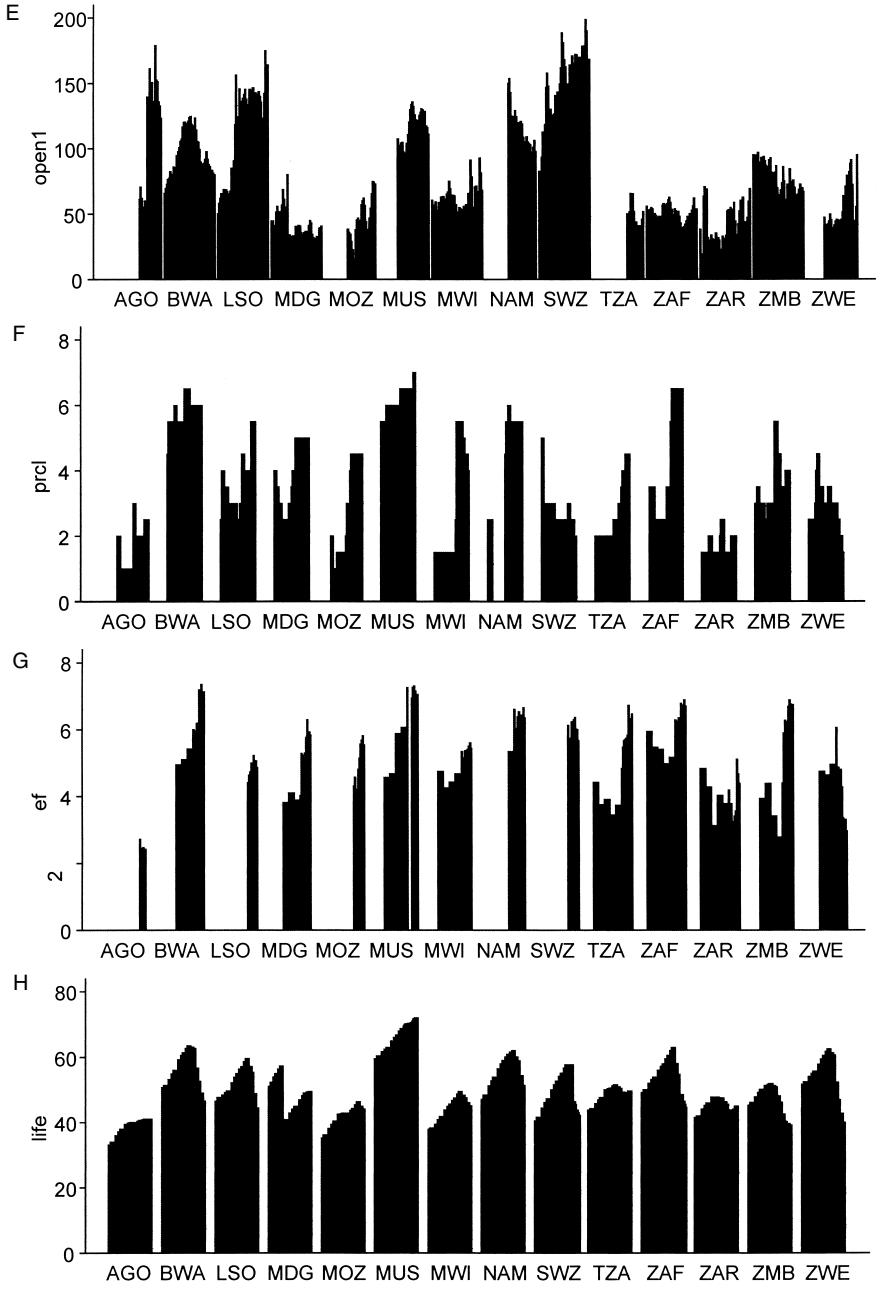

Fig. 7A.2 (cont.)

Note: Panel (e): SADC, degree of openness (X + M/GDP), 1960–2004, read from left to right; panel (f): SADC, political freedom index, 1960–2004, read from left to right; panel (g): SADC, economic freedom index, 1960–2004, read from left to right; and panel (h): SADC, life expectancy at birth, 1960–2004, read from left to right.

