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Clichés, Realities and Policy Challenges of Africa: By Way of Introduction

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After all, the world is full of clichés, and we know that many of them endure even when reality tells us that they are wrong. Well-known clichés about Africa include, "Africans should stop blaming others for their economic problems and first put their own house in order" or "Pumping more money into Africa is useless and will only prolong its addiction to foreign aid." Are these clichés right? Are they wrong? Whatever one thinks about them, they may have one very negative effect: they may prevent Western policymakers from doing what they ought to do in the first place and in all modesty: help African policy-makers more effectively to put an end to the suffering of the African people.

Now I must confess immediately that I myself harbour some clichés about Africa. One of them is that I often think: Let Africa become like us, fully capitalist, otherwise they will never be able to compete with us in world politics and world economics. At the same time, I resist this thought because I am concerned about the shortcomings and negative tendencies in our capitalist societies and would not like to see them copied in African societies. Still, it will be hard to stop this process.

This book examines a number of the economic challenges and constraints that African countries are facing. They range from national and regional challenges such as improving infrastructure and the financial sector to international challenges in the spheres of trade and finance. All of the chapters defy some clichés about Africa's develop-ment and deliver valuable insights into how the constraints can be overcome.

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Domestic and External Constraints to Development

In the next chapter, Wing Thye Woo, Gordon McCord and Jeffrey Sachs challenge some of the economic clichés that many of the Western policymakers and mainstream economists hold about Africa. The main cliché Woo *et al.* deal with is the pretence of the so-called Washington Consensus that Africa's poverty and development problems can simply be blamed on "macroeconomic mismanagement" and "poor governance". "Many parts of Africa are well governed," according to Woo *et al.*, "and yet remain trapped in poverty. Governance is a problem, but Africa's development challenges are much deeper."

I find it remarkable that Andrés Solimano (Chapter 3), who has been with the World Bank for ten years, endorses the critical view of Woo, Sachs and McCord about the Washington Consensus. This shows that another cliché, i.e. that the World Bank and IMF are monolithic institutions that do not allow diversity of opinion, is wrong. Solimano not only agrees that in its original formulation, the Washington Consensus ignored the importance of institutions, politics and social conflict, but also endorses a fundamental point of Woo *et al.*: governance is not an exogenous variable that explains economic performance. "On the contrary," says Solimano, "the quality of governance in itself is a result of the development level of a country.[1] In this line, the traditionally assumed causality from governance to development must be changed for a causality that goes from development to governance."

Indeed, one of the central arguments of Woo, Sachs and McCord is that good governance does not depend so much on the idiosyncrasy of a people but on the availability of sufficient government resources to pay reasonable salaries to well-talented professionals. But there is more. Not only is there a need for money to pay the salaries of good professionals, there is also a need for freedom of design and implementation of African development policies. Here we see another constraint to good policymaking in sub-Saharan Africa: the policy conditionality imposed on African policymakers by Western donor countries and international institutions such as the IMF and World Bank. Even though the IMF and World Bank and the donor countries assert that they do not interfere in Africa's policymaking, or only do so with good intentions, the reality is that they do interfere – and not always with good (say, altruistic)

[1] However, the reverse need not be true. In my view, a high level of development is not a guarantee for a high level of governance.

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intentions. Therefore, it is not surprising that well-informed observers like Matthew Martin (Chapter 17) advocate ending this practice of limiting the room and freedom for policymaking in African countries. "In terms of economic policy," says Martin, "the major constraint for most African countries is excessive conditionality. … Another major problem is that restrictive macroeconomic frameworks set by the IMF still provide insufficient 'fiscal space' to absorb aid in sufficient amounts to reach the Millennium Development Goals."

Constraints to achieving development in Africa is a recurrent theme throughout this book. The contributing authors recognise that these constraints are both of a domestic and an international nature. When I invited them to prepare papers for a conference to be held in South Africa, I asked them to emphasise the international constraints. In no way does this mean that I, or the contributing authors, think that domestic constraints are less important. They are just as important, as public and private authorities as well as civil society in African countries recognise. The main reason I invited the authors to focus on the international constraints is that policymakers all over the world have agreed to engage in enhanced support for Africa to try and help Africa overcome its "poverty trap".

The MDGs and Africa's "Poverty Trap"

The concept of the "poverty trap" (being too poor to grow) features prominently in the chapter by Woo *et al.* and is the basis for their appeal to Western policymakers to fully support the Millennium Development Goals (MDGs) as a way out of Africa's poverty trap. "What is needed is a 'big push' in public investments to produce a large 'step' increase in Africa's underlying productivity, both rural and urban. Foreign donors will be critical to achieving this substantial 'step' increase," say Woo, Sachs and McCord.

