STRUCTURAL ADJUSTMENT AND THE AFRICAN CRISIS: A THEORETICAL APPRAISAL

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BACKGROUND

Since the early 1980s, the economic policy and development debate in sub-Saharan Africa has been singularly dominated by structural adjustment programs (SAPs) which have been part of the conditionality tied to donor assistance. The debate concerning the appropriateness of SAPs for sub-Saharan Africa countries continues to be unabated despite nearly two decades of 'adjustments'.

Numerous studies have attempted to measure the impact of adjustment on the economic performance in sub-Sahara Africa often by using counterfactual exercises [World Bank/UNDP, 1989; World Bank , 1990; 1992; 1994].[1] These exercises typically suffer from methodological difficulties, particularly when separating the program impacts from the ephemeral effects of increased external resources through adjustment lending. The accumulated evidence generally points to the weak link between adjustment and performance in Africa [UNCTAD, 1998].

While official donor reports [World Bank, 1994] have often emphasized some improvements, admittedly fragile, in macroeconomic balances in "adjusting" countries, this has not led to a sustained recovery in growth and investment performance. The actual growth record for the region has been dismal. Compared with the early periods, sub-Saharan Africa over the years 1980-1994 recorded a sharp reduction in total output, exports and investment. Both industrial and agricultural production declined (see Figures 1 and 2). With growing population, per capita income fell on average by 0.6 per cent per annum during 1980 - 1994.[2]

After 15 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. Private investment has been subdued, while public investment was cut sharply (see Figure 3). Savings rates in most of sub-Saharan Africa remain very low (see Table 1). The low savings rates of these sub-Saharan African

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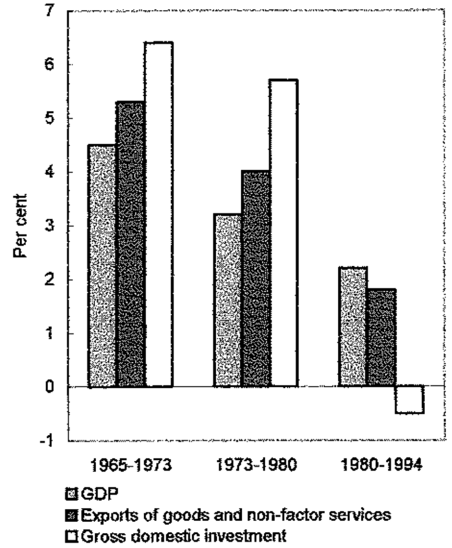
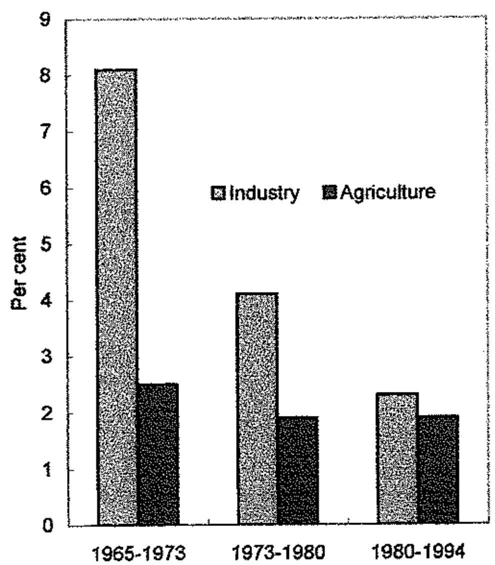
FIGURE 1
Average Real Growth Rates of GDP, Exports, and Investments in Sub-Saharan Africa, 1965-1994
(Percent per annum)



Source: UNCTAD (1998)
Note: the underlying numbers are unweighted averages

FIGURE 2
Growth in Industry and Agriculture in Sub-Saharan Africa, 1965-1994
(Percent per annum)



