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Globalisation, Adjustment and the Structural Transformation of African Economies?: The Role of International Financial Institutions

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Abstract:

Under the auspices of the World Bank and IMF, for almost two decades, sub-Saharan African countries have implemented structural adjustment, an orthodox package of economic reform measures. During this period there has been an unprecedented proliferation of technology investment and trade in the world economy. However sub-Saharan Africa has performed poorly under adjustment and has been largely marginalized from the international economy. The paper investigates the problems with the theoretical model underlying structural adjustment policies to explain why the model is not conducive to either African development or Africa's increasing participation in the global economy. An example is used to illustrate the existence of an alternative set of policies that may be better suited for Africa.

Keywords: Structural adjustment, sub-Saharan Africa, globalisation, economic development.

JEL Classification: O23

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Introduction

One of the most remarkable trends in recent years is the proliferation of global trade, investment flows and communication linkages in a world of rapid technological transformation. Some have referred to this phenomenon as globalisation.[i] In tandem with this rapid change are three disturbing trends. First, beginning with the Mexican crisis of 1995 and most recently in Southeast and East Asia is the growing volatility of currency flows. With a daily volume of foreign exchange transactions easily exceeding one trillion dollars and with more than 85% of it in fast moving speculative activities, a bearish view of a currency can readily overwhelm the reserves of almost any government attempting to maintain a fixed exchange rate. Since July, 1997, we have seen massive involuntary devaluations of the fixed currencies of Thailand, Indonesia, Malaysia, South Korea, and Russia. In other cases the reserves of countries like Hong Kong, Brazil, South Africa and Venezuela have been badly depleted in the attempt to maintain stable currencies levels. Closely linked to devaluations have been huge declines in financial markets in developing and transitional economies as the fear of devaluations has driven portfolio capital in a search of safer havens.

Second is the unevenness, reversal and even apparent marginalisation of some of the regions from this process. While East and Southeast Asia were early participants in this transformation Latin America is a comparatively recent arrival. With the collapse of the Russian economy we have the first unequivocal evidence of a country reversing its participation. In Africa's case, not only did they largely miss the tide of globalisation, but have arguably been overturned by it to the detriment of their economies. In particular, I would argue that globalisation has failed to transform the structure of African economies and might have actually exacerbated some of its structural weaknesses.[ii]

A third disturbing trend is related to the first two the growing hegemony of neo-classical economics as the inspiration behind policies aimed at stabilisation, transformation and economic development. As the volatility of the flows have increased, there has been a growing recognition that the world financial system is at risk. In a world with virtually no regulatory agencies, where banking systems are closely integrated, where billions of dollars are moved almost instantaneously and where no single government has the domain or resources to contain these movements there is growing realisation of the need for a lender at last resort. This has lead to an enormous increase of resources and power for the International Monetary Fund the agency that has been anointed as the lender at last resort. In recent months we have seen the IMF intervene with multi-billion dollar bailouts of Thailand, Indonesia, Korea, Russia and Brazil.

Moreover, with the growing economic malaise in Africa and with the collapse of the Soviet bloc, the IMF along with the World Bank have played an increasing role as the supervisors of stabilisation, adjustment and transitional economies. While the IMF for many decades has been inspired by a monetarist based notion (Pollak model) of how to stabilise economies, the World Bank shifted toward the neo-liberal model around 1980. The senior ranks of the Bank were heavily committed to the orthodox model of change throughout the 1980s and 90s. Agency problems were solved through the hiring process. As Robert Wade (1996) has pointed out, 85% of the operational staff of the Bank became economists trained in American or British universities whose curriculum narrowly focuses on a single economic paradigm the neo-classical model. In

institutional terms, this has meant attempting to impose American style institutions and policies (or at least idealised forms). Foreign exchange means floating rates with no controls; banking means independent central banks aimed at monetary constraint, keeping interest rates positive and intervening only through open market mechanisms, trade means cross the board liberalisation with low and uniform tariffs and no selective protectionism for industrial policy purposes etc.

I believe a parallel argument can be made in the area of politics. As the pace of reform slowed and resistance grew, the neo-classically inspired public choice and rational choice view of the state was used to explain this behavior. Policies outside those narrowly defined by the neo-classical view of the state were seen as generating economic rents which supported the payment of bribes and/or rewarded constituents for political support. Resistance to reform was undertaken by elites in order to protect their entrenched interests. The key was to open up the political process so that new coalitions could be formed that would challenge existing regimes and support the orthodox model. Operationally, this has once again meant an American view of the institutions of democracy with its emphasis on formal elections.

So why is this third issue disturbing? Why should we be concerned by the domination of neo-classical economics in the realm of international policy making. There are two main issues issues. First, the neo-classical view of how markets behave has gradually permeated financial markets on what constitutes rational policy domains. A singular concatenating vision of economic rationality has forced countries to dismantle institutions and regulatory bodies in an attempt to meet an ideal concept. Mechanisms which can be used to mediate global flows in a manner which might be structurally enhancing have disappeared. International organisations have followed the dual process of ignoring or even encouraging new vehicles of global movement while using their leverage to dismantle mechanisms of control at the level of the nation state. Partly for this reason we have seen some growth of regional cooperation. However, at the nation state policies have slowly been reduced to reactive efforts to the short term movement of capital. I would argue here that the volatility and inherent deflationary bias of this concept of rational policies will ineluctably lead to a global depression. However, this is the subject of another paper.

In this paper I would like to discuss a second consequence of the dominance neo-classical economics as it affects Africa. I would argue that Africa's poor performance and marginalisation from the world economy over the period of adjustment is no coincidence. The neo-classical model which underpins adjustment has little understanding of how to develop Africa's economy nor how to better integrate it into the global economy. I will begin with a discussion of globalisation and the structure of African economies under adjustment, followed by a presentation of the orthodox model, and a review of some of the literature on the impact of adjustment in Africa. I will then turn to a critique adjustment and finish with an example of althernative policies that might have better developed industry in Ghana. My main argument is that the major problem with the policy of the IFIs is a theoretical one. The structural transformation of Africa's economies will only occur when we begin to conceptualise the process of development with a different corpus of economic theory.

Globalisation and Economic Trends in Sub-Saharan Africa

Before looking at adjustment from a more theoretical perspective, we need to examine the globalisation and the performance of African economies during the adjustment era. Africa's participation in the flows of foreign direct investment is minute and has actually been shrinking in recent years. According to UNCTAD, Africa's share of developing country's FDI has fallen from 11% in the 1986-90 period to 5% during 1991-96 falling to a mere 3.8% in 1996. In the period 1991-1995 the total going to Africa was only 2% of the world's total FDI. For sub-Saharan Africa this understates the paucity of participation. Nigeria with its foreign dominated oil industry accounted for 44% of the total in 1996 with the other 46 countries receiving only .6% of the world's total. In comparison in 1996 Malaysia and Poland received more than the total of the entire continent(ARB, June-July, 1997;ARB March-April, 1998).

At first glance it would appear that Africa is gaining access to portfolio capital with the expansion in the number of stock markets. For instance, between 1990 and 1998 the number of stock markets in sub-Saharan Africa increased from 7 to 21. A closer examination however indicates that most of these stock exchanges are largely in name only. Only Zimbabwe, South Africa, Nigeria, Kenya and Swaziland had more than 50 companies listed in 1995. Nigeria with more than 200 companies listed is the largest outside of South Africa. However its total capitalisation amounted to only .1% of its GDP compared to 90% in Malaysia. Moreover, the vast amount of foreign portfolio equity capital was flowing to South Africa (94% of the total to sub-Saharan Africa in 1995)(Brautigam, 1998).

Africa has also been missing the large expansion of international trade. Africa's share of global trade has fallen from around 3% in the 1950s to around 1% in 1995. Its contribution to global manufacturing was a mere .3% in 1995(ARB, March-April, 1998). The problem is not only in relative terms to the rest of the world but in absolute terms. In 1995 total African exports in nominal <u>not real</u> dollar terms were actually 10% below the level of 1980 (ADB, 1997). Unlike much of the rest of the world the exports relative to GDP ratio has actually declined from 31% in 1980 to 28% in 1995 (World Bank, 1997). What is particularly interesting is the structure of exports. In 1970 92% of African exports were in primary commodities (fuels, minerals and metal and other primary commodities). In 1991, the figure was exactly the same (World Bank, 1993a). This is a remarkable indictment of the orthodox policies of the IMF and World Bank which has limited the ability of African countries to move up the industrial ladder (more on this below). In contrast, East Asian and Pacific countries' exports of primary commodities went from 68% to 28% as they successfully moved into manufacturing (World Bank, 1993a). The advantages of export diversification and moving into manufacturing is significant not only in the domestic economy but in international price movements.