Some of the authors in this book raise questions about the desirability and adequacy of the MDGs. Yonghyup Oh (Chapter 4) sees two problems. First, he views the MDGs as a combination of enhanced foreign intervention, more external money and a top-down approach, which has the danger of depriving recipients of the spirit of independence. Second, since the focal area of interest in the MDGs is to build up infrastructure to provide more public goods (human development, environmental protection) there is likely to be a funding problem after 2015, the year set to reach the MDGs. How will successful MDG

outcomes be sustained after that date? "The idea is not for the donor countries to continue providing funds," says Oh. "The fact is that a fall in inward ODA is anticipated for after 2015, and the major MDG goals aim to produce public goods, which does not generate cash flows to re-create these public goods."

Roy Culpeper, who recognises the importance of the MDGs as a political commitment agreed worldwide, observes nonetheless that they "are hardly an adequate basis for cooperation internationally on development". Culpeper argues that fulfilment by the year 2015 of, for example, the first MDG of elevating at least 50 percent of the people living on one-dollar-a-day or less would be very unsatisfactory. "Even if, and it is a big if, not just 50 percent, but 100 percent of that goal were achieved, so that no one was left at a dollar a day by the year 2015, what kind of success would that really indicate? If we still had 40 percent or 50 percent of humanity struggling to subsist at between one and two dollars a day, in my view it would not be much of an achievement. MDG-1 is not just a very modest goal; one could say that it is totally inadequate."

Even more critical about the MDGs is Percy Mistry, an Indian economist and investment banker who contributed to a large number of FONDAD publications. Recently Mistry wrote an article in which he said that the MDGs in themselves are laudable, but portraying them as development goals stretches credulity. "The MDGs are, in fact, poverty reduction goals that have surprisingly little to do with fostering development."[2]

In his article, Mistry argues that the history of Africa since independence has been one of development failure. Aid to Africa has not worked because human, social and institutional capital – not financial capital – poses the binding constraint. Doubling aid to Africa is, therefore, a questionable proposition. The aid community's current obsession with the MDGs may even be harming rather than helping the cause of development in Africa as aid damages the psyches and retards the capabilities of recipients in a variety of subtle and not-so-subtle ways. To develop (like China and India), Africa will need to be connected to the global economy in ways that defy the limits of African and donor imaginations. Africa will need a large influx of foreign investment and

[2] Mistry, Percy S., "Reasons for Sub-Saharan Africa's Development Deficit that the Commission for Africa Did Not Consider", In: *African Affairs*, Vol. 104, No. 417, pp. 665-678, September, 2005.

know-how to connect it to the global economy in productive ways. The human capital that Africa needs will have to come mainly from the developing world, particularly from China, India and other emerging countries of Asia and Latin America. "In short, it will require large-scale immigration of a kind that diversifies, widens, deepens and augments Africa's limited human resource base," says Mistry.

Woo *et al.* disagree with Mistry's vision. They argue that jumpstarting growth through inward immigration worked in Australia, New Zealand, Canada, and the United States, but certainly has not been the mechanism that launched East Asian economic growth in the second half of the 20th Century. "The problem is not that Africans are incapable of learning; the problem is that the typical poor African economy cannot even afford to educate everyone at the primary school level. Capacity building is the operative concept, not mass migration into Africa."

The Challenges of Financial Sector Development

The various authors contributing to this book examine a large number of economic constraints to growth and development in sub-Saharan Africa. These constraints include the underdevelopment of domestic capital markets (Brian Kahn, Olu Ajakaiye and Damon Kitabire, Chapters 6-8), the lack of national and regional infrastructures (Benno Ndulu, Lolette Kritzinger-van Niekerk, Ritva Reinikka and Charles Abuka, Chapters 9-10), the lack of successful regional economic cooperation and integration (Mothae Maruping and Zdeněk Drábek, Chapters 11-12), and the ongoing dependence on the export of commodities whose prices and markets are volatile and largely determined by the big companies of rich countries (Kamran Kousari, Chapter 13). All authors analyse these constraints in light of what African policymakers and others can do to overcome them. In this and the next two sections, I highlight the challenges that contributing authors have identified at the national and regional levels; in the third section, I highlight the challenges that they have identified at the international level.

