Effective Private Sector Representation in Policy Formulation and Implementation

Mwangi S. Kimenyi

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Bishops Garden Towers, Bishops Road
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tel: +254 2 719933/4
fax: +254 2 719951

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1 Introduction

Poverty reduction is today the primary focus of policy initiatives in most developing countries. Unlike developed countries that are able to deal with extreme poverty through redistributive measures, developing countries like Kenya do not have this as a viable option. For them, significant poverty reduction can be achieved only by putting in place policies and institutions that are conducive to economic growth. Strictly speaking, no country can fight poverty through redistribution alone. The history of developed countries such as the United States shows that major gains have been achieved in reducing post-transfer poverty (poverty after accounting for transfers from the government) through redistributive programmes, but pre-transfer poverty (poverty before accounting for transfers from the government) has been alleviated only through economic growth (Kimenyi 1995).

Empirical evidence from developing countries shows that economic growth leads to significant decreases in the level and severity of poverty. But poverty cannot be abated if growth is sporadic. Instead, poverty-reducing growth must be sustained over long periods of time. Lessons from economic history suggest that if sustained for decades, economic growth has a real impact on the quality of life for the majority of the people.[1]

Kenya's own history shows that gains in poverty reduction have been achieved only when high rates of economic growth have been sustained for close to a decade.

Historical records show that sustained economic growth requires the institutionalization of a set of pro-growth conditions. In other words, sustaining economic growth requires the adoption of pro-growth policies that take a long-

[1] Powelson (1994), for example, uses the term 'durable economic growth' to denote growth that lasts for up to 100 years.

term perspective. These include the establishment of a legal framework that is capable of resolving disputes and enforcing law and order, sound macroeconomic policies, a mechanism that assures that market actors have access to productive resources, a system of enforcing property rights, and a responsive political establishment.

An important factor in institutionalizing pro-growth policies is the involvement of various economic interests in the policy process. These interest groups are capable of using their leverage to lobby for the enactment of pro-growth policies. If such groups are well organized and have sufficient leverage, the pro-growth policies resulting from their lobbying translate into durable economic growth that, in turn, reduces the extent of poverty in society.

As will be discussed later in this paper, interest groups play a vital role in policy formulation. Some of these groups do not necessarily advocate for pro-growth policies, but are interested in seeking transfers from the government. University students, for example, are a vocal interest group that may want the government to spend more on their welfare at the expense of other groups. These students also might lobby for the abolition of parallel degree programmes if they consider the increase in the supply of graduates in the job market as a threat to their future incomes. Certainly, such activities do not constitute pro-growth lobbying.

A point of caution: the fact that economic interest groups advocate for pro-growth policies should not be taken to mean that their overriding concern is the reduction of poverty. These groups lobby for pro-growth policies because growth is good for business. Economic growth is associated with larger markets and higher profits, and, therefore, it is out of pure self-interest that economic interest groups lobby for pro-growth policies. Therefore, poverty reduction resulting from the activities of these groups is a *by-product*— not the goal— of their good intentions.[2] Nevertheless, it is important to acknowledge the fact that poverty is of concern to the private sector, since low incomes affect the demand for goods and services. Therefore, it is, in fact, in the interest of the private sector that incomes increase.

The generalization that economic interests more often than not advocate for pro-growth policies can be misleading. During the era of controls in Kenya, for example, many businesses were more interested in securing privileges that were extended by the government, without concern for and at the expense of others. Firms that were granted import licenses lobbied hard against pro-growth reforms that would have eroded their privileged positions. Many large producers were more interested in making sure that the government protected them from foreign competition. These producers did not take into account the costs of their privileges to consumers and the implication on economic growth in general. This demonstrates that private businesses can also be important advocates of anti-growth policies.