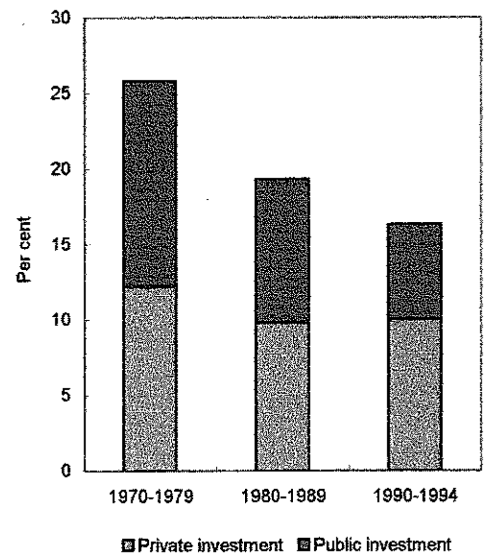
Source: UNCTAD (1998)
Note: the underlying numbers are unweighted averages

TABLE 1
Saving and Investment Rates

	1965-73	1974-81	1982-92
Gross National Savings as % of GNP			
Sub-Saharan Africa	10.7	8.3	4.8
All developing countries	14.1	15.0	11.4
Gross Domestic Investment as % of GDP			
Sub-Saharan Africa	16.9	21.8	19.2
All developing countries	18.7	23.2	20.7

Source: Schmidt-Hebbel [1996].

FIGURE 3
Public and Private Investment in Sub-Saharan Africa, 1970-1994
(Percent of GDP, weighted averages)



Source: UNTAD (1998)

countries suggest that investment and economic growth is still heavily dependent on foreign savings in the form of external finance. Indeed, Table 1 shows that the saving-investment gap has widened over the years. For many countries of the region, dependence on concessional aid flows for economic development has been high and rising.

Today, food security remains a critical issue, while environmental degradation has accelerated. The incidence of poverty is estimated to be in the range of 40 to 66 percent [Ali, 1995].[3] 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 [Stein, 1998].

In the 1990s, faced with the "slowness" of the expected supply response of private agents to the newly liberalized 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 [Adam and O'Connell, 1997; Nissanke and Aryeetey, 1998a].

Reflecting this, while adhering fundamentally to the core adjustment model, the World Bank has gradually added governance, social capital and other institutional conditions. However, recently, the Bank's chief economist has began to question the narrowness of the neo-liberal agenda of the Washington Consensus which underlies the core adjustment model and proposed to broaden the scope of the development policy agenda with a Post-Washington Consensus [Stiglitz 1998a; 1998b]. In this new approach, development is explicitly defined as structural transformation [Stiglitz, 1998b].

In this paper, we attempt to contribute to this freshly initiated policy dialogue. We contend that the main reason for the failure of SAPs to establish a firm recovery and a self-sustainable development path lies in the inappropriate theoretical underpinnings of their design. We locate the chief culprit for the failure of adjustment at the conceptual level, rather than in the weak implementing capacity of African states or institutions in carrying out structural adjustment.

The neo-classical microfoundations, associated intermediate propositions, and the theories based on them have led to serious misinterpretations in understanding the lessons from Asian development, the reasons for Africa's poor performance under adjustment and the feasibility of alternatives. There are theoretical inconsistencies and tensions between the various components of adjustment that detract from their ability to produce the intended results. We shall argue that to understand the structural problems of the sub-Saharan African economies and to design alternative development strategies, we must go beyond the narrow neo-classical micro-foundation of adjustment. Towards this main objective, the paper is structured as follows. In the next section, we examine the methodological and theoretical foundations of adjustment. This is followed by a brief discussion of the inconsistencies in the theories underlying adjustment and the structural features of African economies, which are not adequately addressed by SAPs. We then show how SAPs are incapable of dealing with the exigencies of African development. In the final section we shall begin to outline a theory of dynamic, structural and institutional embeddedness as an alternative framework, which could explicitly treat development as a process of structural and institutional transformation.

METHODOLOGICAL AND THEORETICAL FOUNDATIONS OF ADJUSTMENT

The problem of adjustment in Africa is foremost conceptual and methodological. The microfoundations of the neoclassical economic theories that underpin conditionality misspecify the nature of African economies. All the major theories of adjustment have a common set of components. From there a series of intermediate propositions form a base on which the theories either stand or fall. Here we shall first identify the methodological components of adjustment and the intermediate propositions, and then review the theories underlying adjustment as they reflect these methodological foundations and intermediate propositions.