Terms of trade for Africa have been declining at a terrible rate in the past 15 years. The average annual declines were -6.2, -2.5 and -3.2 respectively for the periods 80-85, 86-90, and 91-95 (ADB, 1997). In sub-Saharan Africa the net barter terms of trade fell by 18% between 1985 and 1992. In contrast the terms of trade in East Asia and the Pacific increased by 7% (World Bank, 1994a). Arguably the very act of flooding the world with resources in response to IMF pressures has a fallacy of composition affect of exacerbating the export position of resource producing countries. This is particularly

acute with commodity exports like beverage crops which have particularly low demand elasticities and where Africa countries control a significant portion of the world market share.

The relative decline in the terms of trade in Africa is also directly related to the shifting nature of global production. The emphasis on raw material and primary product exports is very problematic in an era which knowledge becomes a larger proportion of the value added of commodities. Advances in biotechnology and material sciences are leading to synthetic substitutes for primary products such as vanilla and sugar. Products such as cocoa and palm oil are also being challenged by Western firms as they undertake genetic research to develop outright synthetic substitutes or alternatives methods of production. On the demand side, the usage of resources like copper is being replaced by optical fibres or microwaves putting downward pressure on prices. Processing which would provide employment opportunities and to African economies is discouraged by tariffs and other forms of protectionism which tend to be at higher levels relative to unprocessed commodities (Adesida, 1998).

The poor performance on the export side of manufacturing is also reflected in the production side. Between 1980-93 manufacturing in sub-Saharan Africa increased by only .9% per annum compared to the pre-adjustment decade of the 80s when it increased by a reasonable 4.3% per year (World Bank, 1995a). The period of the 1990s has been particularly poor for African industry with the rate of growth falling to only .2% per annum in the sub-Saharan region. By contrast East Asia and the Pacific managed a extraordinary yearly increase of 15% over the same period. Relative to GDP industry has fallen in sub-Saharan Africa between 1980 and 1995 (World Bank, 1997). One indicator of the lack of progress in this area is the percentage of the labor force in industry which was 9% in 1994. In 1960 the figure was 7% (UNDP, 1997).

Relative to previous periods the era of adjustment has not been a positive one. Participation in the era of information technology is contingent on basic technological literacy. The starting point must be education. One of the most striking manifestations of the profound and protracted social crisis in the era of adjustment in Africa is the plummeting primary enrollment rates. After independence enrollment rates soared for female children from 30% in 1965 to 69% in 1980. For male children over the same period the increase was from 52% to 91%. By 1993 the figures had fallen to 64% and 77%. In some countries such as Tanzania the fall has been precipitous with declines of 20 and 30% in female and male enrollment rates over this period (World Bank, 1989; World Bank; 1996. The decline in Africa is due to a variety of factors including the pulling of children out of schools to support family income strategies in the informal sector after layoffs in the formal sector; the introduction of user fees in education; the cutback in the 80s on spending in education by many African governments partly in response to IMF credit and deficit targets[iii] and the lack of hope in the formal economy for educated graduates has created a demonstration effect due to a paucity of jobs.

Other vital elements of participation in the information technology revolution are seriously lacking. Africa's institutions of research and development and higher learning have seriously eroded in recent years with irregular payments of staff salaries and poor and inadequate staffing. Salaries themselves have fallen seriously behind those paid in areas like finance where short term profits have been boosted by speculative and arbitrage activities arising in the wake of liberalisation. The funding crisis has also led to

a serious deterioration of infrastructure. In an era where the supervisors of the Bank and Fund frown upon any form of state intervention virtually no country in Africa has a science and technology policy. Funding for research and development is very tiny by world standards. Expenditures on science and technology research and development were reported to be only 700 million dollars in 1990 which was .004 percent of the total GDP for sub-Saharan Africa which is a small fraction by world standards(Abiodun, 1998, World Bank, 1992). India by contrast invested 1% of the GDP in R&D in 1990(Lall, 1996). The national science and technology population was also very tiny by world standards with all African countries falling in the lower range .05 and .4 per 1000 population compared to a world average of .8 per 1000 between 1988-1995 (Abiodun, 1998).

Other more common indicators indicate that Africa has not done well in the era of adjustment and globalisation. Gross domestic savings and gross domestic investment have both deteriorated and have fallen between 1980 and 1995 from 27 to 16 % and 23 to 19%, respectively. These are far below what is needed for a sustained improvement in the standard of living. They are also the lowest regional figures in the world (World Bank, 1997). Not surprisingly GNP has not kept up with population growth. Between 1965-73 per capita GNP grew by a comfortable rate of 2.9% per annum, falling to only .1 percent from 73-80 before finally plummeting to -1.2% from 1980-91. The figure for 1985-95 is a similarly depressing -1.1% per annum (World Bank, 1989;1993a;1997). In real per capita income terms the 1994 level was 20% below 1980 and 15% below 1970 (UNDP, 1997). The result was a decline in basic human needs. Daily calory supply per capita has fallen over the adjustment period and was a very meager 2096 calories per day in 1994 which is nearly 20% below the average for all developing countries.[iv] .

Adjustment in Africa: A Brief History

Structural adjustment loans began in 1980 in Kenya. By 1993 a total of 35 Sub-Saharan countries had implemented structural adjustment programs. Sectoral adjustment loans, loans predicated on policy changes in specific sub-sectors, were also initiated at the same time (first in the Sudan for agriculture). SECAL's have covered agriculture, industry, trade, human resources, the financial sector and infrastructure. The largest number of SECAL's has been in agriculture.

Structural adjustment loans have typically run for about three years, before they are renewed. In many African countries such as Zambia in 1986, however, loans have been discontinued when countries have not met their money supply or government credit targets.

Closely tied to adjustment lending has been the International Monetary Fund facilities. The most predominant form of lending has been through stand by agreements which typically lay down the targets necessary to maintain an inflow of stabilisation funds. The problem with these agreements are they are for the short term and at market rates. In 1974 the Fund created an Extended Fund Facility (EFF) for longer term pay backs. However these were still at market rates of interest which was considered too costly for most African countries. In 1986 the IMF introduced the Structural Adjustment Facility (SAF) with an annual interest rate of only 0.5% and a five year grace period with principle repaid over a period of 5.5 to 10 years. In 1988 more money was made available through the Enhanced SAF.

While in theory the Bank has a focus on development in the medium and long term and the fund on stabilisation in the short run, in practice there is little difference now in loan periods and conditions. IMF agreements have now become prerequisites for adjustment lending. The IMF and World Bank, in unison, have cut off loans when governments have not undertaken measures promised in their Policy Framework Papers (PFP)(which lay out the measures, targets and policy changes). IMF agreements have not only become prerequisites for World Bank loans but also for debt relief in the London and Paris Clubs and for many bilateral assistance programs. In essence, African governments have little choice but to agree to the terms and conditions of the International Monetary Fund and the World Bank.

Let us turn now to understand the nature of the adjustment model and the problems with it.

Structural Adjustment view of the cause of Africa crisis

From the perspective of the World Bank and IMF, the cause of Africa's malaise was directly the result of the policies pursued by the governments of Africa in the 1970's. The important policies they pointed to were:

1) overvalued exchange rates which encouraged imports at the expense of exports which caused imbalances in the current account.

2) the neglect of agriculture though low production prices, and government controlled marketing boards, reflecting the broader policy of urban bias.

3) over investment in import substitution relative to domestic demand and to the export industries needed to generate rising foreign exchange.

4) over extension of public ownership relative to their economic justification and existing management capacity leading to inefficiently run enterprises while displacing the private sector.

5) overspending on government, usually to support bloated bureaucracies leading to high government deficits.

6) financing of government deficits and public companies through money supply creation leading to inflationary pressure.