Anti-growth policies involve various other costs to the country. Probably the most important of these are the socially wasteful expenditures by businesses to lobby for preferences from the government (Tullock 1967). These activities— widely referred to as rent-seeking— do not involve in the creation of value but are instead wasteful transfers and thus impact negatively on economic growth (Krueger 1974; Kimenyi 1991; Kimenyi and Mbaku (1993); Mbaku and Kimenyi (1995)). As a matter of fact, the primary method by which private businesses retain

[2] The whole idea that self-interest drives exchange transactions is at the core of the work of Smith (1776), who believes that everyone benefits out of the self-interest of individuals. According to Smith (1776), "it is not from the benevolence of the butcher that we get our dinner but out of his own self interest."

artificially granted monopoly positions is through transfer of resources to politicians and bureaucrats (eg. campaign contributions and outright bribes). The social waste also arises from the fact that, when firms are insulated from competition, they do not innovate and, therefore, they become uncompetitive. Such policies benefit only a few businesses and cannot be sustained for long. In today's era of globalization and market liberalization, the only survival strategy for businesses is to advocate for pro-growth policies.

Granted that pro-growth policies are good for private businesses, the main question then is: how does the private sector participate in the policy process? But before addressing this issue, we need to answer some pertinent questions: what do we mean by the private sector? who represents this group in the policy formulation process? and, more importantly, what exactly are the private sector's views on policy issues and how are these views arrived at? In other words, what type of consultations are used to collect views from the private sector?

This brief note does not seek to address all these questions but to basically provide a framework around which issues of private sector representation in policy formulation can be organized. Section 2 highlights the important role that the private sector plays in economic growth. It suggests that, as the engine of economic growth, the private sector must be the primary stakeholder on matters concerning economic policy formulation and implementation. Section 3 briefly outlines some of lessons from private sector participation in policy formulation. Section 4 provides the conclusions.

2 Private sector and economic growth

The statement that we hear so often these days that the "the government of Kenya is committed to reducing poverty" would actually be meaningful only if the government can play a facilitative role in poverty reduction. In reality, the Kenya government, or any other government for that matter, does not have the capacity or resources to reduce poverty. It is the private sector that is capable of reducing poverty through employment creation and income generation. The role of the government is to provide an enabling environment that allows the private sector to operate with minimal hindrances. Thus, the government's impact on poverty alleviation has to do with how well public policies enable the private sector to expand. Therefore, discussions on how to alleviate poverty should focus primarily on what is necessary to improve the health of the private sector.[3]

Economic growth is basically a process through which value is created. Consider a simple item such as a pen. A pen starts as raw materials that are combined using various inputs and technologies. The production processes that produce a pen involve value addition, which essentially is what translates into economic growth. The more the value added in the production processes, the higher the rate of economic growth. Often, the private sector carries the whole value-addition burden. For example, if the value added by the production process is Ksh. 100, it is most likely that the government's contribution to this

[3] The phrase "improving the health of the Kenyan private sector" does not accurately portray the current state of this sector. If we stretch this medical analogy further, we could say that the sector is in the intensive care unit and needs urgent life-saving measures to bring it back to life.

will be just a tiny amount; it could even be negative.[4] The point is that it is the private sector—not the government— that creates value.[5]

While it is important to acknowledge the important role that governments play in promoting growth, it is worthwhile to note that governments add value only to the extent that they facilitate the private sector to be productive. In general, the government's facilitative role—for example, in the provision of law and order and in the protection of property rights—aims to lower the transaction costs of doing business. It is when transaction costs are low that the private sector is able to engage in value-creating activities. Lessons from economic history show that sustainable (durable) economic development has been realized only in those countries where the private sector plays the most prominent role in the economy. Although some countries such as the former Soviet Union have experienced rapid economic growth under state planning, such growth is not sustainable.

There are numerous examples to support the argument that fighting poverty is successful only if the country has a thriving

[4] The government's part in value addition is in the form of its facilitative role—providing law and order, protecting property rights, speedily resolving disputes, providing infrastructure, and so on. But the government could also be a barrier in the value-addition process by not efficiently providing the necessary services. Furthermore, numerous regulations and complicated licensing requirements add to the cost of doing business, which has the effect of 'eating' into the value created by the private sector.

