Developing ‘free market economies’ in Africa:

Review of Progress and Constraints

P. Kalonga Stambuli[1]

Senior Research Fellow

Surrey Institute of Global Economics Research

United Kingdom

Presented at:

Conference on ‘Seeking Global Equity in Development’
Department of Economics,
University of Cretel
Rethymnoz
Greece 74100

Introduction

The birth of African states is widely documented as a result of a protracted struggle against imperialism that ignited more apprehension after attainment of self-government than before. As exemplified in the post-independence destabilization of Angola, Zimbabwe and Mozambique, disgruntled remnants of the colonial establishment had the potential to indoctrinate tribal minorities to wage war in pursuit of self-serving power sharing.

The postcolonial African design of government therefore espouses sentiments of nationalist leaders who conceived ‘unity’ as the means to prevaricate colonial tactics of divide and rule and the threat of postcolonial polarization. Imperatives of national integration proffered such compelling influence given the dangerous ethnic and social cleavages that pervaded the political and social landscapes in most African societies.

Nationalist leaders therefore embraced superiority of the single party state and bureaucracy as the main ideals of state making for purposes of consolidation. In economic terms, however, the government postured itself as a benevolent amalgamation of political and economic authority seeking to provide for the needs of ‘marginalized masses’. Thus, without embracing communist ideologies, African nationalists turned advocates of the Stalinist-Marxist philosophy that the state should determine, inter alia, *"allocation of resources, distribution of income and consumption, levels of saving and investment, and relative prices of goods and services*.

Early African leaders, advocated government policy of seeking comprehensive ownership of the means of production and also acquiring centralized management of the economy. However, they were also to use the same channels stealthily to capitalize on the synergy of a dominant public sector and hysterical one-party politics to tighten their grip on power. The former aimed to limit the scope for fissiparous sharing and trading of economic

[1] P. Kalonga Stambuli is a former Chief Economist and Economic Advisor to the President of Malawi

influence inherent in capitalist society, while the latter aimed to subdue the dynamics of a free society and force its various tendencies to compete within a single defined political arena.

Public sector expansion

In the 1960's and 70's, most African states used generous flows of foreign aid and gains from favourable export trade towards establishment of state enterprises that ventured into various private sector activities in industry, trade, finance, farming and property development. The state undertook more direct ownership, management and direction than provision of incentives to private sectors. Government ministries became vehicles for enterprise ownership while state banks recycled fiscal resources to invest in private enterprise at the expense of investment in health and education.

Nationalist governments also allowed a reincarnation of colonial exploitation, by using its ownership of agricultural marketing boards to extract surpluses from poor farmers for re-investment in industry and commerce via state owned investment agencies. The state also proffered industrial exclusion by making industrial licensing a precondition to commencement of any business, giving existing operators the right to veto applications from new entrants.

The fact that government directed credit also marginalized the pure private sector in access to finance. This had implications for the macro-economy; the fact that bank provision of credit to non-performing enterprises relied on the generosity of the state to refinance them when such funding turned into bad loans, means that fiscal policy was fused with monetary policy. In effect, the state exercised fiscal policy via the monetary institutions. The governments caused major failures in allocative efficiency of the financial system by suppressing interest rates to reduce the burden of the internal public debt and loans to state enterprises.

Boom Bust

This apparent public sector driven buoyancy was sharply interrupted by collapse of export prices in the late seventies. Agriculture expansion came to a halt while industry and service sectors also experienced retarded growth resulting in rising unemployment. The 1980's saw inflation rising while per capita GDP plummeted, driving much of the African population below the threshold of poverty. Currencies also showed signs of fatigue as a result of declining reserves. Overall confidence diminished as major economic parameters registered negative growth rates.

In the aftermath of the demise of communism in the 1990's Africa's public sector entered a period of serious imbalance, worsened by declining levels of aid as a result of rising demand for assistance to Eastern Europe. Budget deficits rose in response to weak revenues caused by economic contraction. State enterprises that maintained unmitigated dominance exacerbated pressures on the fiscal budget, claiming more resources to cover their losses, while their government resisted demands for restructuring.

Reforms aimed at making state enterprises more independent, market orientated, efficient and competitive were perceived as a means of wrestling their political control over the economy. Reluctantly, though, some African states agreed to address the drainage of public resources by ending state enterprise dependence on the fiscal budget. However, in the absence of progress on liberalization of the financial sector, this strategy saw a mere redirection of the financial hemorrhage from the fiscal budget to the banking sector. In most African states, this is reflected in the rising share of bank credit consumed by state enterprises.

Ending state Paternalism

The end of communism in Eastern Europe had the effect of heightening African of how the continent had positioned itself in such a way that emphasized its own vulnerability to economic meltdown. Large public sectors and intrusive government showed that the African experience of state making had been about moving states from colonial conflict and chaos to nationalist exploitation. Large public sector had achieved consolidation of political space more than the presumed economic benevolence. The single party system and the stifling bureaucracy had emerged as instruments for perpetuation in power ambitions of a particular clique.

Africa's free market economies now embrace an economic agenda based on the premise that privatization require an end to distrustful politics that aroused tenacious bureaucratic resistance under the one party state. By advancing political freedoms of expressions, an end to human rights abuses and also free enterprises the atmosphere for distrust has dissipated at the onset of new democratic African states. The philosophy of government has shifted from obstructive regulation to demonstration of authority and political will to incentivize free enterprise.