Methodological Components: The Neoclassical Roots of Adjustment

There are five neoclassical economic components we believe 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 maximizing 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. In the strictest neo-classical version, homo-economicus lives in a world where people completely grasp the potential consequences of their choices.

The model relies entirely on methodological individualism. It begins with choices at the individual level and ends with the maximization of the welfare of the individual. Markets are perceived as exchanges where goods and services are transferred from producers to consumers. Exchange in the neoclassical 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 reflect of the endowment of societal resources. Thus the outcome is consistent with the natural underlying conditions. Equilibrium is a natural state.[4]

The thinking behind the model is also rational-deductive and axiomatic. It is rational-deductive in the sense that the behavior of agents is predetermined by a set of rules that are deductively posited. Neoclassical economic's reliance on an axiomatic approach is particularly problematic.[5] Economists working in this framework begin with a series of axioms and generate policy initiatives that 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 the core propositions are not altered. In essence, the theoretical level is cut off from concrete historical experiences.[6]

These neoclassical microfoundations generate intermediate propositions, which are embedded in the main theories underlying adjustment policies. These can be summarized 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. For example, the assumption of private actor optimization leads neoclassical theorists to focus on other explanations of why economies are not operating at optimal levels. The search for blame leads to the identification of players influencing markets from outside the realm of exchanges. The reasoning leads ineluctably to the role of the state and how it affects the economy.

In its pure form neoclassical economics does not recognize any role for states, since economies are driven by exchanges, which arise out of the spontaneous interaction of self-seeking individuals. The more relaxed version recognizes that property rights are transferred in exchanges and therefore some external guarantor such as a judiciary is needed. It also recognizes 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, the central bank should also be neutral by using objective criteria like the monetary rule. 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 liberalization, privatization and stabilization. The focus is on the creation of a static equilibrium state where rational private actors make marginal changes in reaction to undistorted prices to maximize their individual utility. However, we question both the realism and desirability of their optimal world-unconnected selfish Benthamite individuals able to successfully maximize their pleasure and minimize their pain.

Theories Underlying Adjustment

Structural Adjustment Programs (SAPs) consists of two components: stabilization policies and supply-side "growth-oriented" policies. The stabilization components are supposed to be achieved by a combination of expenditure-reducing policies and expenditure and production switching policies. As such, these policy configurations are derived from the two types of macroeconomic models:(i) the single-good model typified by the International Monetary Fund (IMF) financial programming model *à la* Polak with some extension incorporated in the World Bank's Revised Minimum Standard Model (RMSM) and (ii) the two goods model (traded and non-traded goods) *à la* Salter-Swan.

These aggregate demand management models incorporate a full-employment assumption. An economy is postulated to experience disequilibrium in external and internal balances because of the 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 using 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. The short-term effect of currency devaluation in developing economies is also known to be contractionary as well as stagflationary due to manufacturing's 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 liberalization and privatization. The liberalization policies are derived from the neoclassical microeconomic models discussed above. Since these models assume that removing price distortions would assure Pareto efficiency in resource allocation, liberalization and deregulation policies are by definition treated as growth-enhancing and social welfare-maximizing.[7] It is conjectured that once the state retracts from direct intervention in economic activities and resource allocation, private agents would react favorably to changed incentives and a more competitive environment by investing in and producing internationally tradeable goods and services, thereby raising savings and earning more foreign exchange. Thus, deregulation of goods and factor markets and trade liberalization are supposed to result in a removal of the 'structural' causes of macroeconomic imbalances.

In SAPs as applied to Africa, the minimalist view of the state was 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.

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.

Clearly, in a longer historical perspective, the core model of structural adjustment reflects a revival of neo-liberal orthodoxy in mainstream economics as well as in popular global economic policy debates. 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" in the 1980s [Toye, 1987].

Microeconomics has also long recognized the prevalence of market failures and imperfections. Market failures are identified in the neoclassical literature with externalities and public goods, which recognize 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 inhibit the development policy discourse. We need to go beyond standard notions of market failure to focus on the nature of early development, which includes missing and incomplete markets and market-supporting institutional infrastructure [Nissanke and Aryeetey, 1998a]. It is also critical to consider the structural transformation needed to overcome the near-perpetual crisis conditions to which low-income, commodity-dependent countries have generally been condemned.