Brian Kahn starts his chapter by mentioning that there is a positive relationship between economic growth, on the one hand, and financial sector development, on the other. He observes that financial markets generally expand when per capita income increases and analyses the role that financial markets and bond markets in particular can play in reducing sub-Saharan Africa's external vulnerability as well as being an additional source of mobilisation of capital. Since financial crises are

often caused or exacerbated by weaknesses in a country's financial system, the development of robust financial systems is important, says Kahn. Moreover, bond markets may also help to finance fiscal deficits and can provide useful market signals for macroeconomic policy. The generally narrow tax bases and growing demands for infrastructure and social services in sub-Saharan African countries have resulted in fiscal deficits which need to be financed either through domestic or foreign borrowing. The lack of depth of the domestic financial systems is a constraining factor, and is to a large extent a result of low savings ratios in sub-Saharan Africa.

A central theme in Kahn's chapter is the question of "original sin", that is the inability of developing countries to borrow abroad in domestic currency. This inability may result in excessive foreign borrowing, which increases vulnerability in the face of a crisis. Kahn recognises, however, that the development of domestic financial markets does not completely insulate countries from foreign exchange crises. Extensive foreign participation in domestic bond markets can make the currency vulnerable when risk perceptions change.

Olu Ajakaiye (Chapter 7) discusses the role of the state in financial sector development in sub-Saharan Africa. He stresses that a major lesson of the past century is that neither the free market nor pervasive state intervention and control, working alone, can lead to sustainable development. The challenge, therefore, is to secure a social order where "the ingenuity, enterprise and initiatives of private individuals and organisations are combined with a purposive state intervention, regulation and guidance". Such social order requires full participation of all stakeholders, stresses Ajakaiye, that is, business community, government officials, politicians and political office holders, labour unions and civil society organisations. "Such cooperative relationships should rest squarely on intensive formal and informal discussions and consultations in an environment of mutual respect, trust and sincerity of purpose."

I cited Ajakaiye's words literally, as they reflect a way of thinking that I consider important for defining Africa's challenges. All too often there is a tendency among both Western and African policymakers, and economists and politicians alike, to analyse development problems and challenges in terms of what government officials and business people think. Ajakaiye clearly departs from this view by emphasising the need for "full participation of all stakeholders".

In his chapter, Ajakaiye provides detailed data showing that the financial sector in sub-Saharan Africa is seriously lagging behind that of

the rest of the world. Therefore, it should be clear that the role of the state in financial sector development has to go beyond the usual provision of regulatory frameworks, says Ajakaiye, as this presupposes that the market exists in the first place. Since capital markets in sub-Saharan Africa hardly exist and still are extremely underdeveloped, it is imperative to recognise that the prevailing syndrome of minimalist state should change. Instead, governments should play three inter-related roles: create an enabling environment for all economic agents; shift frontiers by investing in activities which are either too risky or too large for private entrepreneurs; and initiate development activities that are required to get things started in an otherwise fallow field, including by creating needed state companies. For example, states emerging from war or states that have nothing to privatise should not be precluded by the current development paradigm from creating useful public enterprises.

Anyone reading this far who now thinks that Ajakaiye is an old-fashioned state interventionist is wrong. Listen, for example, to what he says about governments intervening in the economy: "The state should intervene to get things started in the capital market. Therefore, the reform of public sector enterprises should be instrumental in establishing and deepening the capital market. To begin with, the lucrative public sector enterprises should be commercialised and given necessary institutional framework (including incorporation as companies) that will enable them to form the foundation stocks of the capital market. The investment programmes of such enterprises should cease to be funded by government treasury once they are listed in the capital market. Instead, they should issue bonds in the nascent capital market as a way of gradually diluting the ownership. Over time, the share of government in the total equity of the companies should be falling and this process can be speeded up by government offering its own stock for sale to the nascent investing public. The next step is for the government to pursue aggressive reform measures to make hitherto unprofitable public sector enterprises quite profitable and hence eligible for commercialisation and subsequent listing on the national stock exchange. This way, the number of enterprises listed on the national stock market will increase and the market capitalisation will also grow."