Appendix B

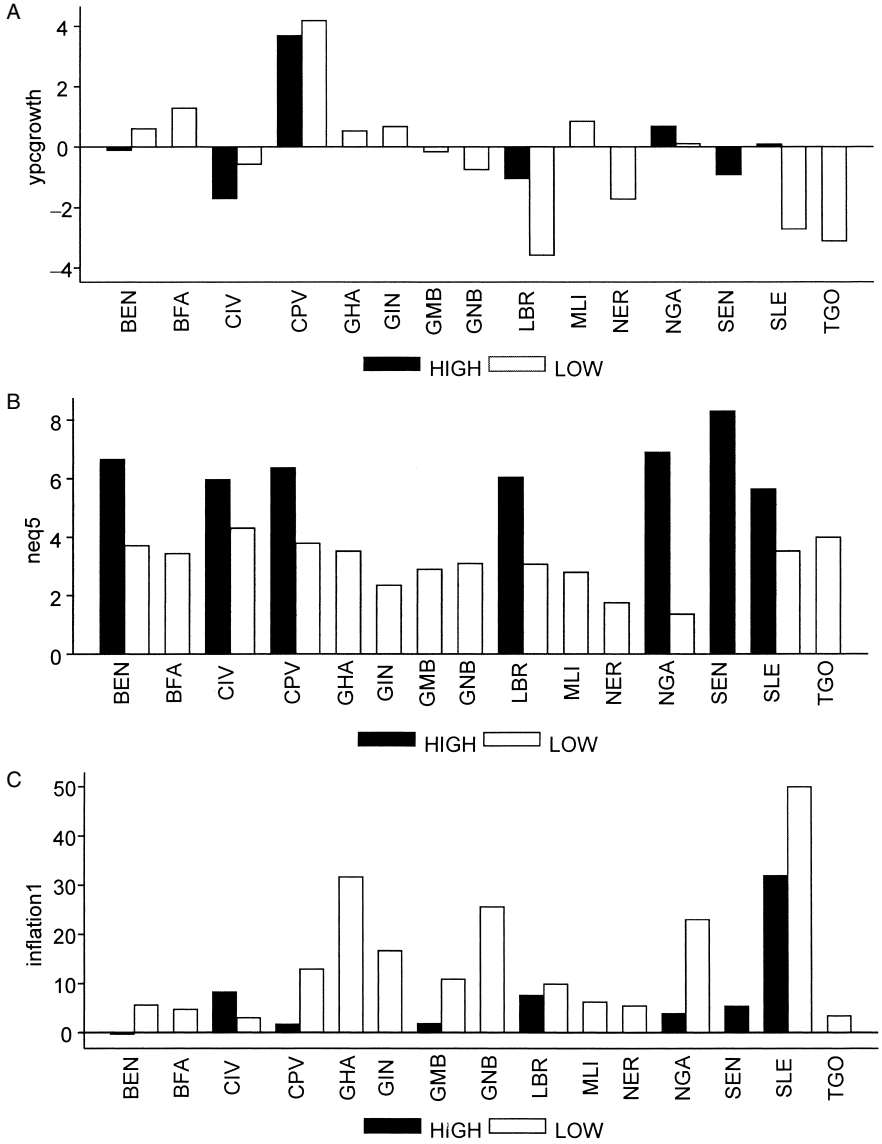

Fig. 7B.1 Comparison of high and low regimes in ECOWAS

Note: Panel (a): ECOWAS, GDP per capita growth, low versus high regime; panel (b): ECOWAS, number equivalent, low versus high regime; panel (c): ECOWAS, inflation, low versus high regime.

