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Keeping Africa's Policies on the Right Track

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Kamran Kousari's chapter on "Africa's Development and External Constraints" touches on some of the core development issues in Africa, and in developing countries more generally. The chapter by Matthew Martin is also relevant in this discussion because the chapters are largely complementary.

The first point to recognise in discussions about economic development in Africa is that the key objective for all observers and policymakers is basically the same: how we can help to increase growth and to raise living standards through reducing poverty and unemployment.

Against that background, the criteria that I use for commenting on Kamran Kousari's chapter is not whether it says things in favour or against particular institutions, initiatives, or "consensuses", but whether the policy recommendations are likely to increase growth and living standards. In that context, several of the main points in the chapter are well made. But some specific arguments are less convincing; in particular the call for an easing of macroeconomic policy discipline to stimulate growth is undermined by actual fact and experience.

My remarks concentrate on the sections on international policies and financial flows.

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Conditionality and Debt Sustainability

First of all, I agree fully with the assertion that the international community has a key responsibility to help in the development process, including the responsibility to increase market access, reduce agricultural subsidies and increase ODA to the 0.7 percent of GNP target.

Second, in that context of aid, the case is well made that that Africa needs a major boost in financing for development and that such financing should include a reduction of the debt overhang. Given the scale of the continent's problems, the simple reduction of the debt overhang is not going to be enough. Something more is needed.

On the next logical step in Kousari's argument, however, a different view is possible. While one can agree that something more is needed, the question is: what exactly? The chapter seems to favour a relaxation of policy discipline, presumably including macroeconomic policy discipline, and the de-linking of assistance from conditionality. However, based on actual experience in a vast number of countries a more convincing argument can instead be made that countries need to reinforce policy discipline in order to ensure that debt overhang and macroeconomic instability do not become problems again.

A key observation to make here is that a debt overhang does not just strike countries like a natural disaster. It is a product of policies and, of course, of other circumstances, but countries do have some responsibility. My conclusion for countries that just have come out from the debt problem would rather be that the countries should try to ensure that the economic mismanagement and excessive borrowing that contributed to these problems in the first place should not be repeated.

Debt relief is clearly good for the countries that get it. Several countries do not get it, however, and that is an issue that needs to be addressed. Furthermore, one can agree with Kousari that debt relief is not going to be sufficient and that additional resources are needed. In that sense, aid and grant financing are very important.

But a key consideration has to be that an ongoing set of actions is needed to prevent external resource constraints from re-emerging and to set the stage for higher growth and poverty reduction. On both of these questions, preventing excessive borrowing and consolidating debt relief, country policies remain a critical consideration.

Policy conditionality could be helpful in that regard. Of course, one can have a debate about the effectiveness of policy conditionality in the past, and indeed a lot of empirical work is being carried out on that question, looking at both the role of conditionality and the role of policy implementation. I do not think that the jury is out yet, but, contrary to the unambiguous criticism in the chapter, my conclusion from the literature is that the experience has been generally positive but that it could have been better in some areas.

Now conditionality can obviously be improved in many ways. That is why the chapter by Matthew Martin is particularly interesting, because some of the points that he makes on areas in which conditionality could be improved, like streamlining, greater ownership and so on, are exactly correct. In fact, those are the areas where the international financial institutions, including the Fund, are looking at trying to make conditionality more effective.

The main point here is that policies matter and policy conditionality can help. If there are areas to improve in policy conditionality, as I have no doubt there are, then I would think that this is an argument for making an effort to improve conditionality, not for abandoning conditionality altogether.

Improving the HIPC Initiative

Still on debt relief, the chapter touches on the HIPC Initiative and it also drew on a previous UNCTAD report that argued that the HIPC is flawed, because many African countries continue to suffer a so-called debt overhang after the HIPC completion points. I will not go into too much detail here, but I would just note that it is important to be clear on what debt relief can realistically achieve. Debt relief can reduce debt burdens at a given point in time towards levels that are seen as sustainable and this indeed has been an objective of the HIPC. But as long as countries continue to take on new debt and are affected by exogenous shocks, debt relief can certainly not guarantee sustainability going forward. Indeed, the fact that debt sustainability itself is a probabilistic concept, by which I mean that it depends on probabilities of future outcomes and events, means that sustainability concerns cannot be addressed by debt relief alone. They need a comprehensive approach to financing (as is acknowledged in the chapter).