In his comment on Kahn, Damoni Kitabire (Chapter 8) reports that in the late 1990s, both the central bank and commercial banks in Uganda supported the introduction of long-term government bonds. The Bank of Uganda was keen to develop a benchmark yield curve to promote capital market development and stimulate long-term bond

issues by the private sector, while commercial banks hoped to boost profits from higher rates of interest income on longer-maturity low-risk government securities. However, Uganda's Ministry of Finance, for which Kitabire works, has some concerns about issuing long-term government bonds. There are several reasons for concern. First, establishing a yield curve requires a critical number of competitive investors in the market for long-term securities to develop a functioning market – Uganda still lacks that critical number. Second, yields on government bonds are higher than on treasury bills, reflecting the premium required for longer-maturity securities, therefore the introduction of bonds will increase the budgetary cost of liquidity management. Third, issuing a government bond crowds out private sector issuers of securities, damaging long-term productive investment in the economy. Fourth, following the introduction of bonds, one-third of Uganda's total domestic debt is now longer-dated, which poses a considerable rollover risk (especially in the event of a withdrawal of donor aid). Because of all these concerns, Kitabire warns that sub-Saharan African countries should carefully sequence the development of bond markets. He stresses that the issuance of government bonds makes only sense when both the number of financial institutions holding long-term liabilities (such as private sector pension institutions) and the number of competitive investors in the market for long-term securities has increased. Otherwise, there will not be a functioning market and a reliable yield curve.

The Challenges of Infrastructure Development

Benno Ndulu, Lolette Kritzinger-van Niekerk and Ritva Reinikka (Chapter 9) argue that the MDGs are fine but that they somewhat neglect the importance of economic growth, while, above all else, sub-Saharan Africa needs to grow faster. They identify four reasons for Africa's slow growth: (1) low capital accumulation; (2) high price of investment goods for African investors; (3) low productivity of investment; and (4) geographical disadvantages. I will not summarise their discussion of these four problem areas but focus instead on the geographic fragmentation of sub-Saharan Africa to which they pay considerable attention. As they emphasise, this geographic fragmentation reduces substantially the prospects of creating growth by exploiting economies of scale. "Sub-Saharan Africa is fragmented into 48 small economies with a medium size of GDP of 3 billion dollars. A large number of these countries are landlocked, hosting 40 percent of sub-Saharan

Africa's population," say Ndulu, Kritzinger-van Niekerk and Reinikka. The consequences of this fragmentation include higher costs of production and trade (within and with the rest of the world), disadvantages of fragmented markets and negative effects of ethnic fragmentation partly accentuated by the sovereign fragmentation.

Having reviewed geographical disadvantages as constraints to growth in African countries, Ndulu, Kritzinger-van Niekerk and Reinikka see the improvement of infrastructure as a key challenge for sub-Saharan Africa. The authors emphasise that infrastructure is not just about supporting growth and trade, it is also about poverty reduction through lowering the cost of access to quality social services. "In this broader sense, the question is not about choosing between infrastructure and other social sectors, but on investing in infrastructure for better social outcomes."

The authors also discuss the importance of regional cooperation and integration. "Regional integration helps growth and infrastructure and vice versa. It is possible to meet Africa's geographical disadvantages and address the financing needs by focusing on regional solutions," they say.

Charles Abuka (Chapter 10) agrees with Ndulu, Kritzinger-van Niekerk and Reinikka that problems with roads, rail, ports, air transport, energy, telecommunications and other infrastructure are one of the chief constraints to economic growth in Africa. He gives as an example that as much as 50 percent of the harvest is lost in many parts of Africa because farmers lack post-harvest storage and are unable to get their goods to the market. Sufficient and reliable electrical power is another infrastructural facility needed to move rapidly into resource based manufacturing and commodity processing as well as trade in services. Africa has the lowest electrification in the world, observes Abuka. Only 23 percent of Africa's population has access to electricity. Yet another infrastructural facility that is still highly inadequate is information and communications technologies. Apart from encouraging developments in Botswana, Mauritius, Namibia and South Africa, the African region lags seriously behind others in the use of modern information technology. The limited use of information technology is caused by inadequate, inefficient and very expensive telecommunications services.

Abuka observes that trade has been a key driver of economic growth over the last 50 years for the rich western countries and for some developing countries, particularly in Asia. Asian countries have used trade to break into new markets and change the face of their economies. But this has not been the case for African countries. The last three

decades they have stagnated, resulting in a collapse of their share of world trade from 6 percent in 1980 to about 2 percent in 2002. Dynamic and competitive regions have made major shifts into manufacturing. Again, Africa has been left behind and the task of catching up is harder.