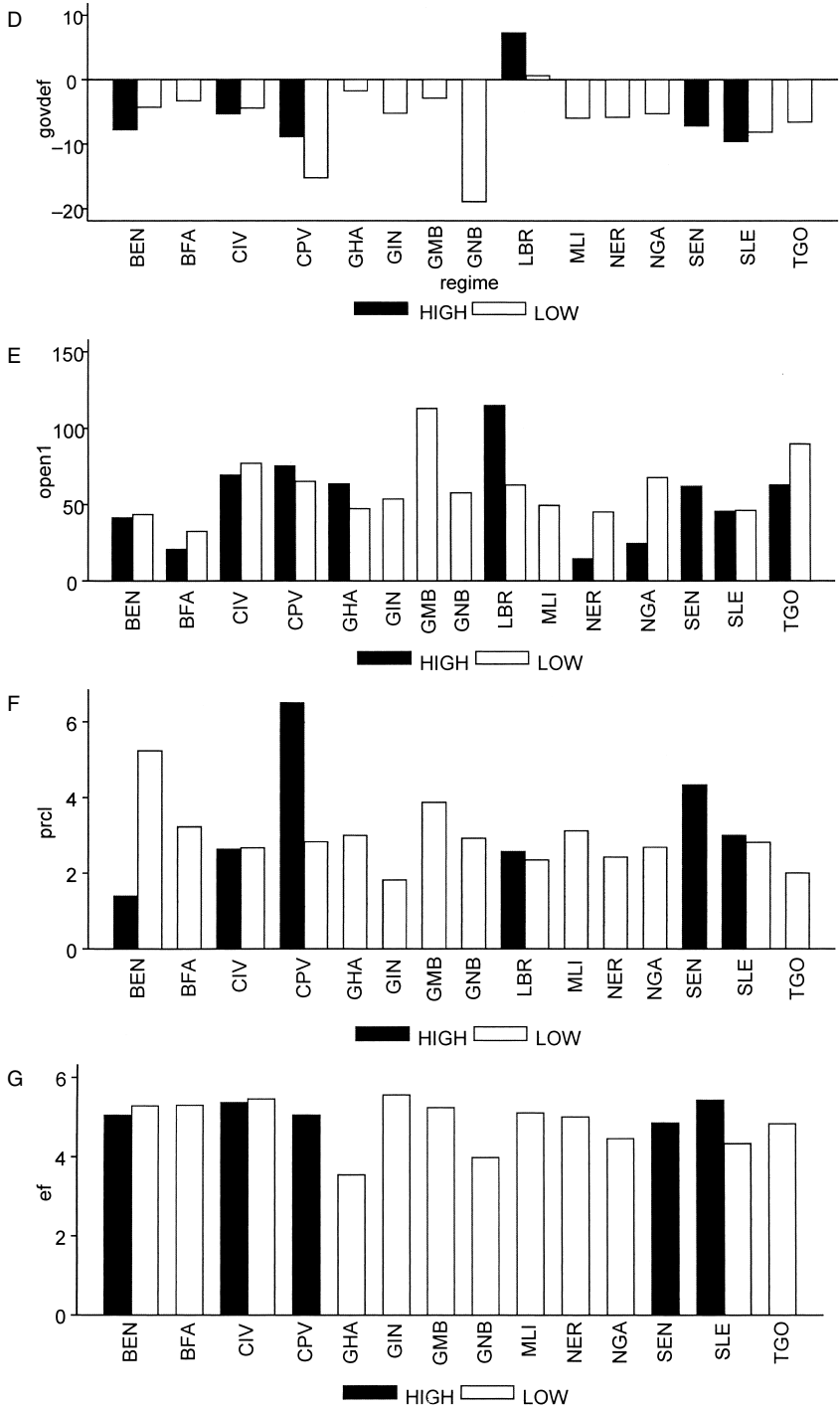

Fig. 7B.1 (cont.)

Note: Panel (d): ECOWAS, government deficit, low versus high regime; panel (e): ECOWAS, openness, low versus high regime; panel (f): ECOWAS, political freedom, low versus high regime; and panel (g): ECOWAS, economic freedom, low versus high regime.