[5] The value-adding process applies also to the services sector. For example, the tourism sector has great opportunities for creating value simply by providing services. However, several 'preconditions' must be in place that make the country an attractive tourist destination.

private sector. The difference in economic growth and well-being since 1960s between Africa and Southeast Asia is explained primarily by the importance of the role each of these regions allowed the private sector to play in the economy. It is countries in which the private sector has expanded that have been able to reduce poverty the most. China's current high rates of economic growth are attributed to the enlarged role of by its private sector.[6] This is also true for some of the Latin American countries that have experienced high rates of economic growth. Likewise, good African performers are typically those that have put in place private-sector-friendly policies and institutions.

Early African civilizations also offer evidence of the role that the private sector can play in promoting economic growth. Lessons from the 'rise and fall' of kingdoms show that the private sector was primarily responsible for the rise of the kingdoms, as individuals engaged in production and exchange. Governments of the day played a crucial facilitative role of protecting trade routes, which they financed by extracting loyalties from traders.[7] Almost always, the fall of such kingdoms

[6] Although concerns over political reforms are well placed and should be pursued, recent events show that poverty reduction is best achieved by adopting policies and institutions that support the private sector. In some counties, such reforms have been institutionalized without significant political reform. Thus, it is crucial that those focusing on constitutional reforms in Kenya should carefully evaluate the elements of the reforms that would support the private sector and, by extension, poverty reduction. For example, the constitution should include an elaborate section on economic liberties.

[7] The loyalties extracted could be considered as taxes that were used to finance a public good, i.e. security. The governments of the time were not predatory, but their interest in expanding their kingdoms was to expand trade. As long as the governments' expansionist goals were linked to an expanded role of the private sector, the kingdoms

was the result of governments' failure to protect trade routes or of their extracting excessive levels of loyalties from traders. Again, history teaches us that all governments have a big appetite for revenue. Often, governments extract extremely high levels of revenue from the private sector, which could end up killing economic activity. The extent to which governments extract from the producers is best explained by the degree to which prevailing institutions are characterized by incentive compatibility. This is best illustrated by Olson's (1993) analogy of the 'stationary' and 'roving' bandits.

Some ancient Asian villages were ruled by bands of bandits. There were two types of bandits: those that moved from village to village (roving bandits) and those that remained in the same territory (stationary bandits). Roving bandits would literally extract (steal) as much produce as they could take with them from the villagers. Once one group of bandits left, the village would be invaded by yet another group of roving bandits. Roving bandits had no interest in promoting production and likewise the villagers had no incentives to invest and produce more than they could hide from the roving bandits.[8] As can be expected, villages that were subject to raids by roving bandits remained poor.

Stationary bandits were *converted* roving bandits who seized and took control of a territory keeping other bandits from

expanded. Thus, the interests of the rulers were compatible with those of the traders. It is this incentive compatibility between the private sector and the government that motivates governments to support the interests of the private sector.

[8] Hiding produce away from the bandits is similar to tax evasion and avoidance. Ample empirical evidence shows that tax compliance is greatly influenced by the extent of taxation— the higher the rates, the lower the level of tax compliance, other things equal.

extracting produce from the villagers. These type of bandits lived with the villagers and extracted only a small portion of the produce. It was in the interest of the stationary bandits to create a conducive environment for productive activity. Villages under the control of stationary bandits prospered relative to those under the control of roving bandits. In essence, economic growth resulted because it was in the interest of the rulers to encourage private sector growth and therefore the rulers created a conducive environment for the private sector.[9]

If as a country we are serious about fighting poverty, we must focus on promoting the private sector, which truly is the engine of economic growth[10] and must, therefore, be the primary stakeholder on matters pertaining to the country's economic policies. Private sector representation in policy making and implementation is not only the right thing to do, it also makes economic sense.[11]

[9] Stationary banditry is equivalent to the rational monopolization of theft.

