Globalization of Finance & Development Prospects in Africa

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Trade liberalization, market-oriented policies, fiscal restraint and more efficient state machinery are essential in sub-Saharan countries. But such measures will not alone overcome currently poor development prospects and achieve poverty-reducing growth. It is also necessary domestically to mobilize savings, invest in physical infrastructure, produce an educated labor force, and provide for stable legal, political and commercial transactions, and externally to obtain debt relief and attract foreign investment. Nguyuru H. I. Lipumba, Tanzanian Economics Professor and Presidential Candidate (1995), argues for both a better mix of growth-promoting national actions and a greater volume and better terms of international aid for the region.

INTRODUCTION

Many countries of sub-Saharan Africa (SSA) have been implementing structural adjustment programs supported by the World Bank and the International Monetary Fund (IMF). These economic reforms include macroeconomic stabilization, liberalization of trade and financial markets, privatization of public enterprises and establishment of stock exchange markets, partly aimed at opening African economies to attract capital inflows. There is a clear commitment to market-oriented reforms by an increasing number of African governments which have formally accepted obligations of article VIII of the IMF Charter; it prohibits them from restricting payments and transfers for current account transactions and engaging in discriminatory currency arrangements.

Extensive restrictions of this type were the norm in the first half of the 1980s. In 1985 only two SSA countries had accepted article VIII obligations. By January 1999, at least 34 sub-Saharan African countries had done so. Some countries, such as Uganda, have liberalized both current account and capital account transactions, and have repealed foreign exchange controls. Nigeria is the only major country that drastically reversed liberalization of the foreign exchange market; it fixed its exchange rate in 1993 and has been operating a dual exchange rate regime until early 1999.

Following IMF advice, many countries have enacted laws that increase the autonomy of the Central Banks to pursue the objective of price stability. Despite adopting market friendly policies, most SSA countries have been bypassed by the surge in private capital inflows to developing countries during 1990–97. These countries have large external debt payment arrears and face a debt-overhang problem that discourages domestic and foreign investment.

Sub-Saharan Africa continues to depend on official development assistance that has sharply decreased in the past four years. The adoption of market-oriented reforms has not been supported by increased assistance. The end of the cold war has not produced a peace dividend to support broad-based growth and human development; instead, it has been associated with widespread aid fatigue in developed countries.

If SSA countries are to significantly reduce poverty and meet targets of the Copenhagen Social Summit of halving the number of the poor by 2015, they need to grow by 6–8 percent per year. The economic and institutional framework for sustained, broad-based growth is not yet in place. For the sub-Saharan region as a whole, growth of per capita income was negative in 1985–94. Though IMF researchers have characterized economic growth in 1995–97 as a turning point in the region, it was only one percentage point higher than the growth rate of population. It is both too low to make a dent on poverty and too fragile to be considered as a takeoff to sustained high growth. The increase in non-oil commodity prices in 1994–95 contributed to the recovery, but private investment did not significantly increase. The collapse of commodity prices emanating from the Asian financial crisis has reduced growth in 1998 to less than the population growth rate.

ECONOMIC GROWTH, INVESTMENT REQUIREMENTS AND PRIVATE CAPITAL MARKETS

Sustained high growth requires an educated and healthy population, and an enabling institutional framework that provides incentives to individuals, households and firms to be productive. Investment in physical capital is a necessary though not a sufficient condition for high growth rate of output. All fast-growing East Asian countries had average annual investment rates of 20 to 30 per cent of GDP during the 1960–92 period, as measured by purchasing power parity prices in the Penn World Tables. By comparison, average annual investment rates in African countries have been low — less than 5 per cent in ten countries (Angola, Burundi, Chad, Ethiopia, Madagascar, Mozambique, Rwanda, Sierra Leone, Uganda and Zaire). Another 13 countries had investment rates of 5 to 10 per cent (Benin, Burkina Faso, Cape Verde, Central African Republic, Congo, Gambia, Ghana, Guinea, Malawi, Mali, Niger, Somalia, and Tanzania). The only countries with investment rates of around 20 per cent — similar to those of China, Hong Kong, Indonesia and Thailand — are some of the mineral-exporting countries, including Botswana, Gabon, Namibia, South Africa and Zimbabwe.