7) artificially low interest rates leading to the discouraging of savings while encouraging investment in capital intensive production at the expense of more suitable labor intensive operations. Shortage of savings ultimately lowered investment levels.

8) price controls on many products leading to disincentives to produce, shortages and corruption.

9) foreign exchange controls with central allocation of foreign exchange also leading to corruption and usage which was of little benefit to the country.

10) excessive use of tariffs and other forms of protection leading to a paucity of competition and inefficient production.

Prescribed Treatment-Model of Adjustment

The treatment follows from the above prescribed causes. They can be divided into five categories exchange rate policies, pricing policies, commercial policies, credit policies and institutional reforms.

Exchange rate policies

The central policies of any World Bank\IMF strategy are currency devaluations and shifting the allocation procedures away from centralised control. At the sectoral level, lower exchange rates will make local funds available for export oriented agriculture and industry thereby providing incentives to produce in this area and in turn increasing the supply of foreign exchange. Devaluation also penalises companies heavily dependent on imported inputs, encouraging a greater conservation of foreign exchange. Since import prices will rise, this will encourage investment into intermediate and capital goods away from non-traded areas such as personal services. Liberalising foreign exchange will reduce corruption and rent-seeking behavior and alter the system which entrenches the existing industrial structure. The most viable industries will then have access to scarce foreign exchange. Liberalising foreign exchange will also encourage the inflow of foreign investment by removing bureaucratic obstacles and providing the security of an exit option.

Prices

Central to the World Bank\IMF structural adjustment polices are changes that will be conducive to the free operation of supply and demand so that prices and profits can play an appropriate incentive role(penalising inefficiency and rewarding efficiency). This means removing all forms of price controls, eliminating subsidies and disbanding all methods of state sponsored inter-firm allocation. Agricultural product prices need to be raised in order to increase production levels and reverse urban bias. Improving agriculture is at the heart of adjustment. It provides raw materials to industry, vital foreign exchange when exported and important demand linkages to the rest of the economy. Also raising the terms of trade in agriculture is the best way to improve income distribution since the majority of the poorest population is engaged in agricultural production. Undistorted markets will encourage the best use of the country's resources.

Commercial policies

In general, it is felt that competition from imports is important in providing incentives to lower costs and raise productivity. The first priority of the World Bank\IMF in this area is to lower protection while making it more uniform to avoid distortions in the economy. Quotas and other protectionism should be replaced by tariffs so that the market can be used as the basis of adjustment. Devaluation should occur in line with the declines in protection to avoid excess demand for imports.

Credit and Financial Policies

An additional dimension of orthodox generated adjustment models is a tight control of monetary aggregates and government deficit spending. Price stability is important to provide a climate that will encourage private investment in industry. In the monetarist world of the IMF, the key to containing inflation is via controlling credit creation. The key to controlling credit is through the creation of an independent central bank which will intervene only indirectly through open market operations and setting discount rates. Public debt will no longer be covered by high powered credits from central banks but through the auctioning of treasury bills to the public.

Moreover, neo-liberals explain the exchange rate levels as a reflection of the relative price levels between countries (purchasing power parity). In a world of floating exchanges, little or no inflation will generate exchange rate stability which in turn will provide a climate more propitious for encouraging foreign investment in industry.

Minimising deficits is important to avoid the crowding out of private investment which can arise from the flooding of markets with treasury bills. The limiting of government deficits becomes easier as part of the broader strategy outlined above. Removing price distortions like subsidies, introducing user fees such as tuition in public schools and cutting back on social expenditures with private markets assuming a larger role will allow prices to more clearly reflect their opportunity costs while permitting governments to meet their monetary targets. Similarly, price liberalisation will reduce informal sector activities and in turn generate a potentially larger tax base and bigger tax revenues making it easier to contain budget deficits (supply side argument).

Removing financial repression is also crucial to the expansion of industry. State control of credit allocation has led to the development of inefficient industries. Privatising and liberalising banking licenses increases competition which improves the quality of services to consumers while providing the incentives for discerning private bankers to allocate loans in commercial terms to the most efficient users. Raising interest rates to real levels is also important for promoting efficiency and growth in industry. From the supply side the higher interest rate levels augment the flow of savings into financial institutes which in turn can loan out the funds for productive investment in industry. The high cost of obtaining credit helps weed out the unprofitable manufacturers (particularly when prices are right). In addition, cheap credit can also play an unfortunate role in encouraging a bias toward capital intensive technology in manufacturing(eg. keeping an artificially low cost of capital) when jobs in industry need to be generated. Raising its cost will help avoid further distortions.

Institutional policies

The focus of institutional changes is on reform of the public sector. Inefficient enterprises should be either closed down, sold to the private sector or systematically restructured. Part of the strategy of recovery in the public sector is for firms to rely only on commercial sources of funds rather than government budgeting transfers. Debt should be converted to equity(to put companies on a sound financial footing). Operating decisions should be developed away from political influences. Managers should be subject to clear financial and economic performance criteria. Profits should be a reliable indicator of efficiency in the public sector. Stock markets should be used as the main source of financing expansion ensuring that managers focus on profitability. Cutback in government spending should lead to layoffs of the bloated bureaucracy, which in turn will free up skilled labor for the private sector.

Public policy towards the private sector should transcend price and foreign exchange alignments. The World Bank\IMF recognise that the regulatory environment is also important to enhance private investment. Any regulation of private investment activity should be made transparent and automatic removing the possibility of discretionary intervention. Private property rights need to be established and enforced through the expansion of an autonomous court system.

The informal sector which is so widespread in Africa, should be strongly encouraged to shift into formal production. This will be greatly assisted by the reduction of the state sponsored regulations and clear undistorted prices. Small scale production has the advantage of using more local raw materials and serving low density markets-two areas neglected by previous state policies.

Overall structural adjustment will encourage production in areas which reflect the country's static comparative advantage. Let us briefly discuss some of the debates concerning the impact of adjustment.

The Impact of Adjustment

Identifying trends in Africa says nothing about causal factors. There has been considerable debate concerning the impact of adjustment in Africa and the role that it has played in some of the negative economic trends. Some of the discussion is rather technical since it deals with isolating the effects of adjustment policies from other factors in a world where quality data is scarce.[v] One obvious question is why there are such distinctive variations in the interpretation of the impact of adjustment. The answer is partly linked to the complications of undertaking empirical exercises aimed at illustrating cause and effect.

As I see it their are five approaches used in assessing the impact of structural adjustment the "before and after" method, the "control-group" approach and the "modified control" group, the "decomposition" approach and the "with and without" simulations based on CGE models and SAMS. The first compares the changes in the mean values before and after adjustment to see if there are statistically significant changes. The second compares macroeconomic performance variables for program and non-program countries. A third approach attempts to control for differences in the external environment and initial conditions when comparing the program and non-program countries.

There have been a number of studies using these first three approaches which present rather contradictory evidence of the effects of adjustment.[vi] Part of the problem has been the weaknesses embedded in these studies. The first approach does not adequately differentiate the impact of non-adjustment factors such as the terms of trade from the influence of adjustment. The second approach suffers from the same weakness as well as the complexity of determining which countries fits in which category since many countries have implemented some adjustment policies but not others. The third approach overcomes the first problem but not the second.

There is a also a fourth method, the "decomposition" approach, which avoids the problem of classifying countries into groups and factors out the impact of non-adjustment variables. The approach econometrically tests the relationship between specific policy changes and outcomes by pooling data of countries undertaking quantitatively similar measures. Some of the results of this exercise are rather interesting. Contrary to the predictions of adjustment lower input subsidies in agriculture and lower tariffs have a negative effect on economic growth. While one can still run into problems with interpreting and classifying data pooled from a variety of African countries, the approach does begin to sort out the relative merit of individual policies within the package.