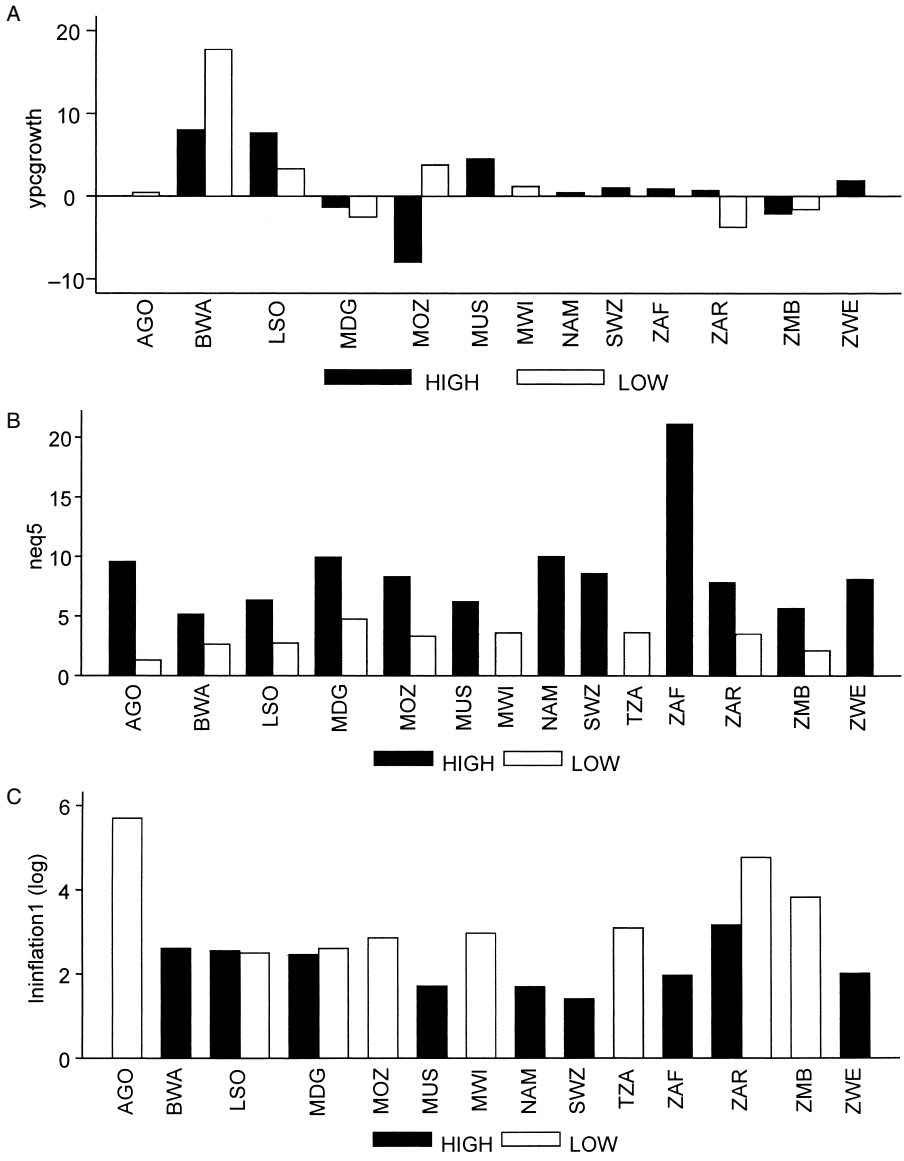

Fig. 7B.2 Comparison of high and low regimes in SADC

Note: Panel (a): SADC, GDP per capita growth, high versus low regime; panel (b): SADC, number equivalent, high versus low regime; panel (c): SADC, inflation, high versus low regime.