The low level of investment rates is partly explained by the fact that domestic savings, which normally finance a large share of domestic investment, are very low. In most cases, African countries have decreasing saving rates, particularly compared to East Asian economies. Low per capita income does not completely explain low rates of saving — for example, low income in China and India is not associated with low saving rates. In Sub-Saharan Africa what has contributed to the low saving rates is economic stagnation and negative growth rate of per capita income.

Another reason for low levels of domestic saving rate is the weak financial system. Financial institutions in most countries of the region have not been performing the role of effectively mobilizing savings and channeling resources to highly productive investment. In almost all countries except South Africa, Mauritius and Zimbabwe, the financial sector is underdeveloped, thin and shallow. Financial sector reforms sponsored by the World Bank and IMF are rooted in the theory of "financial repression". Poor investment and growth are seen to have been caused by negative interest rates, high reserve ratios, and directed credit that has lowered domestic savings and misallocated credit to projects with lower returns. The reforms have emphasized the liberalization of interest rates that should lead to positive real deposit and lending rates, ending of directed credit, restructuring/privatization of state-owned banks, easing of government restrictions and controls on entry into the financial sector by foreign and domestic institutions, and strengthening of the bank regulatory framework.

Governments have been encouraged to establish competitive markets for government short-term debt instruments such as treasury bills. The purposes are to remove financial repression, finance budget deficits in a non-inflationary manner, and introduce indirect instruments for the conduct of monetary policy. Financial repression has been seen as a major cause of low saving rates in less developed countries. However, empirical works that show negative real interest rates associated with low saving rates fail to distinguish between small and large repression. Countries with large negative interest rates drive regression results that show significant positive elasticity of saving rates with respect to interest rate. When these countries are excluded from the sample, real interest rate loses its statistical significance.

It should be noted that high negative interest rates are the result of high inflation, a symptom of government failure not only to collect taxes and control expenditure, but also to deliver government services and maintain the rule of law. Where the government is excessively inefficient, saving rate and growth are likely to be low. Increasing the nominal interest rate to make the real interest rate positive is unlikely to increase the saving rate and promote growth. High interest rates may exacerbate the financial position of weak governments because of increases in government debt servicing.

Before liberalizing interest rates to promote saving and efficiency in investment allocation, economic reforms should focus on improving the government fiscal discipline. African financial markets are highly fragmented, with the majority of the population in rural areas and the informal urban sector having no access to financial services. If savings are to be effectively mobilized, financial services have to be extended to the population that is currently underserved. This requires innovative ways of linking the formal and the informal financial sectors by encouraging the development of emerging semi-formal intermediaries. The problem of lack of access to credit facing small holder-farmers and small and medium scale enterprises cannot be resolved by opening the financial sector to international commercial banks such as CitiBank. International banks can worsen credit availability of local firms by out-competing domestic banks in the lucrative business of well-established enterprises. Domestic banks may be confined to the more risky and less profitable customers, reducing their capacity to expand credit. Financial restraint that includes setting nominal interest rates that make real interest rates only slightly positive and directing credit to competitive sectors such as exports is more appropriate for sub-Saharan African countries at their stage of development.

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According to the World Bank, the prerequisites for complete financial integration into the global capital markets include:

- sound macroeconomic framework, particularly strong fiscal position and absence of debt payment arrears;
- a functioning market system and absence of large price distortion
- sound domestic banking system with adequate supervisory and regulatory framework
- a functioning market infrastructure and regulatory framework for capital markets.

Most African countries do not meet these preconditions.