TOWARD A CRITIQUE OF NEO-CLASSICAL BASED ADJUSTMENT

Inconsistencies and Exclusions of the "Structural Adjustment" Model and Structural Features of the African Crisis

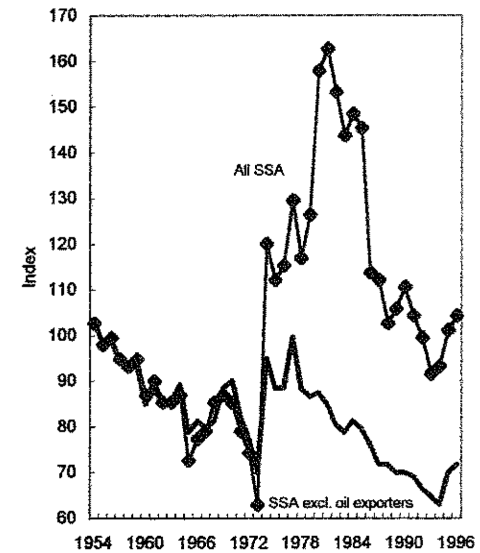
The difficulties arising out of the incongruity between the neoclassical models underlying adjustment and the real world becomes most pronounced when SAPs are applied to low-income countries such as those in Africa. Two features of the theories can be singled out as particularly problematic: the exclusion of structural features and internal inconsistencies in the adjustment model.

SAPs are presented as universally applicable to any economy regardless of its developmental stage, and hence, policies are viewed as "generalizable" under any socioeconomic and political condition. Consequently, the models leave no room for policies that address structural and institutional characteristics. Indeed, Structural Adjustment, despite its name, does not really deal with vital structural phenomenon of recipient economies. However, the African crisis cannot be understood isolated from the structural conditions of the region.

To start, conditions affecting the balance of payments are very precarious. On the export side, most African economies are still uncomfortably dependent on a very limited number of primary commodities — unprocessed agricultural and mineral products — vulnerable to the vicissitudes of externally determined prices and quantities demanded. On the import side, while their import capacity has dwindled, the dependence of African economies on imports remains high. First, agricultural production in Africa has not benefited from any major technological break-throughs (like the "green revolution"). With rapid population growth, dependence on food imports has increased, rising to one-third of domestic food production in recent decades. Secondly, largely as a result of the tied nature of foreign aid, the pattern of industrialization has created an industrial and manufacturing sector with a high import dependence for both inputs and technology.

These structural features have made African economies extremely vulnerable to external shocks. A narrow tax base for raising revenue means that the internal fiscal balance and external trade balance are closely linked and both are exposed to the high volatility of commodity prices and the long-term tendency of their terms of trade to decline (see Figure 4). The scale of required adjustment often has far exceeded the capacity of these economies to adequately absorb them through aggregate demand management.

FIGURE 4
Terms of Trade of Sub-Saharan Africa, 1954-1996
(Index numbers, 1954-1956=100)



Source: UNCTAD (1998)

A series of external shocks from the international economic system in the 1970s and 1980s exposed the weak foundation of these economies and contributed to the crisis conditions of the 1980s. Portfolio and foreign direct investment, which had never been large, came to an almost complete halt.[8] The option of accessing international capital markets to soften the immediate impact of shocks has disappeared due to the African countries' decline in creditworthiness. Many countries turned to the only available source to finance growing balance-of-payments deficits — official foreign assistance and loans, which were increasingly tied to the implementation of SAPs. Access to desperately requested debt-rescheduling facilities has also become conditional upon accepting these policies.

Since world commodity prices exhibit not only declining long-term trends but also extreme fluctuations, commodity-dependent economies have been forced to implement short-run stabilization policies on a perpetual basis [Nissanke, 1993].[9] The imperatives of stabilization have, as a rule, taken precedence over development. It has been very hard for these low-income countries, with their fragile structure and production capacity, to absorb huge terms of trade shocks and at the same time to generate resources for investment.