The fifth method the "with and without" often relies on very problematic CGE simulations utilising static social accounting frameworks for parameter determination. The worst example is in the work of David Sahn and his team at Cornell which aims at showing that adjustment reduces poverty in Africa. They utilise absurd neo-classical assumptions like perfectly clearing labor markets and circular reasoning where the wealthy are defined in terms of their accessibility to economic rents to prove that they are worse off after liberalisation when rents by definition diminish. The poor are in contrast better off after adjustment because they proportionately have more access to income from tradeables which will rise in price in an adjustment world. Very different results arise in CGE models using more structuralist assumptions. Moreover, one must be careful when moving from simulations to the populations being modeled where one "representative" household in the model is being used to represent millions of households in the real world. One of the major errors of Sahn and associates' is that they make sweeping generalisations from the results of their models.[vii]

Overall, my reading of this literature is that there has been no consistent evidence that adjustment has improved conditions in Africa (and as we have seen above, even the Bank has not been able to tell a consistent story eg. Elbadawi et al. study (1992) vs. the rather flawed 'Adjustment in Africa' study) and considerable evidence as discussed above that it may have exacerbated the underlying structural weaknesses of Africa's economies. Perhaps the most significant legacy of adjustment is the huge mostly multilateral and bilateral debt accrued since 1980 (which will be discussed below).

The question is why has adjustment not led to its intended consequences. I would like to argue here that the reason is largely theoretical. Adjustment policies have their roots in neo-classical economic theory[viii] which is badly flawed as a guide to understanding how to build economies capable of structural transformation and sustainable development. In other words, it is not an implementation problem but a conceptual problem. Much of my research in recent years has focused on this question. I can only touch upon a few issues here. In the latter part of the paper I will talk a bit about how neo-classical economics has falsely interpreted Asian development. By way of conclusion I will point to a somewhat divergent interpretation which can be used as a basis for generating alternatives to adjustment, focusing on the question of building the manufacturing capacities of African economies.

Theoretical Origins of Model of Structural Adjustment

The model of adjustment comes from the realm of conservative neo-classical economic thinking (this is what dominates the economics profession in general in the United States). This approach has been formally incorporated into the policies of adjustment of the IMF for many decades. However, the World Bank's approach has been historically more Keynesian with an emphasis on a broader social agenda including matters concerning basic human needs. Beginning in the early 1980's, the World Bank began to work in unison with the IMF in their adjustment agenda. As Robert Wade in a fascinating article on the formation of the East Asian Miracle study indicates the Bank became increasingly dominated by neo-classical economists with degrees from North American and British Universities where the neo-classical approach overwhelmingly dominates the curriculum. By 1991, 80% of all the bank economists were trained in such institutions. Through the retirement and removal of engineers, agronomists, health

specialists etc, the neo-classical economists took control of the Bank from top to bottom leading to what Wade refers to as a meta-policy whereby agency problems at the lower level are reduced due to a concatenating set of beliefs and constructs (Wade, 1996).

The thinking behind the model is rational deductive and axiomatic. It is rational-deductive in the sense that the behavior of agents are predetermined by a set of rational rules which are deductively posited. As with most neo-classical economic models rational predictable behavior will arise from a set of market signals. Unfettered markets normally will lead to indicators that reflect scarcity and choice. Decisions based on markets under these conditions will lead to efficient choices on what and how to produce that are indicative of the endowment of societal resources. The World Bank/IMF model is premised on this behavior. If there is an economic crisis it must be due to distortions in market signals. .

The final stage is specifying culpability before making policy recommendations. The approach is axiomatic. Consumers and private producers are presupposed to be utility and profit maximisers that rationally respond in an efficient manner, if the market signals are correct. However the public sectors' view is deemed to be dramatically different. From the public choice school of neo-classical thinking, the state is presumed to be predatory. From the rational choice school, the members of the state are seen as selecting politically rational policies which are economically irrational [agricultural prices are kept low to build urban coalitions (see work of Robert Bates)].

Thus the public sector must be the source of the barriers that exist to the efficient operation of markets. Clearly then the solution to the economic malaise is to retract state intervention in markets.

The obvious problem with the approach is that the need for adjustment is a product of the model of adjustment. The model of adjustment is a product of a series of theoretical premises or abstraction. Thus any divergence of the real cause from the premised cause will lead to serious errors in the realm of policy formulation and implementation.

Theoretical Problems

There are a number of problems that arise out of this method and the model itself. I would like to make five points: the problem that arises out of the exclusionary method; the internally inconsistent nature of the components of the model; problems with financial repression theory; the weakness of the theory of institutions in adjustment; and the misinterpretation of the lessons from Asian development. By way of conclusion I would like to point to a somewhat different set of lessons from Asian development that might be of use in the search for alternatives to adjustment.

Exclusionary and Underdetermined

What I mean by exclusionary is that the model of adjustment, by its nature, leaves out vital elements necessary to understand the crisis in Africa. Perhaps the most important variable is the absence of structure. What I mean by structure is the framework which constrains choice and in the extreme determines them. Structure tends to be in the short term intractable. The model therefore of structural adjustment, is not only flawed in itself, it is underdetermined in the sense that there are an insufficient number of variables

to explain the economic crisis in Africa. This also has policy implications since structural adjustment, despite its name, does not really deal with vital structural phenomenon.

Among the factors missing we must include

1)The structure of foreign aid
Much of the problem with the reliance on imports in production is linked to the conditional nature of assistance historically, which led to the inappropriate choice of projects with high import coefficients-interest rates, overvalued exchange etc, really had nothing to do with this. Thus the poor balance of payment will not be reversed if the structure of aid doesn't change -- a structure which has involved, at least at the decision level, the participation of agencies like the World Bank.

2) The structure of multinational capital investment
Often the policies used such as tariffs or quotas are the product of bargaining for international capital investment. Private sector capital is important to the success of adjustment yet the WB/IMF ask for the removal of policy tools often used to attract foreign capital.

3) The structure of world trade
Some of the problems with the balance of payments can be linked to the declining terms of trade in Africa as we discussed above. African exports are subject to long term declines relative to the price of their imports. This is partly a function of the nature of business cycles and as we have seen above, the long term decline in the demand for resources Africa produces particularly as the world moves to producing high valued added commodities using fewer primary resource inputs.

4) The structure of agriculture production
On the production side, price increases are unlikely to have a large impact on output given the low level of technology and bottlenecks like poor roads for transporting produce. On the demand side we have a problem with the elasticity of demand, in so far as increases in supply can lead to decreases in prices that are greater than the increase in supply, leading to revenue declines. As was indicated above, this is what we call the fallacy of composition. For example if both Ghana and Cote-d'Ivoire expand their production of cocoa at the same time this could drive prices sufficiently downwards to lower revenues for both. If only one expands however this may not be the case. Obviously, if all countries are pushed to expand agricultural exports by the same structural adjustment policies at the same time, this is likely to happen. In fact this is precisely what has happened with cocoa since the late 80's and early 90s. In Ghana cocoa exports increased from 149,000 metric tons in 1984 to 224,00 metric tons in 1992. However over the same period earnings declined from 347 million dollars to 256 million dollars or in essence a 50% increase in exports led to a 35% fall in revenues.

5) The structure of world finances
Much of the problem with relying on improved exports to pay back debt is the nature of world finances. First, commercial debt often uses floating interest rates. Thus when interest rates rise in the world, this can have a detrimental impact on the payments owed irrespective of what the country does. This is less of a problem in Africa due to the small percentage of debt in this form, but it still exists. Second, much of the assistance

particularly with the IMF is short term, and must be paid back rapidly even before a country can get its house in order after structural adjustment. In fact, in the last ten years, there has been a net outflow of nearly $2 billion to the IMF from Sub Saharan Africa.[ix] In general, the agency should play a far less central role because its purvey is primarily short term while Africa requires instruments with a long term developmental orientation.

Third, once the debt ratios reach a critical level, they can no longer be sustained. Africa has long passed that level. In 1996 sub-Saharan Africa international debt reached $227 billion which was nearly three times the 1980 figure and meant that each man, women and child owed $379. Given the stagnancy of exports the debt to export ratios have risen at a similar rate to 222 to 1. There is no way that they can export their way out of this. While commercial debt can be sold for a discount on world markets (as in Nigeria's case), the large growth in debt has been with multilateral organisations like the World Bank[x], which has only begun to move very slowly to reward a few African countries for "good behavior" (eg. Uganda) with moderate debt forgiveness. Thus the current structure of African debt is a major impediment to Africa's recovery. In Ghana, the Bank's big "success" case, export levels in 1994 had barely returned to their 1980 level. With the large increase in bilateral and multilateral lending over the period which were used to reward Ghana for good behavior, the debt to export levels climbed from 108 in 1980 to a completely unsustainable 343 in 1994 (World Bank, 1990;1995b).