Reducing inflation to single digit levels close to those prevailing in OECD countries is an important policy objective for countries interested in integrating in the global financial markets. However, it is too costly to fight inflation using high interest rates. Most SSA economies do not have in place a competitive financial sector. Market-determined interest rates are most likely to be influenced by collusive behaviour of a few, in most cases less than four, financial institutions that usually account for over three-quarters of the assets of the formal financial sector. Using auctions of treasury bills to establish the benchmark interest rates can lead to high real interest rates for a long period, choking private sector activity and investment in the real economy. Real interest rates of over 10 or even 20 per cent have been common among countries that prematurely try to introduce market-based interest rates before adequate measures are taken to control budget deficits. High yields on treasury bills and government bonds not only crowd out credit to and investment in the private sector; they undermine the development of financial institutions' skill in risk analysis and selection of good projects and entrepreneurs in the private sector. High yields on treasury bills and bonds may attract short-term capital inflows. With floating exchange rates this will lead to the appreciation of the exchange rate, penalizing exports and encouraging imports. Capital inflows may be followed by capital outflow when foreign interest rates increase or in anticipation of future exchange rate depreciation. Large instability in the real exchange rate is not conducive to the creation of conditions to support sustained growth of exports. Central Banks need to focus on maintaining a competitive and stable real exchange rate. If they focus on using interest rates to fight inflation, they will undermine the growth of export and import competing sectors.

Africa still requires development finance to build its physical and social infrastructure. Private markets are unlikely to provide it.

Stabilization and adjustment programs have reduced public investment without increasing private investment. To increase and sustain poverty-reducing growth, SSA countries need increased levels and efficient allocation of investment. Increased public investment in infrastructure is necessary to attract productive private investment. The current average gross investment rate of 17 percent is not adequate to sustain average growth rates of 6 to 8 percent. Africa needs gross investment rates of 25 to 30 percent to develop the social and physical infrastructure and provide the private sector capital requirements for sustained, poverty-reducing growth. Even with prudent fiscal and monetary policies, domestic savings are unlikely to be adequate to finance necessary investment. International financial institutions laud global financial integration as providing emerging and developing economies with access to global financial markets, more productive investment, and modern technology to accelerate their economic growth and modernize their financial systems. But even before the East Asian financial meltdown, African countries were unable to attract large amounts of private capital inflow. Foreign direct investment is attracted to countries that have good physical, institutional and human infrastructure. Huge public investment is a prerequisite for attracting private investment.

Africa will continue to need official development assistance. Private capital flows as a share of total resource flows have been decreasing in sub-Saharan Africa but increasing in all other developing regions. The experience of African countries with private capital flows varies across the region. The CFA zone countries used to receive a large share of their resource inflow in the form of private capital flows. After the debt crisis in the early 1980s, private capital flows declined and stayed low even after the 1994 devaluation. For example, in Côte d'Ivoire, private sources used to account for over 60 per cent of resource inflows from 1970–1984, but since 1984 have reached less than 3 per cent. Kenya's total capital inflows also used to include a large share of private flows in the 1970s, but they decreased in the 1990s to an average of less than 3 per cent. Despite the shortage of capital in sub-Saharan countries, capital inflows have been limited.

Foreign direct investment is concentrated among the developed industrialized countries and only a few emerging economies. The United Nations World Investment Report 1998 estimates that in 1997 the developed countries accounted for 68 per cent of the stock of inward foreign direct investment. In the 1990s, the share of emerging and developing economies has increased from 20.6 percent in 1990 to 30.2 percent in 1997. The whole of Africa, however, accounted for only 1.9 percent of inward investment in 1997, compared to 3.1 percent in 1985 and 2.2 percent in 1990. During 1990–96, sub-Saharan Africa accounted for less than 3 per cent of the total foreign direct investment to all developing countries; this was despite the fact that rates of return on foreign direct investment in sub-Saharan Africa averaged 24 to 30 per cent, compared to 16 to18 per cent for all developing countries (Bhattacharya, Montiel and Sharma 1997, World Bank 1997).

Most foreign direct investment is in natural resource extraction, particularly petroleum. Foreign direct investment to Nigeria, almost all for the petroleum industry, accounted for 60 per cent of all foreign direct investment to sub-Saharan Africa during 1990-95. The next largest recipient was Angola, accounting for 16 per cent of the sub-Saharan total during 1990–95, also mainly in petroleum. Other major recipients include Ghana, with 6 per cent of the sub-Saharan total, largely as the result of the privatization of the Ashanti Gold Mines. Zambia accounted for 4.6 per cent of the total, mainly as a result of privatization of the copper mines.