Several suggestions have been made to change some technical aspects of the HIPC calculations – this is referred to also by Matthew Martin in his chapter. In fact, many of the suggestions on the debt sustainability framework have been adopted. For example, several additional indicators are now used in addition to the standard HIPC ratios, and public domestic debt is now also analysed in the Debt Sustainability Assessments (DSAs). Stress tests do take into account in the countries individual historical trends as well as their volatility.

Overall, it is clear that debt sustainability should be addressed in conjunction with low-income countries' overall efforts to meet the MDGs. But I would not go on to draw the conclusion that the HIPC Initiative itself needs to be extensively modified or that debt relief alone is the solution. While further debt relief would help to reduce the tensions between sustainability and financing needs, in order for it to be effective countries still need to manage their economies and their external debt well, just as they need to manage aid inflows effectively.

So rather than suggesting that further debt relief or modified rules for the HIPC Initiative can guarantee long-term sustainability, a stronger argument can perhaps be made that durable progress toward the MDGs would best be achieved under a paradigm for development financing that allows low-income countries to receive the financing that they need to meet development objectives on terms that will keep debt and debt service at manageable levels. This proposition will require significantly higher grant resources. Further debt relief can indeed be a useful complement but it clearly will not be sufficient. Moreover, it is worth noting that debt relief allocate resources to countries based on past borrowing decisions rather than current policies.

Structural Reforms

On the other parts of the chapter, I am going to be very brief. First of all, on agriculture. The main point that I took away from the chapter is that countries in which commodities form a significant proportion of output and exports are subject to more vulnerability. That is true. What it suggests is that more diversification in production would be useful. I think that is hard to disagree with.

On the extractive sector a key point was made, which I fully agree with, that discretionary tax incentives in favour of foreign firms do have significant costs for the budget and indeed these costs can, and probably usually do, 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. The benefits are of course questionable. A level playing field would be better.

On trade liberalisation, there is a very large amount of empirical work that directly contradicts the suggestion in the chapter that trade liberalisation has harmed poor countries. I will just note two key points.

First, there is a lot of empirical evidence that reducing distortions, including trade distortions, is associated with higher growth. In a widely cited study, Jeffrey Frankel and David Romer (1999) present evidence to show that a higher openness ratio, meaning a higher ratio of trade to GDP, is associated with higher levels of per capita income. Their evidence suggests that a 1-percentage-point increase in the ratio of trade to GDP is associated with a 2-percent increase in the level of per capita income. Moreover, they argue that there is a causal relationship from trade to income. David Dollar and Aart Kraay (2004) have provided evidence that countries that are more integrated with the world economy tend to have more success with growth and poverty reduction than those that do not. Jong Wha Lee (1992) has done another cross-country study showing that high tariffs are correlated with lower growth. And so on. There is also much country evidence on the benefits of trade liberalisation, from countries such Chile, India, and Korea in recent decades, where liberalisation was followed by strong increases in growth performance.

Second, increases in growth have benefits on both the macroeconomic and the microeconomic fronts. On the macroeconomic front, for example, higher growth rates make a given level of debt more sustainable, and to that extent, it is relevant in the context of the present session. It also obviously has macroeconomic and social benefits. It has been generally noted that growth is good for the poor, and there is in practical experience a strong connection between increases in growth and poverty reduction. Indeed, we do not have examples of countries that have decisively lowered poverty that have not also grown rapidly.

In terms of helping countries to adjust to trade shocks, there are facilities that international financial institutions are putting in place to help countries deal with such adjustment. The Bank and the Fund recently developed a trade integration mechanism system (TIMS) that helps countries to cope with the effect on their balance of payments of trade liberalisation in third countries. Bangladesh recently became the first country to take advantage of this support as it sought to adjust its textile sector in response to the Multi Fibre Agreement (MFA) shock.

To conclude, I agree with many of the substantive points that are made in the chapter, particularly on the responsibility of the international community and on the benefits of debt relief. But I would just reiterate two key points: first, that debt relief needs to be seen as a *part* of any increase in external financing, but perhaps only as a complement to other parts of a package that may themselves end up being more important. Second, new financing needs to be accompanied by the right policies, otherwise debt problems and economic instability will simply recur. And conditionality can be helpful for keeping policies on the right track.

References

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