[10] Manu Chandaria, a Kenyan industrialist, reminds us that it is true that the private sector is the engine of growth, but this engine is running out of fuel. To me, the state of the private sector it is more like an engine that is low on oil and is progressing towards a slow 'knock'. And this will be the case if nothing is done to redress the situation. At that point, to function again, the engine will require rebuilding, rather than repair.

[11] There is an unfortunate tendency to thank the government for allowing the private sector to participate in the policy process, as if this were a privilege. This view results from the fact that governments in many developing countries are over-valued. When we over-value the government, we take it for granted that it is the broker of our rights rather than a protector of these rights. The private sector has a right to influence public policy. Governments can thwart the

3 Economic policy making and the private sector

Interest groups, leverage and power diffusion

The interest-group theory of government teaches us that public policy emerges from the interplay of various interest groups in a country (Stigler 1971; Peltzman 1976). Well-organized interest groups that have the necessary leverage are able to influence policy choices in their favour.[12] Weak and poorly organized groups are generally ignored by policy makers, as they do not have the necessary leverage to compel policy makers to take them seriously.[13]

exercising of this right but cannot grant the right. After all, the fact that the private sector is the source of tax revenues suggests that it has a right to be involved in policy formulation and implementation.

[12] Many factors determine the ability of an interest group to influence policy, including financial resources, good organization, size of membership, commonality of purpose and transparency.

[13] Leverage is important if the private sector is to influence policy. Put in simple terms, leverage should be seen as the ability to withhold benefits when a service is not rendered or some specific conditions are not met. It is, therefore, in the interest of the private sector to be strategic in using its leverage in dealing with the government.

As one who has a keen interest in sociobiology, particularly the economics of non-human societies, I have found many examples of how even unsophisticated animals use leverage to their advantage. In some bird species, males are known to be unfaithful and to desert females soon after copulation, leaving the female to take care of the offspring. Females in some of these species have adopted a leveraging strategy that forces the male to invest a great deal of effort and resources before copulation, including a long 'engagement' period, By and large, interest groups seek transfers or preferential treatment from the government. For example, farmers will lobby the government to put in place policies that lower their cost of production (subsidize inputs) and raise the price of their products (guaranteed minimum prices). In such cases, the general taxpayers and consumers are the losers from such policies, while the farmers receive the gains.

But it is unlikely that small-scale farmers will be able to affect such policies. In most cases, it will be the large, well-organized farmers that are capable of influencing government policy. Likewise, well-organized, large manufacturers may be able to demand favourable policies that benefit them, but small-scale, 'jua kali' operators might find it difficult to demand policies that are to their advantage, because they lack the leverage to influence policy.[14]

and requiring that the male build a nest. After such heavy investment, the male birds tend to remain with the female even after copulation. The analogy here is that the government (male bird) collects tax revenues from the private sector (female bird) but it does not commit to support the private sector, for example, by building roads (nest). So, the private sector should use leverage to make sure that the government builds the necessary infrastructure in exchange of tax revenues. The question is whether the private sector can withhold tax revenues if the government does not provide the necessary facilities (see Dawkins (1989) and Tullock 1994 for readings on economics of non-human societies).

[14] The 'matatu' industry is an interesting case. This industry seems to have gained significant organizational capacity such that it is able to influence policy without negotiating with or lobbying policy makers. The threat of a matatu strike is sufficient to compel the government to reconsider policies that are adverse to the industry. Clearly, many informal sector operators in Kenya have not been able to influence

Interest-group activities could result in conflict amongst the various groups, because policies that benefit one group often impose costs on other groups. For example, the textile industry might be interested in the elimination of duty on raw cotton, but at the same time lobby for high duties on imported clothes. (Note that a zero tariff on cotton would be opposed by cotton farmers, and consumers would be hurt by a duty on imported clothes). The final outcome would depend on the level of leverage that the various interest groups have.[15]