Abuka stresses that Africa needs urgent, sustained, coherent and large-scale investment in transport and ICT systems, standardisation of cross-border procedures, and establishment and strengthening of institutions to improve the functioning of markets and expedite the flow of goods. Increasing the volume of trade by producing enough goods, with the right quality and at the right price, will enable African countries to penetrate new markets and to grow at 7 percent by the end of the decade and sustaining it thereafter. Africa must overcome obstacles of discouraging the investment environment to release her entrepreneurial energies. Abuka concludes that the development of adequate infrastructure in Africa is a critical issue and that regional integration could play a vital role in tackling problems that are common to a number of African states.

The Challenges of Regional Integration

The challenges of regional integration are the exclusive theme of the chapter by Mothae Maruping (Chapter 11). Maruping focuses on the achievements, lessons, challenges and the way forward for one of the key components of regional integration process, which is macroeconomic convergence. Reviewing the "dreams and realities" of the various regional integration efforts in Africa, he observes that results have not met expectations. "In spite of the existence of the above African blocs, that have secretariats and regular technical and ministerial level meetings and summits of heads of state and government, African integration efforts have had limited impact so far. Perhaps because reality on the ground does not match ideals in treaties, protocols and MOUs. The degree of integration remains highly superficial."

Responding to the lessons learnt, Maruping suggests a number of challenges and opportunities. The first is to eradicate costly duplication of multiple memberships and rationalise some overlapping sub-regional blocs. The second is to secure commitment beyond political rhetoric amongst member countries of the various sub-regional blocs to the implementation of treaties and protocols. The third is to strengthen technical capacity for conducting informative cost-benefit analysis and ensure fair and equitable sharing of the costs and benefits of integration.

The fourth is to provide the necessary financial and technical resources, in part through international, regional and national private sector involvement at all stages of integration. The fifth is the development, harmonisation and integration of national and regional financial markets, including elimination of barriers and reducing risks affecting the free movement of labour and capital, e.g. cross-border and foreign direct investment. The sixth is the effective pooling of resources and expertise to tackle cross-cutting regional challenges, such as infrastructure, governance, gender, HIV/AIDS, peace, security and conflict prevention. The seventh is to strengthen and empower the institutions that implement and monitor regional integration programmes both at the regional and country levels. The eighth is to apply variable geometry and variable speed that accommodates the effects of different circumstances confronting member states and sectors, which is a pragmatic approach that has worked well for the European Union.

Indeed, the list is almost endless, and clearly inspired by Europe's experience with integration efforts.

Maruping concludes that regional integration remains a critical part of Africa's development strategy. In his view, the era of isolated tiny national economies has to give way to strategic alliances that permit to benefit fully from the advantages of regional integration. Such efforts will only be successful, he emphasises, if there is "greater resolve, speed and effectiveness in translating the good intentions into concrete, implementable, monitorable and results-oriented actions on the ground."

Zdeněk Drábek (Chapter 12) wonders whether policymakers in sub-Saharan Africa are enough aware of the factors that inhibit successful macroeconomic convergence. He sees three inhibiting factors. The first is the presence of serious distortions in product and factor markets, or policies that do not allow those markets to operate efficiently. The second is that countries are likely to have different costs of adjustment, and the question will be how these costs will be financed and by whom. The third is that different speeds lead to different costs of adjustment. Drábek also raises the question of whether policymakers in sub-Saharan Africa can start macroeconomic convergence before opening up their markets and what kind of domestic trade regimes they should adopt. "Should convergence target the regional countries even though most of Africa's trade and financial relations are primarily with the rest of the world? Should a country open its capital accounts and what are the implications for the conduct of exchange rate policies since macroeconomic conditions differ among countries in sub-Saharan Africa?"

Drábek thinks that the main objective for African policymakers should not be to achieve macroeconomic convergence, but to ensure that they provide for a macroeconomic environment that is conducive to a stable trade policy and sustainable balance of payments. "This is somewhat different from thinking about macroeconomic convergence, which could be excessively costly under present circumstances."

Here we see a cautious Czech economist, Zdeněk Drábek, who has been involved in getting his country into the EU (see Drábek's bio in the Notes on Contributors), warning an African colleague (Maruping has been governor of a central bank) about the danger of being too ambitious in efforts at regional integration.

International Challenges: Trade and Finance

The five last chapters of the book (chapters 13 to 17) discuss the international constraints and challenges to African development. Four of the five authors deal with the economic constraints and challenges at the global level, while one (Stephen Gelb) deals with the challenges posed by South-South investment. In this section, I will highlight a few of the many insights they present in this last part of the book. In a final section, I will draw conclusions about the development challenges that Africans and the international community are facing. I will do so by returning to the ideas and proposals put forward in the chapters by Culpeper, and Woo, Sachs and McCord.