In the 1970s, a few countries such as Nigeria, Côte d'Ivoire, Gabon, Kenya, Congo Republic, Congo (Kinshasa) and Cameroon had access to international commercial bank loans. The developing country debt crisis that started with Mexico in 1982 also affected most of these countries; they lost access to new loans from commercial banks; old loans were not rolled over and had to be repaid, causing a net transfer of resources to foreign commercial banks. Angola, Mauritius and South Africa are the only countries that have significant access to external commercial bank loans. Other countries' net flows from commercial banks have been negative. However, if we include official bilateral and multilateral debt flows, most SSA countries had positive net resource transfers on debt throughout 1970–95. The exceptions include Nigeria, Côte d'Ivoire, Gabon, Kenya, Congo Republic, and Congo (Kinshasa). Most SSA countries are not in a position to access commercial bank loans, including long-term syndicated bank loans that can be used for infrastructure investment. This is because they lack credit worthiness and have large arrears on debt payments. Such arrears exceed a billion dollars for 14 countries (Angola, Cameroon, Congo Republic, Congo (Kinshasa), Côte d'Ivoire, Ethiopia, Liberia, Mozambique, Madagascar, Nigeria, Somalia, Sudan, Tanzania and Zambia). Debt payment arrears exceed annual export earnings in 12 countrires (Angola, Congo Republic, Congo (Kinshasa), Equatorial Guinea, Ethiopia, Guinea-Bissau, Madagascar, Mozambique, Nigeria, Sao Tome and Principe, Tanzania and Zambia).

Foreign investment in African stock markets is still quite small. This is partly because only a few stock markets are fully operational and liberalized to allow unhindered participation of foreign investors, particularly institutional investors that have become increasingly important in world capital markets. Among SSA countries only 7 countries had received foreign portfolio investment at least in one year during 1992–96 period (Botswana, Côte d'Ivoire, Ghana, Mauritius, Nigeria, South Africa and Zimbabwe). South Africa is the largest recipient of equity flows. It is the tenth largest market in the world in terms of capitalization value, although its trading ratio is not highly ranked. Ghana is also a major recipient (see box).

Virtually all sub-Saharan African countries, except South Africa and Mauritius, do not have access to the international bond market. The causes of declining shares of private capital inflows to sub-Saharan Africa include low economic growth and small markets, unconducive policy environment, weak institutions and debt overhang. Until recently African countries have not been attracting investment, even in the extractive industry such as mining, with the exception of petroleum drilling. In other developing countries, particularly East Asia, a large share of the private flows are invested in export oriented manufacturing industry or finance infrastructure in export-oriented economies.

Africa is increasingly dependent on official flows and receives the largest share of grants to all developing countries. Overall foreign aid has been decreasing. In 1997 industrial countries offered less aid as a proportion of their national income than any time since comparable data started being compiled in 1950s according to OECD. Aggregate official flows to all developing countries are decreasing in nominal and real terms. In 1994 to 1997 official development assistance to sub-Saharan Africa fell by 20 percent in real terms, even when more countries were implementing market friendly reforms.

With the end of the cold war, the United States has drastically reduced development assistance to all countries except Israel, a high-income country. US multilateral contributions have been decreasing. Continuous Congressional delays in disbursing funds are undermining the burden-sharing principle among donors. At the time of negotiations of the eleventh replenishment the International Development Association (IDA-11), the US was in arrears on payments due to IDA-10 by almost a billion dollars.The decreasing US commitment to multilateral development institutions is the main cause of the one-third fall in commitments in IDA-11 compared to IDA-10. The IDA loans are highly concessional because they are paid over 40 years following a ten-year grace period.These loans are interest-free except for service charge of 0.75 percent. The IDA loans have more economic value than bilateral loans because they are least tied.

African countries should design policies that foster macroeconomic stability, build institutional capability in government, maintain transparent rules of the game and provide incentives for private sector investment. The region still requires development finance to build its physical and social infrastructure. Private markets are unlikely to provide the requisite finance. International development financing institutions need to have more resources. Alternative methods of increasing the resources available to IDA are needed. The World Bank should consider tapping the international capital market using donor-financed interest subsidies that will reduce the cost of borrowing, a method similar to IMF's financing of Enhanced Structural Adjustment Facility (see Killick 1998, Sanford 1997). A club of reforming African countries that have initiated growth, but need additional investment, should lobby the World Bank and donors to subsidize

LEGENDARY GOLD, MODERN CAPITAL FLOWS

In recent years, Ghana has become a significant recipient of equity flows. In particular, this occurred as a result of the privatization of the Ashanti Gold Mines and its listing in the New York Stock Exchange.