The situation has frequently been made worse by both the underfunding of SAPs and the misguided nature of policies [UNCTAD, 1993]. For commodity-dependent economies, there is an inherent contradiction in the "stabilization-plus-adjustment" approach. The supply-side measures, which are aimed at ameliorating the contractionary effects of expenditure-reducing policies, frequently aggravate macroeconomic balances. In our view the inconsistency cannot be adequately addressed just by fine-tuning the sequencing of reform measures.

Thus, the open macroeconomic model used to address balance-of-payment imbalances dictates a cut in absorption levels through contractionary monetary and fiscal policies in the face of negative shocks. However, hikes in interest rates for monetary stability and for increased savings, as advocated by the financial repression school, have usually led to a sharp post-liberalization domestic credit crunch and a fall in productive investment [Nissanke and Aryeetey, 1998b].[10] Further, higher interest rates increase the fiscal burden of domestic debt through increased interest payments. Worse, as we have seen in recent decades world-wide, an abrupt implementation of financial liberalization frequently leads to banking and financial crises combined with mounting non-performing loans. This has had a further destabilizing effect on monetary and financial conditions.

Similarly, policies to address fiscal deficits are inherently contractionary. Since the time frame for reducing deficits through tax collection is usually very tight under the IMF facilities the fiscal balance targets tend to rely on expenditure reduction rather than on revenue increases. Despite the well-established empirical evidence of "crowding-in effects" of public investment, the levels of public investment have been cut on average to 5 percent of GDP in sub-Saharan Africa under structural adjustment programs (see Figure 3). Moreover, a sharp reduction in tariff rates carried out as part of indiscriminate import liberalization abruptly reduced trade tax revenue — a vital source of government revenues in sub-Saharan Africa, leading to worsening fiscal balances with a fresh need for stabilization measures.

SAP-induced trade liberalization has had other negative consequences which in many cases have far outweighed any welfare-enhancing effects postulated in standard international trade theory. In sub-Saharan Africa, under SAPs, import liberalization has been carried out before export capacity has been strengthened. Indeed, export promotion measures have received very little attention. An integrated policy of industrialization and technological development, which has been a critical element in East-Asian economic growth, is conspicuously absent in SAPs.

Instead, export increases are supposed to be achieved exclusively by the reallocation of production exportables by the incentive effects of real exchange rate adjustments. However, this strategy presents some practical difficulties. First, real exchange rate adjustments are not easily effected in a high-inflation environment due to the stagflationary effect of nominal devaluation.[11] Usually, this requires further deflationary measures. Second, a shift of resources between different activities usually takes a considerable lead time, involving new investment in production facilities and labor and management skills. Meanwhile, sweeping import liberalization has an immediate effect: a wiping out of domestic firms engaged in import substituting activities and a deterioration of trade accounts through a flood of imported consumption goods. This is in turn leads to balance-of-payments crises requiring further deflationary measures. Thus trade liberalization has commonly led to premature deindustrialization, rather than to economic development with structural transformation.

While public investment has experienced a substantial cut because of the needs for fiscal austerity with a resulting deterioration in physical and human infrastructure, private investment has not been picked up. Nissanke [1998] attributes a prime cause of the persistently low level of private investment to the extremely high degree of risk and uncertainty facing the private sector under SAPs. It has affected not only the asset composition of savings portfolios held by private agents but also the composition of investment in Africa in favor of reversible and safe investments that have a self-insurance character. Thus, as Adam and O'Connell [1997] note, safe and liquid assets are systematically chosen over less liquid, more productive assets. The latter could generate considerably higher social rates of return.

In the absence of the required investments, there has been little diversification of production and exports in sub-Saharan Africa. After many years of "adjustment" there is very little "vertical" diversification, (i.e. a shift towards processed commodities and manufactures), while "horizontal" diversification (i.e. diversification within the primary commodity sector) has not generally been successful. Four out of five African countries still depend on two commodities for over half of their export earnings [UNCTAD, 1993, 100]. At the same time, attempts to increase the volume of traditional exports can lead to a self-defeating price depression. This fallacy of composition effect arises out of the simultaneous expansion of exports by a large number of "adjusting" countries in the face of low elasticities of demand for their commodities.