Kamran Kousari (Chapter 13) extensively analyses the constraints that sub-Saharan Africa faces in the international trade arena. Drawing on a series of UNCTAD studies on African development, Kousari observes that African countries remain dependent on the export of commodities such as coffee and cocoa for their foreign exchange earnings. Commodity exports account for some 80 percent of Africa's total export receipts. The decline in the prices of commodities since the early 1980s has been a major factor in the poor economic performance of African countries between 1980 and 2000, stresses Kousari. Had prices not declined, investment ratios in non-oil exporting countries would have been 6 percentage points higher per annum, and per capita GDP would have been 50 percent higher at the end of the decade.

International commodity policy has not been helpful, says Kousari. In fact, after the slowdown in the world economy in the 1980s, the international community abandoned any attempts at price stabilisation. Instead, reliance on market forces became the order of the day and

adjustment programmes called for the dismantling of state institutions responsible for the marketing of commodities and providing extension and other services to farmers. The fruits of liberalisation in Africa have not been reaped by the farmers but by a few firms in rich countries that are now controlling the purchase, processing and distribution of major agricultural export products.

In the case of fuels and minerals exports, African countries have not fared much better. In an effort to revive the extractive sector in Africa, policy advice by the World Bank called for privatisation and liberalisation of the sector and the provision of incentives in order to attract foreign capital. African countries undertook wide-ranging reforms of their mining codes, including the provision of generous tax incentives, which contributed to the recovery of investment to the sector and put the region in third place behind Latin America and Oceania. However, Africa has reaped little benefits of this investment. In Tanzania, for example, where gold exports have risen from less than 1 percent of export revenues in the late 1990s to over 40 percent in 2003, six major mining companies earned about $890 million in five years, out of which the government received less than 10 percent in revenues (taxes) and royalties.

In Kousari's view, international trade policy and policy advice by institutions like the World Bank vis-à-vis Africa need a fundamental overhaul. African countries should be allowed to engage in strategic industrial policies involving selective liberalisation and differentiated tariff structures, duty drawback schemes as well as fiscal, credit and other incentives to exporters. In international trade negotiations, African countries should be granted sufficient flexibility to enlarge their policy space to accommodate those policies that respond to their own domestic development agendas.

Vivek Arora (Chapter 14), who is with the IMF, agrees with Kousari that discretionary tax incentives to foreign mining firms outweigh any benefits that they might have since the foreign firms may have come in anyway. "In addition, these discretionary tax incentives distort the playing field in favour of foreign firms and against domestic firms. … A level playing field would be better." Arora disagrees, however, that trade liberalisation has harmed poor African countries. In his view, it has contributed to higher growth and higher per capita income.

Arora agrees with Kousari's emphasis on the need for doubling aid to Africa in order to give Africa a major boost in financing for development and that such financing should include a reduction of the debt

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overhang. However, he disagrees with Kousari and other critics of IMF policy conditionality. Conditionality can be improved, says Arora, by streamlining it, giving greater ownership to African countries and so on, but it should not be abandoned. The IMF should try to make conditionality more effective.

Matthew Martin (Chapter 17) retorts that IMF's streamlining (cutting back) of conditionality should be done much more dramatically than usually considered. Moreover, emphasises Martin, "Africans need to design their own systems for a self-monitoring peer review of policy quality and not rely on external assessments of what is good economic policy".

Adam Elhiraika (Chapter 15) stresses that it is essential that Africa diversifies its exports and gets better access to rich countries' markets through reduction of tariffs and other barriers, and through special and differential treatment. But he warns about having too high hopes of African countries becoming global economic players. An integrated continental market would offer better hopes for Africa to build its manufacturing sector and diversify its economy away from primary products, says Elhiraika. This requires removing trade barriers within the continent and a strengthening of regional infrastructure.

Matthew Martin observes that analysts often make simplistic assumptions (hold cliché beliefs, one might also say) that freer trade would benefit Africa along with other countries. But, if all the barriers and subsidies (in Europe and the United States) went away, would Africa be the one to benefit? No, says Martin, because Africa would still produce a narrow range of primary commodities, and have problems with processing, market information, complying with developed country or purchaser standards, and infrastructure. In other words, it would lack capacity to trade. So the international community needs to continue special arrangements for the poorest countries while they develop the capacity to trade.

Another simplifying assumption often made, says Martin, is that the benefits from trade will get to the poorest people in developing countries. This is highly unlikely as long as there are unfair trade arrangements within countries (such as monopolies, monopsonies, and inability of poor producers to access markets).