Ghana's own stock market, established only in 1990, is the second largest in terms of capitalization. Equity flows accounted for 66 and 51 per cent of total private flows to Ghana in 1994 and 1995 respectively.

Such large flows are not likely to be sustained because privatization of other enterprises is unlikely to attract as much interest as the legendary Ashanti Gold fields which gave Ghana its colonial name of the Gold Coast. The low world price of gold seems to be lasting, and the defeat of inflation in industrialized countries dampens foreign interest in the gold market.

interest payments and enable countries that are performing well to have access to finance in the private capital markets through the World Bank.

AFRICA NEEDS ADEQUATE DEBT RELIEF AND MORE DEVELOPMENT FINANCE

In the 1990s Latin American countries that formerly were highly indebted regained their credit-worthiness and had access to commercial bank loans. African countries are still shunned by commercial banks partly because of high indebtedness and debt payment arrears. Before the 1997 currency and financial crisis, medium-term syndicated bank loans were considered as an important source of private financing for infrastructure investment in middle-income countries in Asia. After the crisis, flows of bank loans to developing countries have turned negative. Private capital flows in general and bank loans to developing countries in particular are highly sensitive to international interest rates. External loans to developing countries are likely to be more available during the downswing in the business cycle of the industrial countries and will be difficult to arrange during the upswing. In the current American boom, inflation rates and interest rates have remained low. If the US can sustain robust growth over a long period with low inflation, interest rate may remain low “permanently”.

In such an environment of moderate access to syndicated bank loans improving export-oriented infrastructure in African countries that have gained credit-worthiness should be considered. Only a few countries have debt-servicing obligation of less than 15 per cent and hence have their credit-worthiness intact, including Botswana, Lesotho, Mauritius, Namibia, Seychelles. The only sub-Saharan African countries that have access to the syndicated bank loan market seem to be Mauritius, Seychelles, South Africa and Swaziland.

Resolving the debt crisis is a prerequisite for building African credit worthiness in the medium and long term. Among the 41 heavily indebted poor countries, 33 are from sub-Saharan Africa. For over a decade, these countries have undergone debt-rescheduling exercise after adopting stabilization and adjustment programs supported by IMF and World Bank. The external indebtedness of these countries has increased after three, four or five debt-rescheduling exercises that have undermined the integrity of the whole exercise.

The World Bank and IMF have sponsored a Highly Indebted Poor Country (HIPC) initiative that is supposed to resolve the remaining debt problems of the low-income countries. This initiative involves a commitment by bilateral and multilateral creditors made at a decision point after a country has a three-year track record of being in the good books of the IMF and the World Bank. The commitment is to reduce the debt burden of eligible countries to sustainable levels, provided the country completes a further three-year period of strong policy performance. Thus, before debt reduction can be effected, a highly indebted poor country has to have six continuous years of good track record. The World Bank and the IMF consider the debt to be sustainable when the net present value of debt to exports ratio and debt service to export ratio are below a country-specific target within ranges of 200–250 per cent and 20–25 per cent, respectively. In the special case of highly open economies that have high debt burdens relative to fiscal revenue, the definition of "sustainable" is that the net present value of debt should not exceed 280 per cent of fiscal revenue (Boote and Thuge 1997).

The debt sustainability measures do not focus on the fiscal crisis of African governments. Debt sustainability should be determined by the ability of government to raise funds to pay debt, while providing necessary infrastructure and social services, and without imposing enormous tax burdens on the private sector that will discourage investment. Sachs (1996) has suggested that African countries can start growing fast if they do four things: strengthen the rule of law; lower the highest marginal tax rates to 20–30 per cent; adopt uniform tariff rates of 10 per cent; and limit government expenditure to 20 per cent of GDP. As a rough guideline, he suggests allocating 5 per cent of government expenditure to education, 3 per cent to health, 2 per cent to public administration, 3 per cent to army and police, and 5 per cent to government investment, mainly in road infrastructure and particularly rural roads.