Africa has failed to diversify export structures under SAPs. In 1970, 92 percent of African exports were in primary commodities. In 1991, the figure was exactly the same [World Bank, 1993]. Clearly, SAPs have limited the ability of African countries to move up the industrial ladder. In aggregáte, Africa's share in world exports fell from 2.4 percent in 1970 to 1 percent in 1992. Equally, SAPs have not been successful in attracting more foreign direct investment, except in mineral extracting activities. In the 1980s and 1990s, Africa's share of foreign direct investment to developing countries was under 1 percent of the estimated total of around $200 billion per year. Consequently, a viable and sustainable position in balance of payments has not been attained. The conditions and prospects facing many countries have actually worsened due to their growing debt servicing burden combined with their reduced export earning capacity.

Adjustment and African Development: Failures and Incapacities

Several other errors arise from using neoclassical economics as a guide for the development of African economies. These errors include behavioral and interactive failures, problems of scope, problems with definitions and in undertaking and interpreting comparative studies, difficulties in dealing with the temporal and spatial dimensions of development, and failures associated with aggregation problems.

Homo-economicus is a very problematic representation of the nature of human behavior in general and in Africa in particular. It is not that individuals do not undertake activities aimed at enhancing their personal welfare, but that people foremost are social beings who are embedded in a broad social and institutional context that has a great impact on their economic activities. More realistic notions of human behavior recognize that rationality is bounded [Simon, 1978]. However, even this formulation cannot adequately account for the boundaries created by the existence of other people in society. The behavior of individuals is often linked to the roles that others expect them to play or a "typified response to a typified expectation". Closely linked to this concept is an institutionalist perception of human behavior as a product of "settled habits of thought common to the generality of men and women" [Veblen, 1919, 240]. Perhaps a richer notion of the embedded being is captured by the concept of *homo-sociologicus* where individuals are not constantly calculating utility maximizers but live according to "rules, roles and relations." [Hargreaves-Heap et al., 1992, 63].

The assumption of atomistic unconnected individuals in sub-Saharan Africa has lead to behavioral failures. Thus, introducing private property ownership in Africa has often not improved the efficiency of land usage because of the competing claims based on clientage and kinship that are part of the decision making of rural *homo-sociologicus* in Africa.[12] Also important here is what is socially acceptable. Other forms of socially defined property rights are often more legitimate than the new private property rights imposed in rural areas. Property rights transformation in a world of *homo-sociologicus* must understand the basis of legitimacy and the normative prerequisites for moving toward new forms of legitimacy [Stein, 1995a].

In the narrower traditions of neoclassical economics there is little discussion of non-economic factors. In rational choice theory non-economic variables are a product of the calculus of *homo-economicus*. Causality between economic and non-economic spheres is therefore uni-directional and all non-economic variables are purposive and instrumental. For example, one rational choice theorist explains African social structure as a rational outcome of reducing uncertainty in a high-risk environment. Critics show that this is empirically unfounded since high-risk environments in rural Africa are ubiquitous and social outcomes vary dramatically.[13] These arguments fall into the old functionalist error of mistaking correlation with causality. The interaction of economic and non-economic factors must include an autonomous definition of spheres that have their own history and dynamic.

Failure of scope in adjustment arises out of the focus of neoclassical microfoundations on nominal variables or legally defined categories (in its broader definition). The focus on marginal changes in response to correct prices where money supply and property rights are legally defined to enhance efficient decision making has been the major preoccupation of orthodox reform in Africa. However, in African economies lumpy institutional, organizational, and structural factors must be proactively transformed for the promotion of economic growth. In contrast, orthodox policies aim at creating neutrality so that private agents are free to undertake their optimal decisions.[14]

