The **United Nations Research Institute for Social Development** (**UNRISD**) is an autonomous agency engaging in multidisciplinary research on the social dimensions of contemporary problems affecting development. Its work is guided by the conviction that, for effective development policies to be formulated, an understanding of the social and political context is crucial. The Institute attempts to provide governments, development agencies, grassroots organizations and scholars with a better understanding of how development policies and processes of economic, social and environmental change affect different social groups. Working through an extensive network of national research centres, UNRISD aims to promote original research and strengthen research capacity in developing countries.

Current research programmes include: Civil Society and Social Movements; Democracy, Governance and Human Rights; Identities, Conflict and Cohesion; Social Policy and Development; and Technology, Business and Society.

A list of the Institute's free and priced publications can be obtained by contacting the Reference Centre.

UNRISD, Palais des Nations
1211 Geneva 10, Switzerland

Tel: (41 22) 9173020
Fax: (41 22) 9170650
E-mail: info@unrisd.org
Web: http://www.unrisd.org

The Neo-Liberal Doctrine and the African Crisis

Machiko NISSANKE

Draft paper prepared for the discussion at the UNRISD meeting on
"The Need to Rethink Development Economics",
7-8 September 2001,
Cape Town, South Africa.

Structural Adjustment Programmes and the Policy Conditionality

The core model of Structural Adjustment Programmes (SAPs) undoubtedly reflects a revival of neo-liberal orthodoxy in mainstream economics as well as in popular global economic policy debates in the 1980s. In this sense, SAPs are an application of the neo-conservatism of the Thatcher- Reagan era to development economics -a product of the neo-liberal `counter-revolution'. The legitimacy of `development economics' as a distinct subject discipline was seriously challenged in the process.

The ascendancy of the neo-liberal school in development economics has not only impoverished the development policy debate with its monolithic understanding of the essentially multi-dimensional process of socio-economic development, but also inflicted irrecoverable costs and pains to low-income countries by imposing its doctrine in the form of conditionality to Structural Adjustment Loans. While its supremacy as applied to developed and emerging market economies has been gradually questioned after a series of global financial crises in the 1990s, its application to low income developing countries has been surviving as the core component of loan conditionality.

Drawing on my recent papers on the topic noted in the bibliography attached, this brief paper examines the effects of application of neo-liberal policies on the continuing fragility faced by most low-income countries in Sub-Saharan Africa (SSA).

Indeed, since the early 1980s, the economic policy and development debate in SSA have been singularly dominated by SAPs. The debate concerning the appropriateness of SAPs for SSA countries continues to be unabated despite nearly two decades of `adjustments'. The accumulated evidence generally points to the weak link between adjustment and performance in Africa (UNCTAD, 1998). After 15-20 years of reform efforts, the region's growth performance remains far too low to lead the economies along a path of economic development, which would counter growing levels of poverty. The incidence of poverty is estimated to be in the range of 40 to 66 percent. In short, much of Africa today is still mired in `a crisis in development', i.e., an economy seized by the general incapacity to generate a sustained improvement in the standard of living.

In the 1990s, faced with the "slowness" of the expected supply response of private agents to the newly liberalised and deregulated policy environment, academics and policy-makers alike, in and out of Africa, began to ascribe “institution failure” as the key impediment to African development. This was a progression from the "capital shortage" diagnosis in the 1960s and 1970s and the "policy failures" diagnosis in the 1980s. In this thesis, the failure of SAPs to deliver the promised positive outcomes is popularly attributed either to the inadequate commitment by governments to reform measures or to the incomplete implementation of SAPS. This impasse itself is more likely to suggest general difficulties encountered by governments in programme implementation under prevailing socio-economic conditions in Africa. However, the slippage in implementation, and indeed, the poor performance *despite* adjustment programmes has been in turn viewed as reflection of the low capacity of African states or institutions.

Reflecting this, while adhering fundamentally to the core adjustment model, the World Bank had started adding, in an ad-hoc manner, other political and institutional conditions such as governance and democratisation, to the list of conditionality. Within the International Financial Institutions, there was a brief attempt by the Bank’s chief economist to question the narrowness of the neo-liberal agenda of the Washington Consensus and to broaden the scope of development policy agenda with a Post-Washington Consensus (Stiglitz, 1998a and 1998b), where development is again explicitly re-defined as the process involving structural transformation as was the case in the pre-SAP-period. However, his departure aborted prematurely the process of the fundamental reappraisal of SAPs within the World Bank.