Sometimes interest groups support policies that appear out of their character. Good examples of this are the 'blue laws' prohibiting trade, particularly in alcohol, on Sundays. These laws are fairly common in the southern states of America (the so called the Bible belt). As can be expected, the primary interest group that lobbied for the adoption of these laws was the church—primarily the Baptists. Surprisingly, the other group supporting these laws was the bootleggers—people involved in the production and sale of an unlicensed alcoholic beverage commonly known as 'moonshine' (a refined variant of '*kumi kumi*'). Here, two groups that otherwise had nothing in common came together to support laws they each considered beneficial. The Baptists were interested in the laws so that more people could attend church and hopefully add to the collection plate. The bootleggers, on the other hand, saw the laws as providing an opportunity to increase the demand for their product. This story suggests that even when interest groups do

policy, and have been left on their own to deal with the harassment they face.

[15] Bates' (1984) work on policy making in post-independence Kenya and Ghana shows that Kenyan politicians were more supportive of agricultural interests, while Ghana's politicians supported the urban class. This is why agricultural interests were better organized in Kenya, while urban interests were better organized in Ghana.

not have much in common, it is possible for them to unite to lobby for a common purpose if they each feel that this is the only way to achieve their goal.[16]

Many groups interested in transfers from others and are not pro-growth in focus but aim to benefit at the expense of others. In the process, they discourage productive activities.

In Africa, the most powerful interest groups are primarily tribal or ethnic based. They compete for government favours in order to improve the well-being of their tribe at the expense of other tribes. A government that responds to such ethnic interest is unlikely to adopt policies that support growth.[17]

Historical evidence shows that economic growth has been sustained only in countries where economic interests (the private sector) are actively involved in policy formulation. On the other hand, countries that have not been able to sustain growth are characterized by concentration of economic policy-making power, and their process of power diffusion has not been significant.

Countries that have sustained economic growth for centuries, such as those in northwestern Europe and Japan, underwent some major transformation in the way policy was formulated. Initially, economic policy-making power was highly concentrated, and only a few individuals determined policies. But the policies that were adopted then basically benefited a few people

[16] Clearly, if the Baptists could work with the bootleggers, there is no reason why private-sector interest groups in Kenya cannot find a common ground that benefits all. But the success of the private sector in influencing public policy will largely depend on identifying policies that benefit all private sector operators.

[17] For an elaborate discussion on the economics of ethnic groups, see Kimenyi (1997), Kimenyi (1989), and Kimenyi et al. (1989).

in the ruling class and were not consistent with the goal of sustaining economic growth. As far back as the 12th and 13th centuries, various interest groups (lobbies for industries, unions and cooperatives) were formed that exerted leverage on rulers. The result was a gradual process of economic policy-making *power diffusion* in which these interest groups were able to bargain effectively with their governments.

It is important to note that various groups in countries that have sustained growth could have had conflicting interests: they were able to bargain with their governments only after negotiating among themselves and advancing well thought out policy positions. Thus, for the private sector in Kenya to be able to influence policy, the various groups in the sector should have the capacity to negotiate amongst themselves to agree on the issues that are of common interest to them. If they cannot do this, then they should not expect the government to take any one of them seriously.[18]

By and large, the private sector in Africa has not been able to impart sufficient leverage—and has not played a significant role—in policy formulation. The main reasons for this relate to the fact that private sector groups have not developed sufficient capacity to negotiate with each other.[19] Some key features of the

[18] The workshop where this paper was presented is part of the process of negotiation among private sector groups.