Martin stresses that the international community should get rid of all the problems it is causing by reducing barriers and protectionism, subsidies and dumping. However, if it cares about African development it should also invest massively in enhancing African capacity to trade,

ensure maintenance of special arrangements for the poorest countries, and reform international and national production and marketing structures to ensure that the benefits from trade really reach the poor.

Martin criticises current aid practices arguing that they result in insufficient aid for public investment to grow and reach the MDGs, that they are of poor quality and low effectiveness, and that the global aid architecture is thoroughly inadequate. He emphasises that the international community should double aid to Africa (from 25 billion to 50 billion dollars) immediately, and not gradually over the next five years.

As far as private flows are concerned, Martin stresses that the international community should encourage greater foreign flows, but not treat them as a panacea. "Often people talk as if more FDI could solve Africa's development problems. Yet many other regions, and indeed Africa, have suffered foreign exchange crises as a result of private inflows turning themselves into outflows. So we need to encourage not just quantity but above all higher quality flows, with less debt and more equity, more stability and less volatility, better risk assessment to reduce the very high returns demanded by countries, and investment in underinvested sectors and regions. Africa and its international partners need to tailor and target the types of investment, encourage public infrastructure investment to facilitate private flows (though avoiding high-cost public-private partnerships)."

Martin says that the international community should also enforce anti-corruption conventions, track capital flight and money laundering, repatriate stolen funds, and encourage inward remittances.

Stephen Gelb (Chapter 16) reports that over the last 10 years there has been a very rapid increase in South-South foreign direct investment (FDI). "South-South" flows rose from $4.6 billion in 1994 to an average of $54.4 billion between 1997 and 2000, equivalent to 36 percent of total FDI inflows to developing economies in the latter period. FDI flows into Africa from other developing countries have increased as part of this broader trend, with two major sources: Asia and South Africa.

Since the mid-1990s there has been a massive increase in investment from China, India and Taiwan into sub-Saharan Africa. Companies from these countries invest in a range of sectors, both services (IT, banking) as well as manufacturing, including automotive, steel and pharmaceuticals. The second major source of South-South investment into the rest of Africa is South Africa itself. Since the advent of democracy in 1994, there has been a very rapid movement of South

African firms throughout the continent.

What does this entry of foreign investors from other developing countries mean for Africa's economic development? Do South-South investments differ from North-South investments, and if so, how? In order to answer these questions Gelb makes a distinction between market-seeking and resource-seeking foreign investment. Although research is still lacking to give any definitive answers, Gelb believes that market-seeking FDI is likely to increase the scope and quality of goods and services that are available to domestic firms and households, while resource-seeking investment (especially producers seeking cheap labour) is more likely to have some impact on employment promotion and exports.

Gelb points to an interesting positive effect of FDI that is often overlooked: the immigration of Asian entrepreneurs into Africa. Indeed, this relates to the issue raised by Percy Mistry in his critical article about the MDGs. Gelb reports, "Asian firms tend to use large numbers of expatriate managers and supervisors in their foreign investments, and these individuals often leave their employers to set up their own firms in the economies where they find themselves. The greater prospects offered abroad are an incentive for aspiring entrepreneurs from China, Taiwan or India to move from their home countries, where their opportunities are more limited."

This observation by Gelb reminds me of what Percy Mistry once told me when we were discussing policy-led and market-led regional integration in Europe and South-East Asia respectively: "Don't forget that the overseas Chinese community has been a driving force in the market-led integration of Asia."

Another important advantage of South-South resource-seeking investments that Gelb mentions is that they embody business models that are less corporatised and more informal than western models, and are often more appropriate to the host country context. Also, such investments can provide individual governments in Africa with greater bargaining power in their relations with multinational corporations from industrial countries and foreign investors more generally, precisely because it diversifies the host countries' options, and so gives their governments more bargaining power.

Whether the beneficial effects of Southern FDI are in fact achieved has not been empirically demonstrated, says Gelb. His institute (The EDGE Institute) will collect firm-level data in South Africa, India, Kenya, Tanzania and Uganda to assess the development impact in both host and home economies of FDI flows.