6) The class structure

An additional area is the class structure of African countries. One of the reasons why the government got into the economy is precisely because of the weak capitalist class. Yet the bank and IMF hope that privatisation and market reform will somehow stimulate a group of entrepreneurs just waiting for the opportunity to respond with investment and production. Often, for example, they point to a large informal class as a budding entrepreneurial class.[xi] This unfortunately is a serious misreading of groups which often are involved with informal activities in order to survive and usually rely on formal jobs just to keep sufficient working capital to continue their informal activities. Many are forced into informal activities out of destitution from the economic crisis. Frequently, the policies of structural adjustment including government layoffs, wage reduction and cuts in subsidies have directly led to an expansion of these "survival" activities. Studies of this sector have indicated the bulk of activities, have been undertaken by women usually because of husbands' declining incomes. Most have been hawking goods or making and selling small scale food items. Most income earned has been used to maintain declining consumption levels rather than to increase savings for capital accumulation and expansion.[xii] Closely tied to the diminishing formal sector employment and growth of "survival" activities is the declining levels of educational enrollments discussed above which are so critical to the development of a competitive labor force. Children have been pulled from schools to support family "survival" strategies.

Inconsistencies in the Program of Adjustment

The neo-classical underpinnings of the World Bank /IMF model are a combination of demand constraints via the control of monetary aggregates and supply inducements through the provision of correct markets signals. Unfortunately the tools used for this purpose are frequently in conflict both with the models stated goals and with each other.

Let me provide a few examples:

1) *Cutbacks in governments spending to meet deficit targets versus the professed attempt to stimulate agricultural production*. Here one needs to recognise the importance of public sector expenditures to agriculture through the expansion of infrastructure, research, extension and input subsidisation. A similar crowding-in argument can be applied to industry.
2) *Setting high interest rates and tightening credit versus increasing private investment and growth of the private sector*. Obviously high interest rates increase the cost of borrowing and discourage investment. The declining investment level of the last decade is partially a product of this phenomenon.
3) *Liberalising foreign exchange vs. the need to increase exports to improve the balance of payments*. Often the most productive sectors with the highest working capital costs can least afford the foreign exchange (particularly after devaluation) needed to finance their operations particularly given the high interest rates and difficulty of obtaining credit. Generally in a climate of liberalised foreign exchange and banking, speculators and importers of finished goods, both with lower working capital costs, dominate open foreign exchange markets. This encourages capital fight and worsens the balance of payments. This is what happened in Nigeria between 1986 and 1994 (Lewis and Stein, 1997).
4) *Controlling credit and government deficits to control inflation on the demand side vs devaluation, interest rate increases and rising agricultural prices which increase inflation from the costs side*. Often early devaluation leads to higher levels of inflation which can only be contained by a severe dampening of demand and a very severe decline in economic activity. This is the kind of deterioration we have seen in Russia in recent years. In Latin America where labor has had more power to resist declines in real wages the devaluation- inflation linkage has led to a process of hyper-inflation since demand constraints can less easily be applied. In Africa, we have seen a severe decline in real wages in the formal sector from devaluation and credit constraints, since labor is much weaker. Inflation therefore has seldom reached hyperinflation levels with a few exceptions.[xiii] The dictum of international agencies like the IMF has been that countries must not live beyond their means. Unfortunately the very act of forcing countries to fall within the domain of their means leads to a reduction in the size of that domain. We are now seeing this in the Asian crisis in the wake of the IMF loans.

There are many others we could discuss such as liberalising import restrictions vs increasing exports to improve the balance of payments where the very act of opening up markets has indiscriminately hurt both import-substituting industries like automobile assembly operations of the kind the World Bank thinks Africa does not have a comparative advantage in as well as textile production (destructive impact of second hand clothing) which would seem to have export potential. Also the very act of cutting subsidies on agricultural inputs and dismantling marketing boards and price support systems has led in some cases to real income declines (particularly in remote areas subject to monopsony buying[xiv] and when devaluations have caused severe increases in the price of inputs). This is contrary to the objective of raising the terms of trade for agriculture in the hope of increasing agriculture production. One could also talk of the impact of demand constraints and income reductions vs the need for improved productivity and efficiency in production while achieving sufficiently high economies of scale to compete internationally. There are also problems with relying on the financial repression theory.

Problems With Financial Repression Theory

Embedded in the theory of financial repression is the classical assumption that prior savings is necessary for investment. The interest rate was the reward for waiting, and determined the choice between consumption and savings. Keynes, in the General Theory pointed to the problematic nature of both these classical assertions. For Keynes it was "obvious" that the rate of interest could not be a return to saving (or waiting) for the simple reason that "...if a man hoards his savings, he earns no interest, though he saves just as much as before." (Keynes, 1936, pp.166-167) For Keynes the interest rate determined the form of savings, not the quantity of savings.

The causal relationship between investment and savings was reversed:

> The traditional analysis has been aware that savings depends on income but it has overlooked the fact that income depends on investment in such fashion that, when investment changes, income must necessarily change in just that degree which is necessary to make the change in saving equal to the change in investment. (Keynes, 1936, p.184)

Post-Keynesians and Institutionalists[xv], following this line of argument, have emphasised not prior savings but the availability of credit and the prospect of a sufficient net return (after loan expenses) as the operational factors in investment levels. From the perspective of the firm, the demand for money represents the inducement to go into debt while money supply is the IOU which it issues. From the bank's view, money demand represents the willingness of a company to enter into debt, while money supply is the bank's acceptance of the IOU and the issue of liabilities to purchase it. Banks in the U.S. find reserves to cover profitable loans using a combination of asset and liability management, the Fed funds market, international sources or the discount window (Stein, 1994, p.1840). Assuming most loans are redeposited in banks, this implies that the supply of loans becomes endogenous, rather than a product of new savings deposits.

In accordance with the Keynesian tradition, an increase in interest rates could affect the form of savings holdings, but not necessarily the savings rate. Financial savings could increase as people shift their savings into interest-bearing financial vehicles, but overall savings are not likely to respond. As pointed out by Warman and Thirwall (1994), there is a common failure to distinguish between financial and overall savings when testing the financial repression hypothesis, and consequently it is important to make this distinction when discussing the literature. There are other problems with the McKinnon-Shaw model.

Embedded in the financial repression theory is the purely neo-classical competitive model of economic textbooks. On the demand side, private sector actors utilise finance to undertake projects which will maximise their gains. Private bankers acting as intermediaries will assess the worthiness of projects and allocate funds accordingly. Interest rates are treated as the market clearing price. When there is an excess demand for loanable funds, interest rates will rise leading to an increased inducement for consumers to save an increase in the flow of funds to the banking system. Overall more money will flow into investment and in turn lead to a pareto efficient welfare enhancing expansion of economic activity. From a policy perspective, the key to reversing

financial repression and creating this virtuous world is through deregulation, privatisation and competition. On the latter point, more banks help reduce the gap between savings and deposit rates thereby increasing the efficiency of intermediation.

The relationship between pure competitive models and the real world is generally problematic. However, the disjunction between the neo-classical view of banking and the actual world of finance is even more profound. Stiglitz (1994) points to seven market failures embedded in financial markets which challenge the orthodox view of finance. First, information about the solvency of financial institutions is a public good leading to an undersupply of monitoring efforts and the possible misuse of depositors funds (one person's efforts will provide a benefit to all depositors leading to a tendency to free ride). Second externalites are present in the monitoring, selection and lending functions of banking. For example the presence of one or two bad banks in the market can impose very expensive screening costs which can make it difficult for good banks to raise capital and attract deposits.

Third, there are enormous externalities associated with bank failures whereby the social costs of insolvency greatly exceed the private costs. Fourth, financial markets are often incomplete due to the asymmetries of risk and information between the different participants in the market. Adverse selection and moral hasard problems limit the ability of markets to deal with these asymmetries. Fifth, by nature, financial markets even with a large number of participants will limit the options available to anyone seeking a loan. Each bank has proprietary information about its customer base which will likely not be available to other banks. A customer with a long history with one bank will likely be unknown to other banks which will limit their options to go elsewhere (eg. they will be a riskier prospect).

