AFRICA AND THE WASHINGTON CONSENSUS

Finding the Right Path

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AS MANY interpretations of the Washington Consensus exist as there are regions in the world. For Africa, the panoply of reforms subsumed under the term has been useful as a guide to economic policymaking—with the main focus on fiscal discipline and privatization—even though it has proved difficult for most African countries to pursue all of them. Few countries anywhere have applied the reforms of the Washington Consensus completely, not least because some of them are culturally and historically sensitive. A larger difficulty, however, is that the reform agenda only partially addresses the growth constraints faced by many developing countries. Macroeconomic stabilization is critical for growth, but it is not clear that privatization is. Moreover, privatization and deregulation simply do not apply to African countries in the same way that they may in Latin American countries.

Nevertheless, most African states have made strong progress with many of the reforms, which helps explain, in part, the continent's improved economic performance in recent years. Economic growth in Africa is expected to average 3.1 percent this year and 4.2 percent next year—more than twice the average in 1984–93 and marginally higher than the average for all developing countries. Macroeconomic stability is being consolidated, with average consumer price inflation at 9.7 percent in 2002, down from 13.2 percent in 2001 and 54.6 percent in 1994. Underpinning the better inflation picture are lower fiscal deficits, which have declined from an average 5.2 percent of GDP in 1994 to 2.1 percent in 2001.

Of course, to reduce poverty, more consistent and rapid economic growth is required. One of the most important drawbacks of the Washington Consensus was that, while it provided a good mixture of reforms to both stabilize the economy and encourage private sector activity, it did very little to help resolve structural and institutional constraints on growth. John Williamson pointed this out in his 2002 speech at the Center for Strategic and International Studies, "Did the Washington Consensus Fail?" when he asked why so little of development economics had made its way into Washington thinking.

Three aspects of development economics are particularly relevant to African economies and their growth problem: the "dual" economy, the creation of social capital, and the role of the state. But before turning to those issues, it is worth discussing the role of external factors in African development, among them, trade and development assistance. The Washington Consensus implicitly assumed that there was nothing wrong with the development assistance relationship, but certainly, from an African perspective, development assistance has tended to undermine growth prospects, even if it has helped fill the investment-savings gap.

Adapting the global environment

Part of Africa's growth problem is due to the incentives and disincentives embedded in the global environment. All African economies, even those of South Africa, Nigeria, and Egypt, are small. Thus, the whole global environment—trade, international finance, and development aid—needs to be supportive of growth and to provide the right incentives for small African states to pursue reform.

Much of the literature on small economies focuses on the problems presented by the volatility of capital flows, but a larger problem for African economies is that their growth potential is directly affected by their ability to export and use export revenue to diversify production. Their ability to do so is constrained by a global trade regime inimical to the full development of African countries' comparative advantage. Limited market access for low-cost textiles, cotton, and agricultural products and competition from heavily subsidized industrial economy exports effectively prevent growth. The current proposal for a Common Agricultural Policy–type organization of global agricultural markets is, from an African perspective, bad economics and, probably, an attempt to spoil any progress at the Doha world trade negotiations.

At the same time, Africa has not developed a continental trading system with low transaction costs. Regional trade arrangements are fragmented and complex, resulting in relatively limited trade between African economies. A good example is the overlapping and inconsistent regional schemes in sub-Saharan Africa. Regional trade agreements are as important as multilateral liberalization. They are needed to provide incentives to diversify production within African economies, while multilateral reductions in barriers would enable countries to maximize revenue from exports of goods in which they have a comparative advantage.

Moreover, the international financial system and prevailing aid practices cause periodic disruptions to economic activity. Development assistance continues to be crucial in supporting poverty reduction and economic development in poor countries, but there needs to be more than the recent slight reversal of the trend of declining aid levels. The recently mooted International Finance Facility holds promise for increasing aid levels. Accelerated progress also requires more and better-targeted financial support for poverty reduction, particularly in policy areas important for achieving the Millennium Development Goals (MDGs)—education, health, clean water, and sanitation (see page 46).

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It is important to recognize, however, that the recent swing in thinking about development assistance has come about as a critique of the Washington Consensus. The 2002 Monterrey Consensus, the 2002 Johannesburg World Summit on Sustainable Development, and the creation of the New Partnership for Africa's Development (NEPAD) a year earlier are deliberate attempts to change the donor-recipient relationship from aid as welfare to aid through partnerships. Without this continued shift away from tied, politically driven, and welfare-based aid, Africa will continue to be faced with what Ethiopian Prime Minister Meles Zenawi calls the "syndrome of the long-term unemployed."

Two further adjustment mechanisms are needed to assist African economies to reap net benefits from trade liberalization, globally and regionally. The first adjustment mechanism is really a set of internal changes (see below) meant to ease the shifting of capital and labor in the domestic economy to take advantage of new economic opportunities.

The second mechanism would be multilateral—a financial facility designed to help low-income countries weather exogenous shocks to the prices of key commodities. The benefits of such a mechanism, if sufficiently funded, would be to make it possible for African (and other low-income) countries to adjust to commodity price shocks without derailing economic reform programs and fiscal plans. For heavily indebted poor countries (known as HIPCs), the facility might also ensure debt sustainability.