[19] Remember the story of the clever female birds. The ability of the individual female birds to succeed in making the male invest heavily is largely dependent on some cooperation amongst the females. In essence, females must have 'negotiated' amongst themselves to decide how each of them would treat the potentially unfaithful males. If a sizeable number of females did not cooperate but agreed to copulate without imposing conditions on the male, then the outcome would have been the exploitation of all females by the males.

private sector that undermine the capacity of the groups to negotiate with one another include:

- The private sector is highly fragmented and the groups lack solidarity
- The sector has no real agenda and does not have a clear vision of what the economic future should be
- In the past, a large segment of the private sector concentrated on seeking preferential treatment, such as protection, which benefits only a few at the expense of others
- There is a tendency for economic interest groups to form alliances along tribal and ethnic lines, which makes it impossible for various economic groups to form strong and encompassing alliances
- Foreign-owned businesses often have access to policy makers and are able to negotiate their own packages, which means that it does not pay for them to cooperate with local businesses
- Economic interest groups lack the technical capacity to analyse critical policy issues or to effectively present them to governments
- Corruption has made it possible for individual firms to negotiate for benefits without joining groups

Private sector participation in policy formulation: lessons from success stories

The basic argument advanced in this paper is that pro-growth policies are likely to be institutionalized if private sector interests have sufficient leverage to influence them. Leverage results in the diffusion of economic policy-making power, and diffusion of economic policy-making power appears to be a necessary condition for the achievement of sustained economic growth.

In a number of countries, the private sector has emerged as a major player in the policy process. While, in fact, it is true that Kenya's private sector is now more involved than ever in policy formulation, it is still a marginal player in the policy game. Furthermore, a large section of the private sector still feels that it has no say in the policy process.

How then can Kenya's private sector become a more effective player in the formulation and implementation of public policy? Based on my readings on the role of the private sector in the policy process from both a historical perspective and contemporary experiences, it seems that for the private sector to be an effective player in policy formulation,

- it must not be fragmented in purpose or organization
- it must have a clear vision of the economic future of the country
- it must focus on broad-based pro-growth policies
- it must focus on long-term growth policies
- it must avoid focusing on single issues that benefit just one sector
- it must appreciate linkages within the private sector— hence act as one unit
- it must not focus on protecting some sectors
- it must prioritize the policy advocated
- it must invest/support information research
- it must undertake proactive policy analysis such as forecasting outcomes

- it must invest in capacity building, education and training in entrepreneurship, leadership, negotiations, policy analysis, etc.
- it must have representatives with the technical capacity to negotiate with policy makers
- it must avoid organizations that are tribal or ethnic based
- it must have a representing body that should be primarily funded by the private sector itself and not donors, as donor-funded bodies be seen as creations of foreign organizations and considered not credible to negotiate with the government.

4 Conclusion

The primary objective of this paper has been to highlight some key issues concerning the role of interest groups in policy formulation, with particular reference to the private sector. It has shown that economic interest groups, as opposed to other groups that primarily seek transfers from the government, are best positioned to advocate for pro-growth policies. Historical evidence shows that economic interests have been responsible for accelerating the economic policy-making, power-diffusion process. The diffusion of economic policy-making power is central to the institutionalization of pro-growth policies.

The paper has briefly touched on the various weaknesses of Africa's private sector that make it relatively ineffective in influencing policy. And it has outlined some key conditions that would be necessary if the private sector representation in policy process is to be effective. How Kenya's private sector deals with these issues will determine how much the sector will influence the PRSP (poverty reduction strategy paper) process and also will be crucial in the achievement of the long-term goal of institutionalizing pro-growth policies.

As a final word, it is important that those in government realize that improving the environment for business makes all citizens better off. As a matter of fact, public officials should seek to improve the environment for the private sector for their own interest. The analogy of the state of prisons during Amin's rule is informative. I am told that while during dictator Idi Amin's rule most public institutions collapsed or were in a terrible state, the prisons were not so bad. Reason: many government officials, including those charged with the Prisons Department, ended as prisoners. Thus, those in government had an interest in creating a "conducive" living environment in prisons just in case they ended up there themselves. Today, many of our public servants will exit from government service while still young and will necessarily join the private sector. It is therefore in their best interest to help create a conducive environment for the private sector.

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