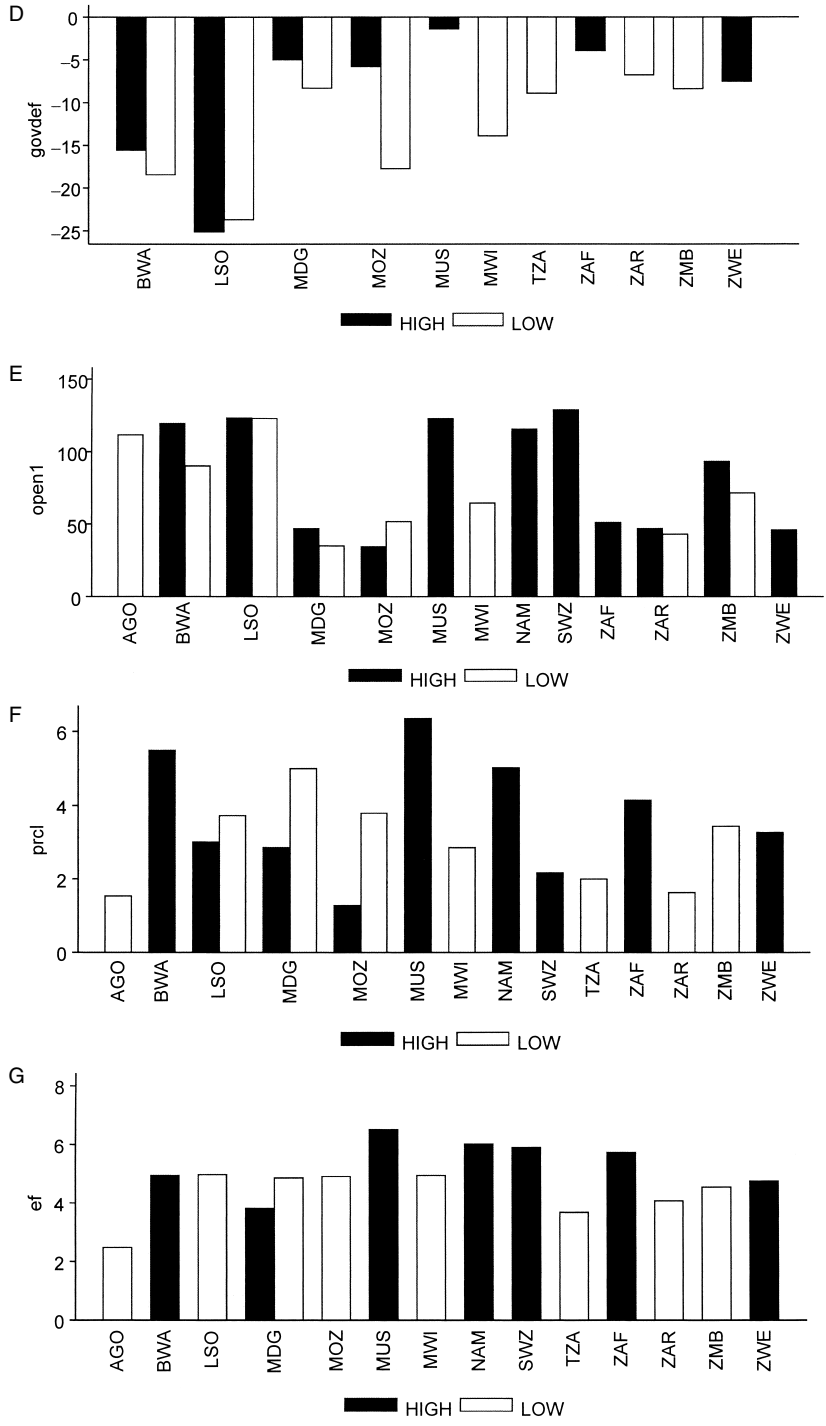

Fig. 7B.2 (cont.)

Note: Panel (d): SADC, government deficit, high versus low regime; panel (e): SADC, openness, high versus low regime; panel (f): SADC, political freedom, high versus low regime; and panel (g): SADC, economic freedom, high versus low regime.

OLS and 2SLS Estimation Results

Table 7B.1 Determinants of diversification in ECOWAS (OLS)

			lnneq5		
Variable type	Variables	OLS pooled	OLS random effects	OLS between effects	OLS fixed effects
Policy	lnygap	–0.263***	–0.241***	–0.793***	–0.214**
		(–3.550)	(–2.812)	(–3.626)	(–2.711)
	govdef	–0.0109***	–0.0106***		
		(–2.971)	(–2.677)		
Institutions	lnprcl	0.0484	0.0651		0.0875
		(0.908)	(1.203)		(1.069)
	lnef	0.264**	0.380***		0.516**
		(2.217)	(3.418)		(2.282)
	demage	–0.0353*	–0.0482**		–0.0483***
		(–1.945)	(–2.367)		(–3.787)
	demtot				–0.00773*
					(–2.029)
Control	lnpopdens	0.208***	0.176***		
		(4.100)	(2.678)		
	lnltotal				1.164**
					(2.333)
	lndisteur	7.313***	7.262***		
		(6.185)	(3.515)		
Dummies	landlock	0.811***	0.766**		
		(3.717)	(2.115)		
	cpv	0.609***	0.760***		
		(4.280)	(4.196)		
	gha	–1.200***	–1.225***	–0.861***	
		(–20.55)	(–13.54)	(–3.362)	
	sen	1.267***	1.292***		
		(8.722)	(5.502)		
	legaleng	–0.123**			
		(–1.984)			
	Constant	–61.19***	–60.95***	4.423***	–15.48**
		(–5.967)	(–3.426)	(5.035)	(–2.168)
Model diagnostics	Observations	223	223	592	228
	R-squared	0.853		0.635	0.171
	Adjusted *R*-squared	0.844		0.574	0.149
	F-test	318.2		10.44	30.54
	Prob. > F	0		0.00236	9.52e – 07
	Number of countries		14	15	14
	R-squared within model		0.151		
	R-squared between model		0.954		
	R-squared overall model		0.848		
	Wald Chi^2		973.2		
	Prob. > W		0		