Sixth, financial factors, left to their own competitive devices will not be pareto efficient. The standard assumption of market clearing prices is based on the notion that prices measure the marginal benefit of a good to a buyer and the marginal cost to a seller. However, in banking with imperfect information those that are willing to pay the most may not be those who are expected to provide the highest return to the lender. At too high an interest rate the expected return may actually diminish since the probability of default rises. Thus it will be in the interest of banks to keep interest rates lower leading to excess demand for credit and markets not clearing. Similarly, higher interest rates do not necessarily improve the quality of investment. As Stiglitz (1989) has pointed out, rising rates may discourage borrowers with worthwhile investments, leading to a decline in the quality of the applicant pool. Successful borrowers (particularly given problems of adverse selection) might undertake riskier projects. For example, in Nigeria, higher interest rates fostered loans to enterprises with rapid turnover (such as importing and speculation), where borrowing costs to finance working capital were much less. Moral hasard problems may also increase when applicants increase borrowing to pay higher interest expenses or to stave off bankruptcy. Moreover, investment could fall with the possibility of a lagged affect on aggregate savings levels over time.

Moreover a divergence between social and private benefit is likely since projects with the highest expected return will often not be projects that will maximise profits. Financing real estate speculation can be highly lucrative over extended periods of time leading to a paucity of funding for manufacturing even though the latter is generally of greater social value. Finally, even if all information is available, in the complex world of

finance depositors may not be able to properly comprehend it. This is perhaps less to do with a standard notion of market failure and more to do with the orthodox depiction of homo-economicus.

All of these problems, which are present in varying degrees in the well formed financial systems of developed countries, are magnified in the transitional and underdeveloped countries. None of these fundamental flaws in the operation of financial markets is addressed by the financial repression theory. As a result liberalisation with its efforts to create a financial system based on the image of pure competition has engendered enormous financial problems. Moreover factors beyond the issue of market imperfections are sui generis to developing countries. These include the question of politics, institutions, and macrostability.

McKinnon in a 1993 book argues that much of the financial disarray has arisen because the proponents of liberalisation have not followed an optimal sequence of liberalisation including ensuring macrostability before financial deregulation. In particular, he suggests the sequence should be inflation control, followed by interest rate liberalisation, privatisation and commercialisation, unification of foreign exchange rates, trade liberalisation and lastly opening up economies to capital flows. Many countries have not followed this particular order. In Nigeria and Russia, trade liberalisation occurred much too early in the sequence. There is a serious question whether following some "optimal" sequence would have much consequence given the structure, institutions and politics of these countries, elements typically ignored by neo-classical economics. For instance, in Nigeria, given the role of military connections in the allocation of bank licenses (even if trade liberalisation came later), it is hard to imagine a different ownership pattern (eg.these individuals would have still sought bank ownership to obtain a license for malfeasance, gain access to future profits after trade liberalisation etc.) One must go beyond the formal plane of getting prices and ownership patterns "right" to examining the embedded context of financial systems.

Moreover, there is widespread agreement that financial liberalisation in the midst of macroinstability greatly exacerbates any economic dislocation. However, in the fragile economies of Africa and elsewhere which are subject to the vicissitudes of international commodity prices, rapid shifts in financial flows and frequent transformation of political regimes periods of macroinstability are likely to be common. There are serious questions concerning the merit of completely liberalised financial systems. Under conditions of instability (or some future threat), even the most honest and discerning private bankers will gravitate toward short term lending activities or to the certainty of government paper. Unfortunately, the activities that are best suited for growth and development require much longer loan periods and tend to have higher risks. An unfettered private sector banking model will not generally lead to activities that generate growth and development. On the demand side, high interest rates due to inflation combined with elements such as import liberalisation and rapid devaluations tends to push entrepreneurs toward economic activities with low working capital and short-term horizons such as importing. This also creates a bias against economic areas such as industry which tend to have long term horizons and large working capital requirements. All of this raises questions about the purpose of the design of financial systems.

Due to the almost exclusive focus on getting prices right, the financial repression theory. like most neo-classical economics, is largely ainstitutional. However, as Stein (1996)

indicates the institutional nature of the financial system is of central importance. In practice the Bank and Fund have often pushed an American style or arms length system of banking which might be inappropriate for developing and transitional economies. Despite some of the recent difficulties in Japan's banking system, their model might be more suitable to deal with the endemic problems of poorly developed markets in the early stages of development.

Once we move from the world of perfect competition to the real world we recognise the need to design institutions to deal with the fundamental market imperfections discussed above which are endemic to finance. What becomes important here is ensuring institutional homology such that the rate of transformation or reform in the different components of the system is internally consistent. From the experience of Nigeria (Lewis and Stein, 1997), issuing a plethora of new private bank licenses, without adequate prudential guidelines, depository insurance, regulatory staff, accounting rules etc. will ineluctably lead to a financial crisis. The institutional inheritance beyond the orthodox focus on public vs. private ownership and mechanisms of financial repression must be carefully evaluated before venturing on any path of transformation.

One of the most pressing exigencies is the institutional challenge associated with the temporal mismatch between savings and the longer term lending needs of more productive areas like industry. The central issue, in this context, is the nature of the nexus between the state, real sector and the financial sector. One approach, which is outlined by Machiko Nissanke (1999, forthcoming), is the institutional mechanisms in Asian countries associated with the state allocation of contingent rents based on private sector performance. Rent opportunities are first accrued to banks as performance-index rewards. Banks are then encouraged to undertake long term lending and to rescue firms that are viable in the long run. An important part of the viability and continuity of these institutional mechanisms is careful monitoring. As Ha-Joon Chang (1998) illustrates in the context of Korea, institutional viability can be threatened when ill-conceived financial liberalisation exercises remove the mechanisms of monitoring and constraint.

However the institutional exigencies must transcend a focus on functional remedial design to incorporate other imperatives. What is crucial is designing financial systems that will service the needs of the real sector of the economy. Financial liberalisation under adjustment has often engendered financial sectors of accumulation, speculation and arbitrage that have little to do with real sector production. One must go beyond the focus on American style organisations of financial systems to examine other arrangements such as the main bank system of Japan which has better integrated the financial and real sectors (Stein et al., 1999, forthcoming).

In addition, the broader and older tradition of institutional economics recognises institutions not only as formal rules and organisations but of habits of thought common to the generality of men and women.[xvi] In order for systems to operate fluidly and for transaction costs to be reduced, individuals within the system must follow patterns of behavior with little contemplation or thought. Trust and cooperation become absolutely crucial not only for internal operation of financial organisations but in its linkages to other economic units in the economy. The temporal rate of transformation needs to be sufficiently slow to allow new banking relations to be properly internalised. For this reason alone, "shock therapy" approaches to financial liberalisation are likely to be rather problematic.

Moreover, for financial systems to be fully institutionalised they must go beyond being legally recognised entities to become legitimate. Legitimacy arises from the degree of social and economic embeddedness. Banks that mostly focus on a narrow circuits of accumulation and consumption that service a small elite segment of the population (e.g.the case of Nigeria or more recently Russia) are not properly embedded. Banking habits among the general population, which are an important part of the development process, are likely to form more rapidly in an institutional climate of participation and accessibility.

Theory of Institutions

The focus of neo-classical economics is on monetary and financial variables. To neo-classical economics, once prices reflect their scarcity value the real sector will respond accordingly. This is what is behind the "getting prices right" doctrine of adjustment. In its pure form there are no reasons for institutions. This view arises out of the general equilibrium foundations of neo-classical economic theory. Economies are driven by exchanges which arise out of the spontaneous interaction of self-seeking individuals. In the more relaxed version there is some recognition that property rights are transferred in exchanges and therefore there is the need for some external guarantor such as a judiciary. There is also some recognition that money is needed in exchanges as a means of payment which sets the preconditions for monetary institutions such as a central bank tightly controlling credit creation. Like the guarantor of property rights, it should also only be neutral by using objective criteria like the monetary rule.