Definitional problems have also led to poor policy recommendations under adjustment. Public choice and rational choice theories have dominated the adjustment concept of the state. One of the great paradoxes of structural adjustment in the 1980s in Africa, observed by proponents and critics alike, was that the state was the primary focus of criticism by the World Bank and IMF for Africa's ills as well as their major vehicle of policy delivery. The 1980s pattern was to conditionally tie credit to civil service retrenchment targets. The claim was that this would help reduce government budget deficits and allow the country to meet IMF credit targets. Implicit in this problematic policy was the erroneous presumption that cutting back on "bloated" bureaucracies would somehow diminish the dysfunctional nature of state intervention while "freeing up" scarce human resources for the private sector.[15]

An important dimension of any development strategy is to understand the successful development process in other parts of the world. Unfortunately the proponents of adjustment have employed rational deductive methods and relied on axioms to interpret these comparative experiences in a manner that predetermines the importance of variables and their direction of causality.[16] In contrast, any comparative exercise should begin with facts to identify what can be generalized into a workable theoretical framework that will be a guide to generate policies and concepts concerned with the development and reform of markets.

Additional failures are linked to the spatially and temporally static nature of the neoclassical microfoundations. We have seen above that the focus of adjustment has been on removing distortions to create a state that is optimal and in equilibrium. However, development is a dynamic process involving change over time. The adjustment policies in Africa have been preoccupied with macroeconomic stabilization, constraining government spending and money supply to maintain ever-elusive momentary macrostability (as discussed above). The tie between this static state and the dynamic world of development, which involves the transformation of the polity, economy and society, cannot be properly addressed using neoclassical microfoundations. Since there is no relationship between momentary equilibrium and a future point in time and space, adjustment must rely on an axiomatic belief that price stability and government constraint will be conducive to a rise in private investment and an increase in the standard of living.

The emphasis on methodological individualism raises additional spatial questions related to the connection between individual decision making and higher outcome levels. The problem of aggregation is a very thorny one in all the social sciences. The challenge to the scholar is to trace the ways that choices and actions taken at one level of social action are systematically combined with the actions of others so that they constitute a new aggregate or entity. Development requires the transformation of policies, institutions and organizations. The neoclassical concepts underlying adjustment do little to connect these higher outcomes to choices at the individual levels. Even within the confines of their own definitions of individual motivation, neoclassicals must consider problems like free-riding and how economically efficient outcomes can arise when they might be contrary to the preferences of some individuals.

CONCLUSIONS: TOWARD A THEORY OF DEVELOPMENT AS A PROCESS OF STRUCTURAL TRANSFORMATION

In sub-Saharan Africa, structural adjustment programs have failed to build institutional and technological capabilities that would transform the structure of production and trade. Relying on axiomatic reasoning and rational deduction, theories and policies have been presented as universally applicable. 'Adjustment', due to its foundations, has failed to take into account the structural features of the economies where policies have been applied.

The supply-side policies of SAPs have little relation to the real structural and institutional constraints that are impediments to these economies. The pre-occupation of neoclassical theories with attaining 'static efficiency' through resource reallocation along the production possibility frontier, results in a misconception of the developmental challenges facing these economies. These economies are generally characterized by points inside the production possibility frontier with a substantial underemployment of resources relative to their real potential output. Their developmental aspirations lie in moving toward a full employment point on the production possibility frontier and then not only moving along the frontier but in pushing the production possibility frontier outward over time. The attainment of this latter goal calls for policies aimed at enhancing dynamic efficiency, not at meeting the Pareto optimality criteria of static efficiency.

In our view, the structural transformation of Africa's economies is a prerequisite for reversing Africa's economic malaise. Without structural transformation, macroeconomic stability cannot be achieved on a sustainable basis. Indeed, "Adjustment" 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 the 1980s.

Many governments in sub-Saharan Africa have experienced "a drastic erosion of their capacities to function as a state" [Mkandawire, 1998] due to policies that have perceived government as an agent that distorts and is opposed to the operations of markets. African states today are typically left in a fragile situation with a reduced institutional capability to function: the scope and quality of public social services and infrastructure have progressively deteriorated. Aron [1996] concludes that the state in Africa has come full circle to the *small* government of pre-colonial days, but with a seriously depleted and impaired institutional capacity to deliver social services and to build physical and social infrastructure.