This type of minimalist expenditure on essential areas leaves no revenues for debt servicing. Many African countries, including the favoured reformers, are unable to raise 20 per cent of their GDP in fiscal revenues. The unending rescheduling of external debts with new arrears being accumulated after the end of every Paris meeting has damaged the integrity of budgetary process of African governments. It is impossible to have serious government budgeting and prioritization of government expenditure when you allocate 20 to 40 per cent of government revenue to debt servicing and still accumulate external debt payment arrears. The external debts of Africa were contracted under single party or military governments. Many African governments have been moving, in most cases grudgingly and under pressure from western donors, towards pluralistic democratic systems. Newly elected governments need to take bold measures to impose fiscal discipline, reduce runaway inflationary pressure and establish a conducive and level playing field with supporting infrastructure to encourage private sector investment. A debt overhang will make it impossible to carry out economic reforms and will undermine political stability of democratically elected governments.The six-year waiting is longer than the normal political cycle of five years. A newly elected government faithfully implementing reforms cannot show that its external indebtedness has been reduced to sustainable levels at the end of its term in office and before the next election. Many countries that have been implementing reforms will not celebrate the new millennium with sustainable external debt levels.

By the end of 1998, the IMF and the World Bank had agreed debt relief under the Highly Indebted Poor Country (HIPC) initiative to seven countries in Africa (Uganda, Burkina Faso, Côte d'Ivoire, Mozambique and Mali) and two others (Bolivia and Guyana). Only Uganda and Bolivia have benefited from HIPC debt reduction in 1998. Mozambique and Mali may receive debt reduction in 1999, Burkina Faso in 2000, Côte d'Ivoire in 2001. Ethiopia, Tanzania, Niger and Zambia will not qualify until 2002–2003. A modest funding of the IMF debt reduction measures by selling a small part of the IMF gold was strongly opposed by Japan and the previous CDU administration in Germany. After the unfolding of the East Asian crisis, the IMF and the Group of Seven countries mobilized more than $100 billion and bent the country-quota-related rules to prevent an Asian financial meltdown. The IMF is having problems raising $7 billion needed to implement the HIPC initiative in more than 20 African countries.

The failure of the club of the rich nations to extend debt write-off to highly indebted poor countries imposes pain by restricting the ability of governments to extend health and education to the poor. It also undermines their ability to prepare for selective and prudent integration in the global capital markets. African countries need debt relief to promote private investment, attain sensible tax and expenditure policies and foster integrity in fiscal and financial systems.

Debt cancellation should not be conditional on having an agreement with the IMF and the World Bank. Linking debt cancellation to IMF approval undermines ownership of the reform process. Market-oriented reforms that are accompanied by institution-building with broad-based political support can initiate long-term growth, but there is no evidence that IMF programs have initiated sustained growth anywhere in Africa. Moreover, IMF policies are not always appropriate. Under IMF pressure many countries have liberalized interest rates by auctioning treasury bills in thin markets before reducing fiscal deficits. As a result, the domestic cost of debt servicing has skyrocketed, worsening government finances. Yet a government that refuses to liberalize interest rates will not reach an agreement with the IMF and will fail to qualify for a debt reduction.

In most sub-Saharan African countries, external debt was contracted to finance projects proposed and designed by foreign experts selected by donor aid agencies or the World Bank. Many of these projects proved to be white elephants. Increasingly, African countries have realized policy mistakes of the past and have implemented far-reaching economic reforms. There is, however, a lack of humility among the donor community and multilateral aid agencies that most of the projects with costly inappropriate technology were imported from Western countries at their insistence and advice. Their private companies profited from exporting equipment and consultancy services, without taking the risk of success or failure of the investment. Both African governments and Western aid agencies are jointly responsible for the African debt crisis. In these circumstances the morally right thing to do is to wipe the slate clean. Write off all the debt of low-income African countries and make new aid available only to those countries that have right policies for long-term development, the protection of human rights and democratic transition.

Debt cancellation should not be conditional on having an agreement with the IMF and the World Bank, which undermines a country's ownership of the reform process.