Because adjustment is based on neo-classical theory it has no understanding of the role of institutions in development. Among other sources one can draw on concepts from old and new institutional theory to get a better understanding of the institutions that must be in place to build and operate a market economy. Markets are not simply exchanges. They are social institutions that structure, organise and legitimate contractual agreements and the exchange of property rights. They take on many forms and are in need of a variety of different state and non-state institutions to foster and develop. Moreover, we will see below that this lack of an institutional understanding spills into areas like the neo-classical view of the firm leading to misconceptions on how to build manufacturing capacities.[xvii] There are also problems with the misinterpretation of Asian experience.

The Misinterpretation of the Asian Experience

Let me begin by laying out a series of constructs which may be useful for understanding the applicability of concrete historical experiences such as those found in Asia. One needs to differentiate three conceptual levels the abstract theoretical, the generalisable that can be inductively generated from concrete studies and the specific which is embedded in the particularity of the concrete moment. The search for models of development should begin with the concrete to identify what can be generalised into a workable theoretical framework which
will act as a guide for generating policies and concepts to economies concerned with the construction and reform of markets.

Neo-classical economics, to date the major theoretical inspiration for economic reform, inverts the process. Economists working in this framework begin with a series of

axioms and generate policy initiatives which are applied to concrete historical conditions. When policies have not worked it is generally because non-economic variables have subverted the process. Policy variations are possible within a narrow realm, but since the basic body of theory arises from a set of axioms there is no alteration of the basic abstract theoretical level. In essence, the theoretical level is cut off from concrete historical experiences. The concrete can only be used to affirm the theoretical realm not to reject it (the character of an axiom). This very much affects the neo-classical interpretation of the Asian development experience.

There are two basic problems in understanding Asia's experience and its possible usage as a model of development, one is identification and the other is reproducibility (Stein, 1995). The first is identifying the factors responsible for industrial development in Asia. This is a complicated task that involves pinpointing not only what factors are intrinsic Asia's development but also the direction of causality between the factors. From the discussion above, we see that neo-classicals impose a rationally-deductive framework which predetermines the importance and dependency of the interaction between variables. The reasoning is syllogistic for if undistorted markets are what underlies successful growth and development, since Asia has been successful, it must be because they have not distorted markets or a least have reversed that distortion at some point. Thus states have been neutral allowing countries to specialise according to their comparative advantage. I think this reasoning is embedded in the neo-classical interpretation of Asia including the work of Krueger, Lal, Little and to some extent the World Bank's "E.Asian Miracle" study.

The second problem relates to the feasibly of reproducing the model elsewhere once the identification problem is solved. This is complicated by historical and structural considerations including the uniqueness of international temporal junctures, the specificity of historical economic preconditions, the irreducibility of social attributes and the peculiarity of political alignments. To the neo-classicals reproducibilty was not an issues since if there was only one successful route to achieving development, rational leaders would eventually recognise the superiority of market led growth. However, there was some modification in this position due to the slow pace of economic reform and resistance to structural adjustment. Public and rational choice explanations were then used to explain why governments resisted economic reform.

In contrast to the neo-classical interpretation of Asian development the approach best suited for understanding Asian development is to move from the concrete to the generalisable to the theoretical realm. Let me conclude by talking very briefly about some of the policies Africa might need based on Asia's experience.

Asian Development and its Possible Application to Africa

Manufacturing

At the heart of Asian development has been a robust rapidly expanding manufacturing sector with a heavy export capacity. It seems inconceivable that Africa can enter a path of sustainable development without considerable emphasis on manufacturing. However, under adjustment manufacturing has been floundering.

Take Ghana, until recently the Bank's showcase of adjustment. The logic behind adjustment as it affects industry, is that import liberalisation, devaluation, the reduction of protectionism and positive real interest rates will punish inefficient industries and reward the efficient ones which are export oriented, more labor intensive and use more local raw materials leading the country to exploit its comparative advantage. The result will be a prosperous and growing sector which will greatly contribute to an increase in exports while using fewer imports. Unfortunately, in practice it has not worked this way. Ghana implemented a standard package of policies and overall manufacturing expanded in the first few years of adjustment due primarily to an increased availability of foreign exchange. However, it has badly stagnated since 1989 and has fallen to only 8% of GDP by 1993 from 10% in 1987 with employment declining by two-thirds over the same period to a paltry 27,000. In 1965, manufacturing also accounted for 10% of GDP. Manufacturing export levels have been rather disappointing reaching only $14.7 million in 1991 with the bulk in the traditional areas of aluminum and wood products (Lall, 1995).

Why has this occurred and what are the lessons from East and Southeast Asia?

Adjustment has not worked as anticipated because the real world of manufacturing does not look anything like the imaginary one living inside the neo-classical mind. In that world, perfectly competitive firms, operating with full knowledge and accessibility to all possible technologies, choose the most efficient process given market determined prices of inputs and outputs which reflect their relative scarcity value. The international technology market is assumed to work efficiently with firms buying the right technology off the shelves without costs or barriers. Capital and technology must flow freely without state interference. Markets must be allowed to generate the correct prices without disruption such as those caused by protectionist distortions.

In the real world in a place like Ghana (we know some of this from Lall's et al's (1994) detailed work on Ghana) management and labor skills are in very limited supply, finance is difficult to secure, information is costly, relations between firms are poorly developed, technology is difficult to obtain and costly to use, transaction costs are high, public goods are poorly developed, property rights are not always clearly defined, products are not standardised etc. Opening up industries to the full force of international markets will hardly lead to the desired results when institutions and capabilities are so weak. If Asia is any indicator what is needed is a fostering environment which will permit industries to mature and prosper.

Let me begin with a more general point about states and markets. Government expenditures and intervention must not be seen as opposed to markets and the private sector. It must be reconfigured to support the growth of the private sector. In the pre-adjustment period we had poor quality of intervention in Ghana. During the adjustment period the aim was to retract the state in the rather faulty belief that the private sector would then be free to prosper in reaction to unfettered market signals. If the experience in Asian countries is any indicator, African countries, including Ghana, might need more not less intervention but the quality and direction of the intervention must change. What does this mean in practice?

New Policies to Support Future Manufacturing in Ghana

One can point to five policy areas. The first is there must a strong commitment to public education with an emphasis not only on basic literacy but on science and engineering. This should also include specialised training institutes which are widespread in Asia and which are aimed at preparing employees to meet the changing needs of industry. As we have seen, there has been very little progress and likely considerable retrogression in these areas under adjustment. For instance, Ghana has only one college which grants engineering degrees, the University of Science and Technology in Kumasi. In 1984 they graduated only 125 students. By 1991 the numbers were up to only 193 students. This is woefully inadequate relative to the needs of an industrial drive. In contrast there were thousands graduating from Korean universities in the early stages of industrialisation. Moreover, even more disturbing, like much of the rest of Africa, enrollment rates at both the primary and secondary school level in Ghana have fallen fairly significantly between 1980 and 1993.

Second, there needs to be a large commitment of public funds to the development of infrastructure. In that sense, public investment must be seen as crowding-in not crowding-out private investment. The latter view has dominated much of the economic theory underlying structural adjustment.

Third, there needs to be heavy levels of spending on health, housing and other important basic needs. In adjustment there has been far too much focus on cutbacks and user fees without regard to their social welfare impact. While basic needs are an end, in themselves, they are also a means to an end. There are quite clear positive linkages between the health and welfare of the work force and higher levels of productivity in industry.

Fourth, a set of institutions are needed to be organised to assist (particularly small and medium size enterprises) in the acquisition and diffusion of product development and technology along with the standardisation of the quality of products. These were of vital importance to the early stages of industrialisation throughout E. Asia.

Fifth and here is perhaps the most controversial issue, the state needs to organise an industrial policy group manned by the best trained individuals in the country (preferably engineers not economists) who would be given independence to use technical criteria:

a)to organise a system to ensure subsidised credit gets to industrial enterprises (mostly private)
b)to selectively use tariffs and other mechanisms to support manufacturing investment and production
c)to design tax incentives and other instruments to encourage investment in manufacturing

One should raise one note of caution. What has been crucial in designing an industrial policy in Asia has been not only providing rewards but proper enforcement so that the rewards are not continued if the criteria for receiving the rewards have not been fulfilled. This process of ensuring that support goes to the most worthy investors has been designated as contests by the World Bank in their 1993 "East Asia Miracle Study". Companies were provided with support but only if they were able to reach agreed targets of competitiveness or export levels. There are many other policy domains such as wage policies, the design of banking systems and finance, the organisation and structure of

industry, the role of foreign investment, the relation between agriculture and industry etc (World Bank, 1993b).