In the more recent HIPC initiatives, the content of policy conditionality has been again expanded to include the goal of poverty reduction, while a good track record of good performance under IMF-and World Bank-supported SAPs firmly as an eligibility criterion. In my view, however, there is a considerable tension and potential contradictions between the different components of new policy conditionality embedded in the HIPC initiatives. With the ‘eligibility’ criteria still firmly in place, the underlying assumption of the HIPC policy conditionality is presumably that there exist complementarities between SAPs and additional policies aimed at poverty reduction. This presumption fails to recognise the well-established premise in development economics literature that the growth-poverty nexus is rather complicated, and the pattern of economic growth and development, rather than the rate of growth per se, has significant effects on a country’s income distribution and poverty profile. This suggests that ‘growth-enhancing’ economic policies of SAPs are not necessarily in agreement with policies for addressing the income distribution issues and poverty alleviation targets.

Simply appending the `poverty reduction policy’ to SAPs without due attention to this complex growth-poverty nexus is really problematic, giving rise to internal inconsistency of the policy package. Furthermore, PRGS country papers suggest that poverty reduction is supposed to be achieved almost exclusively through an increase in social expenditure. While these policy measures are undoubtedly important elements of any poverty reduction strategy, an unfounded expectation that poverty could be reduced by applying these measures only should not be encouraged. This is because poverty is outcome of economic, social and political processes and their interactions, which are mediated through a range of institutions. The multidimensional nature of poverty implies that any poverty reduction strategy should include a set of long-term strategic measures of changing institutional structures and environments.

Moreover, there is an urgent need to evaluate the effectiveness of the use of policy conditionality in the HIPC initiatives in the wider context of appropriateness of SAPs to effect structural transformation of economies of HIPCs, leading to changes of their disadvantaged form of international linkages. In my view, the conventional way of debating the effectiveness of policy conditionality is too inhibiting, as it is based on the assumption that SAPs are generally appropriate for dealing economic problems facing the HIPCs. Furthermore, policy conditionality is seen as a means of tying the hands of recipient governments to policy reforms designed by the donor community. Therefore, the debate has been conducted largely from a narrow perspective of the moral hazard problem arising from granting debt relief and foreign aid without a firm commitment to reform programs on the part of recipient countries.

Collier (1998), for example, argues that policy conditionality attached to SAPs is faulted on incorrect rationales given to adjustment lending. In his view, none of the three rationales for programme lending, namely the use of aid as an incentive for reform, financing the 'cost of adjustment', and 'defensive lending' to service external debt, are soundly based as it fails to secure unconditional commitments to, and comprehensive implementation of, reform programmes.

Based on this diagnose, Collier proposes to redesign conditionality from 'incentives' based on promises for policy change to 'selectivity' based on retrospective assessments of performance. That is, in place of using conditionality to induce policy change, Collier proposes that aid should be used to target financial flows on those governments that have already established good policy environments. His proposal is based on the empirical work by Burnside and Dollar (1997), which suggests that 'when good policy and aid flows happen to coincide the outcome has been very good (p.30). It also originates from Collier's conviction that Africa desperately needs significant 'role models' within the continent. Thus, creating star performers by engineering aid allocation in this way, he argues, would induce many non-reforming governments to change their policies through the pressure of emulation and would result in enhanced overall aid effectiveness.

However, Hansen and Tarp (2001) question the validity of the empirical analysis by Burnside and Dollar, which forms the basis for the 'selectivity' proposal. Their extensive literature survey, covering three generation of models on the aid-growth relationships, confirms that aid enhances growth through the positive effects of aid on domestic savings in the framework of first generation studies, and on the investment enhancing effect of aid investigated in second-generation studies.

Furthermore, their critical review of the third generation models based on new growth theory, which include the Burnside-Dollar study, shows that the results by Burnside and Dollar are an odd-one out from the other three studies. While all other three studies suggest a significant impact of aid on growth as long as the aid to GDP ratio does not exceed 25 % or more, only the former study concludes that the effectiveness of aid depends on economic policy. Overall, in each generation of studies, those arguing the negative effect of aid on growth are in a minority. Hence, they caution us strongly against basing aid allocation rules on the single-cause explanations.