The IMF dismisses unconditional debt cancellation because it will promote moral hazard problems. It is argued that creditors will not lend again to recipients of such cancellation. Why should countries that have misused resources more than others have more of their debt cancelled? What guarantee is there that the money saved would be put to effective use? Most of the loans to

Because both African governments and Western aid agencies are jointly responsible for the African debt crisis, it is morally right to wipe the debt slate clean. Then make new aid available only to countries with right policies for long-term development, protection of human rights and democratic transition.

countries such as Mobutu's Zaire were motivated by strategic cold war calculations of western powers who knew the money was not being used to promote development. Why should the Congolese citizens who suffered under the Mobutu kleptocracy be responsible for paying the external debt that Mobutu deposited abroad and squandered with the full knowledge of the creditors? Why does the IMF ignore the moral hazard on the creditor side? If creditors that provided loans to government with wrong policies and institutions do not lose their money, they will improve their lending policies.

In any case a large fall in concessional loans to Africa has occurred when more African countries are adopting market-oriented reforms. Countries that have governments opposing economic reforms do not service their external debt and accumulate payment arrears. Their misuse of resources is not affected. It is governments that are interested in reforms that are bound to service their debt. Governments interested in implementing economic reforms have to allocate their scarce technical and administrative manpower in negotiating debt rescheduling instead of designing programs to initiate and sustain poverty-reducing growth. Even the HIPC debt cancellation is not deep enough and does not lead to debt levels that are sustainable.

The IMF calculations of debt sustainability use assumptions that are too optimistic. I therefore support the 1998 UNCTAD Trade and Development Report proposal that an independent body should be selected to review the debt sustainability of the highly indebted low-income countries.The IMF pretends to have policies that promote high quality growth that leads to poverty reduction. Economic development is a do-it-yourself process. External capital inflow, foreign ideas and technology transfers are important in facilitating economic growth. They can, however, only complement and not replace domestic effort in understanding, adapting and managing development policy. The fundamental causes of the African debt crisis are foreign donors, motivated either by good intentions or cold war politics, and African governments which tried to find shortcuts and avoid the "do it yourself" process that is necessary for economic progress.

IS UGANDA'S DEBT "SUSTAINABLE"?

Uganda was the first country to receive debt cancellation under the Highly Indebted Poor Country (HIPC) initiative of the International Monetary Fund. Over time, it is expected to reduce Uganda's external debt by US$ 650 million — 20 percent of its nominal value.

IMF concludes that the Uganda's debt is now sustainable. Projections are that its debt- servicing ratio will decrease to an annual average of 14.5 percent in 1998 to 2001, compared to 22.2 percent in 1995 to 1998. This reduction can be attained if exports in dollars grow at an annual average rate of 15.4 percent in the next three years. However, such export growth seems too optimistic, given that commodity prices are weak and that Uganda's annual growth rate of exports was only 0.4 percent during 1986 to 1996. The optimistic projections seem to be based on the unusual export performance of 1994 and 1995, when there was a coffee price boom and good weather conditions led to a bumper coffee harvest.

Uganda tax collection is around 10 to 11 percent of GDP. The export GDP ratio is still low — around 12 percent of GDP. A debt-servicing ratio of 15 percent implies using 1.5 percent of GDP or 15 percent of tax revenue to service debt. Can Uganda afford to service its debt and invest in poverty eradication? Without continued development assistance, Uganda will not be able to service its debt.

For Uganda, donors have been quite sympathetic. Pledges of providing almost a billion dollars in aid in a year's time were made at the end of 1998. These levels of aid may be needed for at least the next five years for Uganda to avoid unsustainable indebtedness after the HIPC debt cancellation.

A STABLE GLOBAL FINANCIAL SYSTEM WILL SUPPORT DEVELOPMENT IN AFRICA

Sustained economic growth in Africa depends on robust growth of the world economy. Although the financial system of most African countries, except South Africa, is not integrated into the global financial system, their economies are not insulated from the fallout of global financial crisis. Financial crisis and low growth reduce demand for SSA commodity exports, and lower their prices and foreign exchange earnings. Decreased world demand for all products makes it difficult for SSA to diversify their exports. The minuscule private capital flows to SSA countries fall during financial crisis. African countries will benefit from a stable global financial system that promotes growth, international trade, foreign direct investment and transfer of technology. It is in the interest of Africa to have a global financial system that is stable and promotes sustainable growth of the world economy.