Note: Robust *t*-statistics are in parentheses (except for the case of between effects).

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

Table 7B.2 Determinants of diversification in ECOWAS (2SLS)

Variable type	Variables	lnneq5		
		2SLS random effects	2SLS between effects	2SLS fixed effects
Policy	lnygap	–0.138	–0.945***	–0.358**
		(–1.599)	(–3.910)	(–2.501)
Institutions	lnprcl	0.149**		0.130**
		(2.473)		(2.216)
	lnef	0.374***		0.351***
		(3.226)		(2.852)
	demage	–0.0342**		–0.0334*
		(–1.991)		(–1.816)
	demtot			–0.00852***
				(–2.929)
Control	lnpopdens	0.210**		
		(2.409)		
	lnltotal			1.463***
				(4.074)
	lndisteur	7.244***		
		(4.097)		
Dummies	landlock	0.750**		
		(2.345)		
	cpv	0.599**		
		(2.536)		
	gha	–1.290***	–1.409***	
		(–7.445)	(–5.242)	
	sen	1.275***		
		(5.474)		
	Constant	–61.34***	5.183***	
		(–4.051)	(5.256)	
Model diagnostics	Observations	200	315	183
	R-squared			0.227
	Adjusted *R*-squared		0.721	0.138
	Number of countries	13	14	13
	R-squared within model	0.153	0.0278	
	R-squared between model	0.966	0.764	
	R-squared overall model	0.860	0.328	
	F-test	0	0.000370	0
	Prob. > F		0.721	0.138

Note: The *t*-statistics are in parentheses (robust in the case of fixed effects).

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

Table 7B.3 Determinants of diversification in SADC (OLS)

		lnneq5			
Variable type	Variables	OLS pooled	OLS random effects	OLS between effects	OLS fixed effects
Policy	lnygap	–0.132***		–0.315	
		(–2.839)		(–1.626)	
	lnopen1	–0.468***			
		(–7.422)			
Institutions	lnef	0.803***	0.886***	2.278***	0.619***
		(5.081)	(4.988)	(3.327)	(4.274)
	dictrans		–0.328***		
			(–3.793)		
Physical	lnk				0.148*
					(1.839)
	lnpopdens				–4.949***
					(–3.108)
	lnltotal			0.471***	4.155**
				(4.570)	(2.635)
	landlock				
	mdg	0.633***	0.972*		
		(5.062)	(1.847)		
	moz	–0.275**		–0.805*	
		(–1.997)		(–1.912)	
	tza	0.584***			
		(7.243)			
	zaf	1.197***	1.557**		
		(9.883)	(2.364)		
	zwe	0.854***	0.963***		
		(9.927)	(2.668)		
	Constant	2.619***	0.0189	–7.705***	–48.18**
		(4.926)	(0.0657)	(–3.539)	(–2.538)
Model diagnostics	Observations	254	290	217	237
	Number of countries		14	14	13
	R-squared	0.641		0.789	0.142
	Adjusted *R*-squared	0.630		0.696	0.127
	R-squared within model		0.0964		
	R-squared between model		0.672		
	R-squared overall model		0.555		
	F-test	67.08		8.439	10.31
	Prob. > F	0		0.00410	0.00122
	Wald Chi^2		49.57		
	Prob. > W		1.70e–09		

Note: Robust *t*-statistics are in parentheses (except for the case of between effects).