Africa's free market economies advance the view of Adam Smith that the state is *"a spectator that steps in to correct the actions of the private sector when it commits errors of commission or omission".* The new beliefs about reduced size and role of the public sector epitomize the contrast between the African old and the African new on the same scale as the death of communism allowed economic democracy to thrive over the demise of state patronage.

Since the most direct form of government intervention in the economy is fiscal policy, newfound African democracies are moving with speed to reoriented budget policy towards irreversible decreases in the level of spending, and changes in composition in favor pro-poor spending. Direct subvention is diminishing with progress in privatization while implicit expenditures, in the form of concessions to state enterprises are also being eliminated via commercialization.

Market Reforms

African states are now moving towards market liberalization to eliminate price distortions caused by under pricing of farm output in an effort to subsidize urban consumers. Unrealistically low interest rates that provided cheap credit to the public sector have been replaced by market-determined rates that aim to allocate capital in accordance with the marginal efficiency. Prudential rules are also in place to limit concentrated borrowing by enterprises endowed with enormous collateral, a legacy of politics of primitive accumulation.

The end of directed credit is also making more financial resources accessible to the private sector. In response to elimination of policies that had constrained free and fair competition in the banking sectors, there is increased and diversified development of financial institutions. Potential gains point towards more financial deepening and competitive lending.

Exchange rate liberalization has also eliminated implicit subsidies on imports that encouraged inward looking industry. Realigned currencies are encouraging development of domestic resource based industries targeting the export market. Having raised the domestic opportunity cost of importation, realignment of currency based on market value is contributing to the decline in net growth in external debt. The problem of capital flight has practically been arrested in a large number of African States.

The Africa's free market economies are also dismantling protective discriminatory tariffs that amounted to piggy backing of inefficient enterprise. Trade liberalization is ending the captivity of domestic markets, thus giving choice to the consumer and the benefit of price competition. Industrial liberalization has also archived requirement for industrial licensing for new entrants.

The new African State has public expenditure choices defined with a growth-orientation, focusing on its contribution to national savings, expenditure on infrastructure, incentives to invest and cleaning up of the remaining public debt between enterprises and banks. In some African countries public expenditure choices are becoming more market-orientated, undertaken like private investment with cost-benefit analyses done prior to investment. An increasing share of expenditure is also being devoted to health and education.

Hegemony

Despite all the energies directed at economic reform, the Africa's free market economies are facing large difficulties associated with downsizing of government. The end of subsidization of enterprises means that disguised unemployment is manifesting itself into widespread joblessness. The government is continually challenged as political activists and interest groups fiercely oppose many of these measures. The alternative of reversing these measures means that budget deficits re-emerge and government remains in the vicious circle of stabilizing the economy in the face of declining foreign aid resources.

Tax systems have also failed as African economies embarked on the transition to market-orientation. The resulting fiscal deficits are startling, as the ability of these governments to cut spending by similar proportions is limited by demands of the development program. The revenue collapse owes to incompatibility of the old taxation system with a market-based economy.

Previously the state had to extract taxes from enterprises over which they had great control. However, privatization means that the state was faced now with millions of individuals and privately owned enterprises. The liberalization of prices and wages to market-determined levels also means that the state is no longer be firmly in control of the tax base.

High inflation that accompanies liberalization also undermines profits of enterprises, hence less taxable income. Since the onset of market reforms the private sector has become larger and difficult to tax. Financial reforms also mean that the state had to sell off corporate control of the banking sector to private interests. It is therefore becoming cumbersome to levy withholding taxes without requisite information.

There is need for tax reform in Africa. Some of it is underway, especially new tax systems like value-added tax and personal income tax changes. However, these cannot be just introduced overnight while the donor community fails to support transitional arrangements to ensure that effects on the fiscal deficit are minimized.

There is also rising disagreement over the policies of the IMF. Africa's free market economies are being asked to reduce expenditures sufficiently so that budgetary surpluses should allow the state to mobilize savings in the private sector, provide resources for privatization and allow the banking sector to foster private investment. However, the reality is that private sector institutions are weakened by high rates of interest occasioned by inadequate donor funding. At this stage of the transition, it is often up to the state to prop the economy so that there is initial buoyancy from which it is hoped that private enterprise may flourish.

The implications of IMF policies in Africa are that stabilization spells disaster for the needed fiscal stimulus. This combines with terms of trade deterioration to constrain demand and result in economic depression. In some countries, current account deficits are re-emerging with severe hyperinflationary implications. Combined with high interest rates, this is hindering investment.

The 'New African State'

The reality is that the post-independence African State has conceded to the systematic disintegration of all its utopian promises. Meanwhile, the 'new African State' is better equipped to undertake modernization of society, more rational management of economic forces and also defend the classical liberal tradition of individualism, free markets and limited government.

The doctrine of 'Africa's free market economies' emphasizes economic liberalism underpinned by progress in privatization, state enterprise restructuring and downscaling of public expenditure along the transition to a market economy. The doctrine represents integration of rural agricultural sectors into the mainstream of the cash market economy.

The doctrine of 'Africa's free market economies' also emphasizes disappearance of traditional negative discrimination against poor farmers and miners while industrial liberalization is developing a new competitive culture in business. Liberal trade policies also continually integrate Africa to the world economy while community projects are being decided, designed and implemented by the poor themselves.

However, unless there is adequate financial assistance to Africa, it is becoming increasingly difficult for fiscal-monetary links to be severed thus eluding the doctrine of 'Africa's free market economies'.