Sustainable global growth is good for African growth. Designing development policies to promote exports and attract foreign investment is more feasible in a world where major currencies have relatively stable exchange rates. A stable global financial system will reduce the use of international public resources to bail out private financial institutions and crowd out development finance to poor countries. Emerging African economies can benefit in having access to finance in a stable system. Africa needs more foreign direct investment, not only in extraction of natural resources, but also in export-oriented manufacturing. Liberalization of capital account transactions is, however, not necessary for promoting foreign direct investment into Africa.

To take advantage and benefit from opportunities of globalization and mitigate adverse impacts of the global current requires effective and capable state machinery. Getting beneficially integrated in a global economy is not automatic once you remove trade and investment barriers. It requires an educated labor force and enabling environment that promotes learning as a life-long activity. It depends on having a good physical infrastructure, particularly for transport, telecommunication, power and water supply. It necessitates an institutional framework which promotes the rule of law and stable rules of the game for commercial transactions. The rule of law requires institutional arrangements that effectively implement the laws of the land, protect the security of individuals and their property, adjudicate disputes, and provide orderly succession of power.

As Polanyi argued, markets are sustainable only in so far as they are embedded in social and political institutions. Widespread perception of legitimacy of economic outcomes is necessary for maintaining political stability. Globalization is not sustainable if it significantly erodes that perception. It is a myth to think that a country can attain prosperity by simply opening its markets. Globalization does not nullify the need for development strategy — a purposeful action by the state to mobilize and motivate economic actors to initiate and sustain poverty-reducing economic growth. There is no single development strategy relevant to all countries regardless of their initial conditions. Globalization has made designing country-specific development strategies more difficult because of policy convergence promoted by international financial institutions.

All countries are required to move towards free trade regimes and convertible currencies. Financial markets have to be liberalized and interest rates have to be market-determined. To attract foreign direct investment, tax rates on profits must be low and government revenue should increasingly be dependent on consumption taxes such as value-added taxes. The current wave of promoting trade liberalization and the condemnation of state interventions in the economy is based on what Rodrik has characterised as market fundamentalism — myths and half truths that freeing up international markets is the surest way to global prosperity. It is ahistorical to assert that the necessary and sufficient condition for the initiation and acceleration of economic growth and structural transformation is to have sound money, open markets and the protection of property rights. Historical evidence from both developed market economies and the newly industrialized countries does not show automatic economic development once a country has adopted a free market regime. Laissez-faire free markets are neither necessary nor sufficient for triggering and sustaining economic growth and structural transformation. If the objective of a less developed agrarian society is to undertake industrialization and the transformation of its economy to a modern one with high labour productivity and good standards of living, it should not expect that market forces would accomplish this objective. If economies of scale are important and imperfect information abounds, the market cannot allocate resources efficiently to promote structural transformation.

For latecomers, a necessary condition for industrialization is a systematic and well-coordinated government intervention to promote manufacturing investment and supportive infrastructure. Learning by doing is a vital aspect of the development process and the realization of a country's constantly evolving, potential comparative advantage. The new rules of the World Trade Organization preclude the use of industrial policy that carefully combines market forces and selective intervention to protect infant industry. A liberalized import regime for consumer goods tends to have a demonstration effect, which promotes consumption and discourages saving. The corporate saving rate is likely to be high in an import regime which promotes investment in equipment and machinery, but discourages the importation of consumer goods. The ethos of an emerging industrial bourgeoisie could be influenced by public policy that promotes investment and discourages conspicuous consumption.

Historical evidence does not show automatic economic development once a country adopts a regime of laissez-faire free markets. They are neither necessary nor sufficient for triggering and sustaining economic growth and structural transformation.

To promote and sustain development in a globalized world, SSA countries need capability of implementing "market oriented" planning to adapt the local economy to opportunities offered by the global economy. The government must have the capacity to formulate and implement a set of coordinated policies that will mobilize domestic savings, offer stable and attractive incentives to promote investment and provide public goods needed for broad based growth. International rules such as those of the WTO and wrong-sequenced financial liberalization constrain the emergence of market-oriented "development states" in Africa, and may undermine initiating the development process and integrating SSA countries into the global economy in a way that will be beneficial to its citizens. ■

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