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

Table 7B.4 Determinants of diversification in SADC (2SLS)

		lnneq5		
Variable type	Variables	2SLS random effects	2SLS between effects	2SLS fixed effects
Policy	lnygap	–0.380***	–0.242*	–0.310**
		(–3.976)	(–2.164)	(–2.091)
Institutions	lnef	0.936***	2.505***	1.196***
		(5.791)	(3.831)	(6.992)
	constage	0.00611***		0.00602**
		(3.427)		(2.006)
Physical	lnpopdens			–4.974***
				(–3.415)
	lnltotal	0.401***	0.512***	4.415***
		(5.909)	(9.075)	(3.587)
	moz		–0.508*	
			(–2.273)	
	zwe	0.753**	0.628**	
		(2.603)	(2.897)	
	Constant	–4.563***	–9.092***	
		(–5.020)	(–5.444)	
Model diagnostics	Observations	156	156	156
	Number of countries	12	12	12
	R-squared			0.350
	Adjusted *R*-squared		0.899	0.270
	R-squared within model	0.258	0.148	
	R-squared between model	0.850	0.945	
	R-squared overall model	0.734	0.663	
	F-test	19.62	20.63	35.51
	Prob. > F	0	0.00102	0

Note: The *t*-statistics are in parentheses (robust in the case of fixed effects).

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

Table 7B.5 Determinants of convergence in ECOWAS (OLS)

		lnygap			
Variable type	Variables	OLS pooled	OLS random effects	OLS between effects	OLS fixed effects
Policy	lnneq5	–0.157***		–0.340***	
		(–5.848)		(–3.680)	
	inflation1		–0.0435***		
			(–3.658)		
	govdef				–0.00222*
					(–1.932)
	lnopen1				–0.0498***
					–0.00222*
Institutions	lnprcl	–0.0764***	–0.0833**	–0.414**	
		(–2.827)	(–2.166)	(–2.475)	
	lnef		–0.309***		–0.166**
			(–5.831)		(–2.460)
	demage	–0.0696***	–0.0504***		–0.0216**
		(–10.44)	(–6.215)		(–3.153)
	demtot	0.00897***	0.192***		–0.00162**
		(22.17)	(6.243)		(–2.610)
	dictrans	0.148***	0.00828***		
		(5.416)	(15.00)		
Control	lnk				–0.0830***
					(–3.922)
	lnpopdens				–3.145**
					(–2.720)
	lnltotal				4.296***
					(3.737)
	landlock	0.0997***	0.209***		
		(2.932)	(3.945)		
Dummies	oil	–0.610***	–0.497***	–0.564***	
		(–18.17)	(–7.637)	(–4.766)	
	cpv		–0.219***		
			(–4.714)		
	gha	–0.351***	–0.452***		
		(–6.363)	(–9.250)		
	sen	–0.379***	–0.359***		
		(–10.07)	(–7.010)		
	legaleng	–0.212***	–0.133***		
		(–6.335)	(–3.417)		
	Constant	3.880***	4.177***	4.975***	–45.71***
		(65.32)	(44.93)	(30.59)	(–3.491)
Model diagnostics	Observations	441	181	444	140
	R-squared	0.732		0.811	0.917
	Adjusted *R*-squared	0.725		0.759	0.912
	F-test	154.7		15.73	64.62
	Prob. > F	0		0.000271	9.04e – 06
	Number of countries		13	15	11
	R-squared within model		0.739		
	R-squared between model		0.920		
	R-squared overall model		0.849		
	Wald Chi^2		785.3		
	Prob. > W		0		

Note: Robust *t*-statistics are in parentheses (except for the case of between effects).

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

Table 7B.6 Determinants of convergence in ECOWAS (2SLS)

