LEGISLATIVE ALERT

A Publication of The Institute of Economic Affairs *Vol.19 No.1 January/February 2011*

AFRICAN COUNTRIES SHOULD CONTROL THEIR ECONOMIC DESTINY AND NOT MORTGAGE IT TO WASHINGTON

by

*Dr. J.K. Kwakye**

Summary

This Legislative Alert argues that neo-liberal "Washington Consensus (WC)" policies prescribed by the Bretton Woods Institutions (BWIs) to African countries receiving their financial assistance that favor free markets and private enterprise over systems characterized by economic controls and "statism" come with costs and do not always deliver maximum economic and social welfare. For these reasons, African countries should not swallow these policies " hook, line and sinker" but should intervene directly in their economies to mitigate the associated market failings and socio-economic costs.

IEA Ghana

Legislative Alert is a bi-monthly publication of The Institute of Economic Affairs, Ghana, an independent public policy institute. Subscriptions to the Legislative Alert are made available to those who make contributions to The IEA. Address all correspondence to: The Editor, The Institute of Economic Affairs, P.O. Box OS 1936, Accra. Tel. +233-302 244716/226333/226359/226388, 0307010713/4. Fax:+233-302-222313. Email:iea@ieagh.org. Website:www.ieagh.org

ISBN 0855-2452

African countries have for several decades been receiving development assistance from the Bretton Woods Institutions (BWIs) based in Washington, D.C. The assistance comes with policies that reflect a liberal ideology fashioned in Washington and dubbed the "Washington Consensus" (WC). The WC's underlying philosophy is the superiority of the market and private enterprise, as against economic control systems and "statism," on "efficiency" grounds.

In consonance with this philosophy, BWIs' policy advice to African countries includes: promotion of specialization in production and trade; promotion of private enterprise generally in the economy; elimination of state subsidies, particularly to industry and agriculture; external trade liberalization; liberalization of financial markets; macroeconomic retrenchment; and liberalization of product markets.

There are however costs to these "market" policies in the sense that, despite their claim to efficiency, markets do not always work perfectly and may not always deliver maximum economic and social welfare. In that sense, there may be a need for an intervening hand to correct the associated market failings and to mitigate the socio-economic costs involved.

The BWIs push African countries to continue to pay attention to their traditional primary products, in which they are professed to have "comparative advantage." Adherence to this advice has left African countries as the "hewers of wood and drawers of water" in the international production and trading system, and stifled their development.

African countries should break out of this liberal-orchestrated charade. They should follow the example of the South East Asian Countries (SEAs) to diversify their economies and promote industrialization if they are to develop and break out of poverty. The BWIs insist on privatization of State-Owned Enterprises (SOEs) in Africa. While, in principle, privatization can lead to greater economic efficiency, there may not be enough African capacity to manage privatized SOEs efficiently.

New foreign owners of SOEs are usually motivated more by profit and may, therefore, take measures, such as retrenchment of employees, which may have widespread socio-economic consequences. Price hikes and other inefficiencies are also possible, especially in monopolistic and oligopolistic industries.

African countries should undertake selective, not wholesale, privatizations, keeping under state control industries they deem strategic for national welfare, but with strengthened management systems. Private farming in Africa, based on the peasant system, which the BWIs usually support, is obsolete and unproductive. Large-scale, mechanized farming should be promoted, but in a manner such that the state plays a facilitating role rather than being in the driving seat.

The BWIs recommend elimination of state subsidies, which often entail fiscal costs and may create moral hazard. This policy has caused the demise of many infant, potentially viable African industries. Here too, a system of selective, targeted, rather than universal, subsidies is the best approach. In particular, potentially viable infant industries should be assisted to develop into mature ones. Such assistance may be provided in the form of subsidized credit, subsidized materials, tax incentives, technology, and services as needed to both industry and agriculture.

The BWIs prescribe trade liberalization in

Africa, ostensibly to open up domestic industries to competition and provide consumer choices. However, fledgling industries may not all be able to face fierce competition from cheaper imports, many of which benefit from subsidies in their countries of origin. African countries should use both tariff and non-tariff instruments to “shield” their industries from unfair competition from imports and allow them to flourish rather than wither.

Africa must directly promote its exports using appropriate instruments, including supportive infrastructure and other facilities and services. Africa must also push for an international trading system that is mutually fair and beneficial to all parties using the WTO and the Doha Round platforms.

BWIs’-sponsored liberalization of African financial markets, including through privatization of state banks, fast enrollment of new banks, and deregulation of interest rates, has had adverse consequences. It has led to denial of access to banking for many, particularly people in rural areas and the informal sectors.

The cost of credit has skyrocketed in many African countries, including Ghana, leading to high business costs and the demise of many potentially-viable industries and projects. Meanwhile, liberalization has not generated the expected competition and efficiency in general banking services. African countries should promote access to banking by as much of the population as possible, including by using nontraditional financial institutions and instruments that particularly cater for constituencies often excluded by the traditional banks.

Wherever necessary, credit quotas and subsidized credit should be deployed to support critical sectors, especially Small and Medium-Sized Enterprises (SMEs). In Ghana, Central Bank intervention is absolutely necessary to regulate lending-deposit rate spreads that cannot in any way be justified in a highly oligopolistic, inefficient, yet highly profitable banking industry.

Often, overheated African economies may need a dose of stabilization. The BWIs' approach of fiscal and monetary retrenchment, however, leads to painful cuts in development and social spending, tax hikes, credit restrictions, and high interest rates, all of which are inimical to growth.

A different approach is needed to mitigate these costs. “Macroeconomic restructuring,” rather than “universal retrenchment” should be the approach. This calls for expenditure streamlining and reprioritization, enhanced spending efficiency, and tax reforms to broaden and deepen especially direct taxes and to strengthen tax administration.

When the fiscal house is put in order, monetary policy will be unencumbered and thus be able to be more supportive of economic growth through a regime of lower interest rates. Since banking system inefficiencies and the industry's oligopolistic nature, however, stubbornly hold up interest rates in Ghana and many other African countries, some regulation may be necessary to rein them in as well as other equally-high industry charges and fees.

The BWIs advocate for liberalization of product markets in Africa in order to promote efficiency in allocation of resources. However, because of production/supply bottlenecks in Africa, liberalization only generates a sellers' market at the expense of consumers who become perpetual takers of prices that may often be riddled with high inefficiency and “costs.” Universal liberalization may also particularly hurt the poor who are usually less able to protect themselves. The right approach is to institute "subsidized pricing" of the kind of goods and services used largely by the poor—a kind of social safety-net system—including food staples, rural energy, rural water, primary education, primary healthcare and public transportation. Discriminatory taxes relating to luxuries and necessities may also be used as an instrument to assist the poor.

The key message of this piece is that African countries should control their economic destiny and not surrender it to Washington. In other words, they should avoid an unbridled application of BWI-prescribed free-market policies in consonance with the WC model, given the possibility of market failures in practice. African countries should identify the market failures associated with free-market policies and institute appropriately-directed policies to mitigate them. Some of the WC policies will have to be rejected outright because they may be anachronistic or do not serve the continent's long-term development interest. Other policies may have to be countered with interventions geared to addressing the market failures and costs associated with them.

---

*Dr. J. K. Kwakye is a Senior Economist at The Institute of Economic Affairs (IEA) and a former Advisor to the Executive Director in charge of Ghana at the International Monetary Fund (IMF), Washington DC, USA.