The literature has juxtaposed the existence of developmental states in Asia to weak states in Africa. Africa, it is argued, has states which have been rife with patronage and clientalism and which in some ways has been worsened by the retrenchments and adjustment-led erosion of state capacities. They are therefore incapable of undertaking the kind of interventionist activities necessary to build and foster private sector led development in Africa. This is a formidable challenge which suggests the need to move forward but with caution in building the capacities necessary for an Asian type strategy.[xviii]

Conclusions

The paper has discussed some of the trends in globalisation and their impact in Africa. To date Africa under the era of adjustment has not fared well. A brief history of adjustment in Africa was presented as well as the logic and policies of the model. The paper argues that the primary problem is the conceptual nature of the model underlying the policies introduced into Africa since 1980.

There are five basic problems one could raise. First, neo-classical economics by nature is exclusionary since it narrowly focuses on financial variables with a presupposition of how agents react to those variables. There is no basis of understanding structural problems such as class relations, fallacy of composition problems in world trade, or the historical structure of foreign aid which contribute to some of Africa's pathologies. A second problem is embedded in the inconsistency of the model which relies on demand constraints and supply inducements often which are often in conflict. A third problem lies with using McKinnon-Shaw as guide to financial reform in Africa. Here liberalising banking systems in the belief that the key is private banking and real positive interest rates, in a world of high uncertainty, poor regulation, unstable foreign exchange and trade regimes and weak private sector capacities will ineluctably lead to the kinds of financial chaos we have seen in African banking systems in places like Nigeria. Fourth, Africa's future lies in building economic institutions that will allow mixed economies to operate. Neo-classical economics very simply has no institutional theory. More interesting extensions have been proposed by new-institutional economics. However, as I have argued their are many theoretical problems with this approach. Finally, I believe the neo-classical interpretation of Asia's development as reaffirming the adjustment model is largely mythical. The starting point for African policy makers, is not that it should follow the Asian route, but that they at least should know that workable alternatives exist. The final section of the paper points to alternatives using the example of Ghana.

In recent trips to Africa, I sense a growing weariness with the Bank and Fund imposed model of the past decade and a half along with a reluctance to return to the strategies of the pre-adjustment period. The profound global crisis of the past 18 months has perhaps also created an atmosphere to begin to challenge the orthodox policies of the Bank and Fund. Perhaps there is a new openness to consider alternatives that transcend the arid debates which have been captured by the ideologies of the past and begin to consider new policy domains for the future.

Footnotes

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i. By globalisation, I mean the increasing integration of the world economies through a combination of capital, information and technology and trade flows.

ii. The usage of structure in the economic sense in this paper refers to the sectoral allocation, backward, forward and demand linkages and depth as indicated by a number of indices including financial savings, research and development expenditures relative to GDP, the extent of manufacturing using increasingly sophisticated technology etc. Globalisation can be mediated or filtered into economies at a variety of levels (individual, local, meso, national, regional etc.) through a variety of organisation, institutions and policies. The impact of globalisation is hardly uni-dimensional and can be structurally impoverishing or enhancing. Moreover the ability to respond to the forces of globalisation can be circumscribed by the power and rules of international organisations. This is affected by the relative power of the mediating units and the extent of concatenation concerning the definition of what constitutes development enhancing structural transformation and the policies that are needed to access global forces for this positive transformation.

iii. In line with some of the other misleading statements and outright falsifications of the Bank's mendacious "Adjustment in Africa" study, the Bank claims "public spending on health and education did not decline in the adjustment period"(1994b, p.9). Their own data presented in the book contradicts this statement. The median expenditures of education as a percentage of GDP fell in all categories between 1981-86 and 87-90(large improvement in macro policies, small improvement, etc.). Moreover, in real expenditure terms the median decline in a sample of fourteen countries was -4.6% between 1980-83 and 87-89 (World Bank, 1994b, pp. 171-172).

iv. For example the daily calorie supply per capital was 2152 in 1980 (World Bank, 1989;UNDP, 1997).

v. For a good discussion of the complications of empirical studies see Ajayi (1994) and Mosley (1994).

vi. The evaluation of the impact of adjustment, even within the Bank, has varied over time. The 1988 Bank "Report on Adjustment Lending" could find no significant differences in the rate of growth comparing recipients and non-recipients of structural adjustment loans. In 1989, however, using 1985 as a date of comparison, classifying countries into three groups and discounting countries with large external shocks, the Bank argued strong adjusters did better than weak and non-adjusters. The ECA, in what became a rather rancorous debate, accused the Bank of using subjective criteria to classify countries in order to prove the effectiveness of adjustment. By switching dates and reclassifying countries, they were able to achieve rather different results. By 1992, Ibrahim Elbadawi in a Bank study which controlled for external shocks, the political atmosphere and the initial conditions and policy stance in the pre-adjustment period, could find no statistically significant affect from adjustment on the growth rates of early adjusters and significant indications of declines in investment and savings in this group. By 1994, the Bank`s "Adjustment in Africa" study was again claiming positive effects in countries undertaking more adjustment. These divergent results

reflect differences in classifications, definitions, data and methods of testing. For a good discussion of some of these issues, see Paul Mosley and John Weeks (1993). There have also now been many highly critical reviews of the 1994 Bank study on adjustment including Mosley, Subasat and Weeks (1995) which provides a very incisive critique of the methods used.

vii. A perceptive critique of the CGEs used by David Sahn's group is presented by Maio et al. (1997). Stein (forthcoming) focuses on a critical review of their latest published volume.

viii. By neo-classical economics I mean a reliance on methodological individualism, homo-economicus, equilibrium as a natural state, rational deductivity and a reliance on axiomatic reasoning. Much of the theoretical discussion and critique in this paper is aimed at the narrowest forms of neo-classical economics which underplays the role of imperfections in markets. The reason is very simple. Adjustment is based on a hodgepodge of neo-classical theories (McKinnon-Shaw financial repression theory, Swan-Salter Australian model of macroeconomic adjustment in a small and open economy, the IMF financial programming model, tradional trade theory, public choice models of government behavior etc) which rely on the most extreme microfoundations. A more extensive examination of the microfoundations of adjustment and alternative approaches that might better develop Africa are found in Stein and Nissanke (1999).

ix. Between 1988 and 1997 there was an estimated net outflow from sub-Saharan Africa to the IMF of $1.7 billion (Calculated from Lovett, 1998, pp.4-5).

x. The portion of long term debt owed to multilateral organisations reached 30.6% in 1996 up from 13% in 1980 (Lovett, 1998).

xi. Here the architects of adjustment seem to be falling back on a Hayekian notion of entrepreneurs as risk takers. However, at the heart of any thriving capitalist economy are not risk takers which have always been in abundance in Africa but Shumpeterian entrepreneurs who are inventors and innovators. Entrepreneurship of this type thrives best in a fostering climate which includes research and development, highly trained human capital, access to finance etc all of which are poorly developed and even eroded under adjustment.

xii. A good discussion of many of these issues based on survey data from Zimbabwe is found in Brand, Mupedziswa and Gumbo (1995).

xiii. However Weeks (1998) shows that the adjustment period has been associated with a large statistically significant increase in the rate of inflation in sub-Saharan Africa compared to earlier periods.

xiv. This was apparently happening in the more remote areas of Tanzania. For an interesting paper which examines this and other problems with agriculture after liberalisation in Tanzania, see Putterman, 1995.

xv. A good summary of the post-Keynesian position on the financial repression hypothesis is found in Warman and Thirwall (1994) and Gibson and Tsakalotos (1994). Stein (1994) presents the institutionalist perspective. While both focus on

the investment to savings causal direction and the importance of endogenous money, old institutionalists place more emphasis on the development of banking habits as an institutional construct.

xvi. For a detailed analysis of the differences between new and old institutional economics in the context of structural adjustment see Stein (1994).

xvii. For a comparison of the neo-classical and old and new institutional theories relevant to African reform and development see Stein, 1994.

xviii. An excellent discussion of how Taiwan and Korea developed their interventionist capacities can be found in Chang, Haggard and Kang, 1996.

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