From Poverty to Development

The chapter by Woo, Sachs and McCord (Chapter 2) summarises the fallacies of the Washington Consensus that Woo has identified in his contribution to a previous FONDAD book, *Diversity in Development: Reconsidering the Washington Consensus* (2004). In that same book, I suggest in my introduction that officials of governments and international financial institutions may tend not to consider the arguments and proposals of critical observers (from both within and outside their institutions) seriously enough, because they know it is often not the quality of the ideas that count, but whether they serve certain interests. This is another simple notion or cliché which unfortunately turns out all too often to be true – but not always and not by definition. And, of course, there is no reason to consider good but "unviable" ideas as less important.

Many of the ideas presented in this book run the risk of not being adopted, or much later than suggested. For example, I am afraid that Roy Culpeper's suggestion in Chapter 5 that inequality is an issue that needs to be addressed urgently if one really wishes to reduce poverty in the world has little chance to be adopted widely and soon. Chances are higher that the processes and interests that create and maintain inequality will be prolonged. Nonetheless, Culpeper's arguments sound convincing, at least to me. Commenting on Woo *et al.*'s chapter, Culpeper says that health and education investments in developing countries will certainly improve the current circumstances of the poor and the outlook for their children, but will hardly change existing inequalities. Those will only change if one goes beyond health and education to consider real assets. "In a poor country context," says Culpeper, "one has to consider things such as land reform and land redistribution. This is where the fuse starts to get a little bit short and people start really to get nervous, because these are intensely sensitive political and social issues. And yet, they are issues that we have ignored at our peril if indeed our objective is to have an impact on the poorest quintiles of society."

As far as income distribution is concerned, Culpeper believes that one has to look at strategies that have an impact in the productive sector. Referring to some of the discussion in Woo *et al.*'s chapter on the rural economy, Culpeper observes that the strategy of East Asian countries was one of protection of the agricultural sector, which in many ways persists to this day. The protection of the agricultural sector

led to price and income configurations that benefited the rural poor and rural workers directly – and the cost of redistribution was borne by society as a whole. However, the policy advice given to developing countries today is completely at odds with the East Asian experience, says Culpeper. "They are faced with the prospect that, if the North abolishes its agricultural subsidies, then the South also has to open its markets to agricultural imports. Such propositions completely neglect the adverse impact those kinds of liberalisation policies in the South will have on the rural poor and in the agricultural sector."

In Culpeper's view, the MDGs also pay too little attention to poverty in the urban economy. "Again, the MDGs as they are currently articulated, say hardly anything about the need for decent employment. Employment in the productive sector is surely the pathway out of poverty for the poorest urban dwellers, and yet this is understated in the MDGs and in strategies related to the MDGs."

Finally, Culpeper argues that tax policy has an important role to play. He observes that the current tax systems in developing countries are too often regressive, relying as they do on sales and consumption taxes, and not enough on progressive income taxes. "It seems to be the rule rather than the exception that in so many developing countries elites do not pay taxes or very little tax, which indicates a very regressive distributional policy. A more progressive tax policy, on the other hand, is difficult to design and implement. Income taxes are administratively beyond the current reach of many poor countries." Moreover, income taxes will receive fierce opposition by powerful groups in developing countries, says Culpeper.

While Culpeper thinks that the proposals by Woo *et al.* do not go far enough, it is likely that those in power in rich and poor countries and in international financial institutions such as the IMF and World Bank will consider some of the criticism and policy proposals of Woo *et al.* as too radical. For example, they will have difficulty with the blunt statement by Woo *et al.* that the fallacies of the Washington Consensus apply fully to the African case and that the improved second-generation Washington Consensus (which recognises that not only prices but also institutions are important) "is still woefully incomplete in its prescriptions for the African countries".

However, it will be difficult for the policymakers to dismiss the plea by Woo and his colleagues for moving Africa out of the poverty trap. Woo, Sachs and McCord echo the UN Millennium Project's core operational recommendation, which is that each developing country with

extreme poverty should adopt and implement a national development strategy that is ambitious enough to achieve the MDGs. The authors stress that the country's international development partners – including bilateral donors, UN agencies, regional development banks, and the Bretton Woods institutions – should give all the technical and financial support needed to implement the country's strategy. It seems to me that policymakers cannot disagree with this recommendation as they themselves lay emphasis on the importance of "country ownership" of policies to be pursued.

In the case of Africa, the adoption of policy proposals by Woo, Sachs and McCord, as well as those made by Culpeper and other contributors in this book, will certainly help to achieve the goal of Africa moving more rapidly and effectively from poverty to development.

At the same time, as deputy governor X.P. Guma of South African Reserve Bank observed prior to the publication of this book, "the issues discussed in this book are of great relevance to the development prospects, not only of the African region, but of poor countries in general."

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