Variable type	Variables	lnygap		
		2SLS random effects	2SLS between effects	2SLS fixed effects
Policy	lnneq5	0.790***	–0.326***	
		(5.400)	(–3.613)	
	lnopen1			–0.0728***
				(–4.100)
Institutions	lnprcl	–0.234***		
		(–4.391)		
	lnef			–0.178***
				(–4.876)
	demage		–0.0868**	
			(–2.702)	
	demtot	0.00622***	0.0150***	–0.00242***
		(6.262)	(3.338)	(–4.113)
Control	lnk	–0.197***		–0.0901***
		(–6.001)		(–5.150)
	lnpopdens			–3.222***
				(–5.026)
	lnltotal			4.506***
				(7.162)
Dummies	landlock	0.606***		
		(6.985)		
	oil	–0.401***	–0.530***	
		(–3.704)	(–4.506)	
	cpv	–0.537***		
		(–4.387)		
	sen	–0.494***		
		(–4.256)		
	Constant	6.577***	3.507***	
		(11.71)	(9.792)	
Model diagnostics	Observations	208	313	118
	R-squared			0.939
	Adjusted *R*-squared		0.762	0.930
	Number of countries	10	14	10
	R-squared within model	0.371	0.566	
	R-squared between model	0.913	0.835	
	R-squared overall model	0.613	0.654	
	F-test	28.90	11.42	215.7
	Prob. > F	0	0	0

Note: The *t*-statistics are in parentheses (robust in the case of fixed effects).

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

Table 7B.7 Determinants of convergence in SADC (OLS)

		lnygap			
Variable type	Variables	OLS pooled	OLS random effects	OLS between effects	OLS fixed effects
Policy	lnneq5	–0.222***	–0.0351		
		(–6.120)	(–1.193)		
	open1			–0.532**	
				(–2.327)	
	lninflation1				0.0327**
					(2.304)
Institutions	lnprcl		–0.0549*		–0.166**
			(–1.704)		(–2.545)
	lnef			–1.940***	
				(–3.707)	
	demage	–0.00638*		–0.0553**	
		(–1.678)		(–2.479)	
	demtot				0.00759***
					(5.016)
	dictrans	0.262***	0.184***		
		(5.978)	(3.649)		
Physical	lnk	–0.138***	–0.286***		–0.349***
		(–3.798)	(–9.104)		(–5.390)
	lnpopdens	0.165***			
		(9.680)			
	lnltotal	0.401***	0.510***		
		(18.00)	(7.454)		
	oil	0.239**			
		(2.392)			
	moz	–0.302***			
		(–4.752)			
	mus	–1.707***	–1.014***		
		(–15.81)	(–6.400)		
	zaf	–1.247***	–1.098***	–1.235**	
		(–11.66)	(–4.958)	(–2.740)	
	Constant	0.642	2.281**	9.321***	10.31***
		(0.949)	(2.221)	(7.609)	(8.000)
Model diagnostics	Observations	265	253	254	278
	Number of countries		13	14	12
	R-squared	0.898		0.845	0.657
	Adjusted *R*-squared	0.894		0.776	0.652
	R-squared within model		0.471		
	R-squared between model		0.917		
	R-squared overall model		0.891		
	F-test	640.6		12.26	13.21
	Prob. > F	0		0.00109	0.000576
	Wald Chi^2		362.8		
	Prob. > W		0		

Note: Robust *t*-statistics are in parentheses (except for the case of between effects).

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

Table 7B.8 Determinants of convergence in SADC (2SLS)

		lnygap		
Variable type	Variables	2SLS random effects	2SLS between effects	2SLS fixed effects
Policy	inflation1	–0.356***	–0.600	–0.101
		(–3.216)	(–1.633)	(–1.098)
Institutions	lnprcl		–5.893***	
			(–3.645)	
	lnef		–1.389*	–0.120***
			(–2.280)	(–3.065)
	demage	–0.591***		–0.372***
		(–6.474)		(–4.585)
	demtot	–0.591***		–0.372***
		(–6.474)		(–4.585)
Physical	lnk	–0.591***		–0.372***
		(–6.474)		(–4.585)
	lnltotal	0.561***		0.730***
		(6.187)		(5.226)
	Constant	8.115***	16.42***	
		(4.910)	(4.400)	
Model diagnostics	Observations	190	178	190
	Number of countries	12	12	12
	R-squared			0.358
	Adjusted *R*-squared		0.690	0.299
	R-squared within model	0.191	0.0726	
	R-squared between model	0.919	0.775	
	R-squared overall model	0.809	0.235	
	F-test	24.09	10.11	22.96
	Prob. > F	0	0.00426	0

Note: The *t*-statistics are in parentheses (robust in the case of fixed effects).

***Significant at the 1 percent level.

**Significant at the 5 percent level.

*Significant at the 10 percent level.

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