In summary, the external problem is that the global economic environment makes it less likely that internal reforms will be either initiated or sustained. For example, reliance on exporting a single commodity partly reflects inadequate external incentives to diversify production. Reform of revenue management (broadening the tax base and lowering marginal rates) becomes difficult because there is heavy dependence on a few sources of tax revenue, such as export and import tariffs. This makes it more difficult and much more important to reform the public sector and public expenditure management or to agree to sweeping trade liberalization.

Uneven consensus

From a domestic perspective, the Consensus does not address three aspects of African economic development that I believe are critical to making sustained growth a reality.

Dual economy. African countries tend to exhibit severe economic and social imbalances, particularly between the urban formal and the rural informal sectors. Unemployment and poverty levels are normally much higher in the rural sector, exacerbated by insecure or nonexistent land ownership. This results in rural dependence on fiscal transfers and employed workers in urban areas. Household income is shared among family members, raising relative poverty levels and creating disincentives to finding a job.

Social capital. Critical to spreading economic activity is not to choose between developing formal or informal sectors but to ensure that the regulatory environment is supportive of economic activity in both sectors. A trickle-down development strategy is insufficient, particularly where there are large poor populations reliant on the informal sector and few low-cost, effective public services. Human capital creation, through informal or formal employment and rapid advances in public services, needs to be a key plank of African development strategies.

The NEPAD proposals seek to strengthen ties further between rural and urban sectors and the expanding formal and informal economies, through, among other things, improved transport and communications networks. Other methods might include further development of specialist financial services. Agriculture, as the main form of rural production and income, requires special attention—particularly in terms of land redistribution and reform and strengthening property rights for smallholders.

Role of the state. The problem in Africa is that most states are weak and limited, not that states try to do everything and account for 50 percent or so of national income, as in other regions. This means that, while there have often been problems with privatization, they normally have more to do with flawed processes (nontransparent, discretionary) than with the extent of privatization. Most African states need to expand, not contract, their public sector—and dramatically improve its efficiency in delivering quality public services. This demands institutional capacity, especially in areas of regulation, service delivery, and social spending.

Economics as a discipline long ago recognized the need for adjustment, particularly where price signals are not strong or labor is not able to move to different sectors because of skills constraints and mismatches. Capable states are required to ensure not only that prices fulfill their signaling role (a regulatory function) but also that populations are able to respond to them (a public service function). Some of the more important requirements are

- effective regulation of key sectors such as transport, communication, and finance;
- policies that encourage new entrants, enterprise, innovation, and the development of social capital;
- labor markets that allow for reabsorption of labor; and
- public services and institutions that lower supply-side costs of changing from one type of economic activity to another.

Public institutions must be capable of achieving the balance between private and social costs and benefits, which requires a minimum level of democratic accountability in those institutions. Technical capacity needs to be combined with transparency and representation in public institutions. The IMF and the World Bank have made strides in recognizing these issues and incorporating them in their programs. The Poverty Reduction Strategy Paper process should be continuously reviewed to ensure its relevance to African development challenges.

Conclusions

It is not clear that rigorous pursuit of the Washington Consensus reforms in African countries would have delivered the outcomes expected from their application in Latin America. A number of key assumptions do not apply, and it has never been proved that privatization is the best approach to *all* of the problems of public sector inefficiency. At the same time, African economies suffer from a variety of constraints to growth that the Consensus reforms may have indirectly eased but would have done little or nothing to resolve directly.

Nonetheless, the Washington Consensus did impart new, if not always unfailing, direction to reform efforts throughout the developed and developing world. This in itself provided guidance to those seeking more rapid growth, economic development, and poverty reduction. Perhaps most usefully, the Consensus emphasized the importance of maintaining prudent macroeconomic policies and balances—a lesson taken to heart by most of the developing world but neglected by the developed.

Since 1994, Africa's development has received three major boosts, including the reentry of South Africa into the world economy, the agreement to establish NEPAD, and the decision to pursue economic and political integration through the creation of the African Union. A wide variety of other significant developments have also contributed to improved prospects for Africa's development, including the Southern African Development Community free trade zone and initiative on macroeconomic convergence, and the Africa Growth and Opportunity Act.

The NEPAD program sets out a critical set of actions to speed up African economic development through integration of trade, finance, labor, and infrastructure between individual African economies. Deeper integration gives rise to a number of direct and indirect benefits, including, but not limited to, lower transaction costs (tariffs and exchange rates); increased flows of goods, services, capital, and people; expansion of economic opportunities; increased public revenues and greater means for social development; broader transfers of knowledge and technology; greater regional political stability; and fewer asymmetric exogenous and endogenous shocks and, hence, fewer negative spillovers.

Large investment-savings gaps in African countries mean that sustained official and private financing is required. This is being addressed in the NEPAD Capital Flows Initiative through efforts to institute best-practice investment rules, improve public expenditure management and revenue administration, and develop financial markets.

The global community has made significant progress with the Monterrey Consensus, the MDGs, and the Johannesburg sustainable development goals in defining additions and pragmatic adjustments to the Washington Consensus, most notably in a redefinition of useful development assistance that emphasizes partnership. State-focused reform efforts are under way in African economies. An external environment conducive to increasing African exports and economic opportunities must match these reform efforts. ■

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