I argued elsewhere (Nissanke, 2000), the 'selectivity' proposal in aid allocation requires a critical examination in the light of possible consequences of adopting it on aid distribution as well as the special roles attached to official bilateral and multilateral aid flows in a web of global finance. While private capital flows by nature move globally in search of higher rates of return, criteria and motivation surrounding aid distribution have been historically much more complex (Maizels and Nissanke, 1984), Noting that "aid is given for many different purposes and in many different forms", Hansen and Tarp (2001) suggest that the unresolved issue in assessing aid effectiveness is not whether aid works, but how and whether we can make the different kinds of aid instruments at hand work better in varying country circumstances. Furthermore, unless structural transformation gets firmly under way, a 'star performer' in Africa continues to shift from one country to another, as Ghana found it difficult to maintain its status as a 'front-runner in adjustment' attained in the early 1990s (Aryeetey, Harrigan and Nissanke, 2000).

The 'selectivity' proposal should be also examined in relation to a more fundamental question as to who defines (and how to define) good policies for country-specific conditions. The appropriateness of the design of policy conditionality attached to the HIPC initiatives to be re-evaluated in this context. The HIPC initiatives are praised for being based on the improved donor-recipient relationships, involving recipient governments and civil societies at large in drafting and debating the poverty reduction strategy papers (PRSPs). However, unless genuine debate can be extended to another component of policy conditionality, i.e. the design of structural adjustment programmes, real ownership of economic reform programmes cannot be in the hands of recipient countries. Instead, given the reality that foreign aid and concessional loans are in short supply, it is more likely that the granting debt forgiveness through the HIPC facilities becomes a convenient de-facto rationing device for aid allocation on the basis of the 'selectivity' principle.

As we argued elsewhere (Stein and Nissanke, 1999), an uneasy mismatch exists between the abstract model in which SAPs are conceived and the reality found in SSA. The slow progress with SAPs in reviving countries in SSA by inducing substantial changes to the structure of trade and production is more to do with this fundamental problem of the theoretical construct, rather than the weak implementing capacity of African states or institutions in carrying through Structural Adjustment to its perfection and completion.

Methodological Foundations of Structural Adjustment- a Critique

The problem of adjustment in Africa is foremost conceptual and methodological. In this sense, a critical assessment of SAPs should extend, beyond the neo-liberal school, to microfoundations of the neo-classical economic theories in general.

A. Methodological Components: Micro-foundations of Adjustment

There are five neo-classical economic components, which are at the core of the methodology embedded in adjustment theories: homo-economicus, rational deductivity, methodological individualism, axiomatic reasoning and the acceptance of equilibrium as a natural state. At the heart of all the theories is homo-economicus, which posits a rationally calculating individual maximising his or her welfare. This concept incorporates a mode of rationality, which is instrumental, where actors make choices which best satisfy a person's objectives.

The model relies entirely on methodological individualism. It begins with choices at the individual level and the end point is maximisation of the welfare of the individual. Markets are perceived as exchanges where goods and services are transferred from producers to consumers. Exchange in the neo-classical model arises spontaneously from the atomistic interaction of self-seeking individuals. Equilibrium arises in the sense that the market clears and optimal choices are made. Moreover, in this ideal world 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. Thus the outcome is consistent with the natural underlying conditions. Equilibrium is a natural state.

The thinking behind the model is also rational deductive and axiomatic. It is rational-deductive in the sense that the behaviour of agents is predetermined by a set of rules, which are deductively posited. Neo-classical economic reliance on an axiomatic approach is particularly problematic. Economists working in this framework begin with a series of axioms and generate policy initiatives, which are then 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 theory level. In essence, the theoretical level is cut off from concrete historical experiences.

These neo-classical microfoundations generate intermediate propositions, which are embedded in the main theories underlying adjustment policies. These can be summarised in six propositions, including a focus on static efficiency, state neutrality/minimalism, distortions and marginality, a view that changes in relative prices lead to predictable outcomes, and development as a static equilibrium state. The search for blame leads to the identification of players influencing markets from outside the realm of exchanges. This narrow reasoning leads ineluctably to its own perspective on the role of the state and how it affects the economy.

Two principles arise from this model: the imperatives of state neutrality and the need for state minimalism. Indeed, much of adjustment is driven by the principle of creating state neutrality and minimalism in the belief that once prices reflect their scarcity values the real sector will respond accordingly. It is taken for granted that enormous static efficiency gains can arise from liberalisation, privatisation and stabilisation. The focus is on the creation of a static equilibrium state where rational private actors make marginal changes in reaction to undistorted prices to maximise their individual utility.

Unfortunately, the adjustment model adopted the extreme version of the neoclassical world described above, where agents interact in a world of perfect certainty and perfect information. Naturally, the mainstream neo-classical school in a broader vintage has long recognised the prevalence of market failures and imperfections. Market failures are identified in the neo-classical literature with externalities and public goods, which recognise divergence between private and social returns and hence call for government intervention. More recently, as the theory of imperfect information has been advanced and refined by Stiglitz and his associates, market failures caused by incomplete, costly and asymmetric information have received increasing attention to justify government actions.

However, these definitions of market failures may be too inhibiting for the development policy discourse. We need to go beyond standard notions of market failure to focus on the nature of early development, which include missing and incomplete markets and market-supporting institutional infrastructure. More generally, a question of market development and transformation has to be explicitly addressed. We shall return to this question in the concluding section.

B. Macroeconomic Models Underlying Adjustment

SAPs are in essence a framework for a stabilisation-cum-adjustment model, deriving its rationale from an eclectically assembled set of macroeconomic and sectoral models. In macroeconomic models used for the stabilisation component of SAPs, an economy is postulated to experience disequilibrium in external and internal balances because of misalignment of domestic absorption levels from a full-employment equilibrium. Whether shocks to the equilibrium originate externally or domestically, the models dictate that policy responses to deficits must be deflationary through expenditure-reduction via fiscal retrenchment and domestic credit contraction. This is usually combined with substantial currency devaluation to effect expenditure switching and a shift in production towards tradeables. However, the short-term effect of currency devaluation in developing economies is known to be contractionary as well as stagflationary due to their high input dependence on imports.

In order to counterbalance these short-run contractionary effects, the supply - side policies are supposed to initiate structural reforms through liberalisation and privatisation. Liberalisation policies are derived from the neo-classical microeconomic models where consumers' utility maximisation and producers' profit maximisation would evoke a strong response to changes in relative prices. As these models assume that removing price distortions would assure Pareto efficiency in resource allocation, liberalisation and de-regulation policies are by definition treated as "growth-enhancing and social welfare-maximising". De-regulation of goods and factor markets and trade liberalisation are supposed to result in a removal of the `structural' causes of macroeconomic imbalances. As prices signals are assumed to embody all necessary information, changes in relative prices are viewed as a critical prerequisite to a predictable shift to a new equilibrium state. If efficiency is not observed, it is argued that this is due to price distortions exogenously imposed on markets.

In SAPs as applied to Africa, the minimalist view of the state was specifically formed by an uncritical acceptance of the position taken by the public/rational choice school. According to this school, the state is essentially a tool used by acquisitive homo economicus for predatory purposes.

Again here, the sharply dichotomous view of the role of the state and markets and the open `anti-statism', which has dominated the design of the core adjustment model from its inception in the Berg report (World Bank, 1981), has long been regarded as a rather extreme position among mainstream economists. In macroeconomics, for example, the presence and efficacy of the `Invisible Hand' in equating aggregate supply with aggregate demand has been a focal point in the debate between the Monetarist and Keynesian Schools.

Thus, the demise of the Keynesian school within mainstream economics since the late 1970s has had a profound implication on the subsequent course of the development policy debate for the economies in SSA.

C. Inconsistencies of the "Structural Adjustment" Model and its Exclusion of Structural Features of the African Crisis

The difficulties arising out of the incongruity between the neo-liberal models underlying adjustment and the real world becomes most pronounced when SAPs are applied to low-income countries such as those in Africa. Two features of the theories can be singled out as particularly problematic: internal inconsistencies in the adjustment model and the exclusion of structural features. Internal consistencies of recommended policies are not closely checked, except for their conformity to the prime agenda- absorption-contraction and liberalisation-cum-privatisation. This has produced a high tension between the two stated objectives-stabilisation and growth (let alone development) -, both of which are supposed to be achieved within a short tight timeframe tied to the way donor finances are made available.

SAPs are presented as universally applicable to any economy regardless of its developmental stage, and hence, policies are viewed as `generalisable' under any socio-economic and political condition. Consequently, the models