The anti-statism, underlying SAPs and the Bank's "market friendly view," can be contrasted to the "market enhancing view" which has redefined and identified the role of governments in East Asian economic development [Aoki *et al.*, 1997]. It emphasizes the interplay between institutions and markets and recognizes the role of institutions in supporting the market deepening process in East Asian economic development. Instead of viewing the role of government and that of markets as mutually exclusive substitutes, the emerging perspective is one of complementarity between the two for the resolution of market failures and coordination problems. A critical role of governments is identified as enhancing the functioning of markets.

Institutional development and learning — the strengthening of organizational capabilities of economic agents and market deepening — are explicitly recognized as the critical aspects of economic development. Market deepening is interpreted here as the process of intensification of interactive relationships among agents and institutions, as individual agents undergo their own organizational evolution. It involves the development of institutional arrangements for network relationships among agents. This perception of markets is similar to that found in the institutional economics literature and hence, conceptually different from the perspective that underlies the conventional neoclassical paradigm.[17]

In contrast, institutional economics defines markets as broad institutional structures and arrangements that support and govern the process of exchange with an aim of minimizing transaction costs. It views both market and state as institutions that shape patterns of economic activity. It also recognizes that neither the state nor market is invariably the best way in which to organize the provision of goods and services.

Advancing the theory of imperfect information, Stiglitz [1989] also defines markets as an important set of institutions. More specifically, markets are viewed as institutionalized in environments characterized by imperfect, costly, and incomplete information. Hence, market participants incur transaction costs. The theory further emphasizes that in order for markets to function properly, appropriate governance mechanisms and arrangements are required to reduce agency problems arising out of opportunistic behavior such as moral hazard and adverse incentives.

Stiglitz' theory of imperfect information is in many aspects quite comparable to the analysis of such institutional economists as Coase and Williamson [Coase, 1992; Williamson, 1985; 1995]. They represent one end of the spectrum of the new institutional economics.[18] This school of new institutional economics adopts the neoclassical choice theoretical approach as a starting point of its microeconomic analysis. However, it criticizes the neoclassical model for failing to include the role of transaction costs in exchange and in its inability to explain the role of institutions in the formation and operation of markets, minimizing transaction costs, and reducing uncertainty. In their perspective, institutions are seen to be created and refined to deal with market failures, including those arising out of imperfect and costly information and agency and incentive problems.

However, the concept of market failure appears to be too restrictive to adequately address policy issues related to structural transformation. In our view, dynamic concepts of *market transformation* and *market construction* are needed to identify the real hindrances to structural transformation. In this respect, institutional economics as a whole has a much wider analytical scope: it embraces an interdisciplinary and historical approach to the examination of institutional and structural dimensions of economies. This approach emphasizes the micro-foundations of economies in their institutional environments and organizational governance structures and stresses the dynamic and evolutionary nature of economies [Toye, 1995].

In this dynamic framework, the sources of low growth are associated with the inability of economies to transform institutional structures in response to new technological and market opportunities. Institutional economics can offer a coherent account of the institutional changes necessary for economic development, and hence a set of tools to inform the design of institutional and policy alternatives for structural transformation.

This perspective is particularly pertinent to our quest for an appropriate theory of institutional and structural change aimed at enhancing the process of market transformation and capital accumulation. Analyzing markets as social institutions, North [1989] shows that markets have historically evolved and transformed over time in line with the increasing specialization and the expansion of the division of labor. With higher rates of return to the *formalization of markets*, long-term and multi-contract impersonal exchanges have developed. However, market transformation does not necessarily take place automatically. For markets to transform and graduate to a higher stage, an appropriate institutional environment and governance structure should be developed to reduce uncertainties and transaction costs.

As discussed in Nissanke and Aryeetey [1998a; 1998b], private agents in sub-Saharan Africa, operating in high-risk environments without effective insurance and credit markets, have used traditional social institutions and mechanisms, based on village and kin groups as surrogates. These arrangements have provided informal social safety nets and redistributional mechanisms. They have served as social and economic stabilizers and have displayed a remarkable degree of resilience and dynamism.

However, in the absence of functioning formal institutions, economic exchanges have been restricted to the interpersonal relations of small-scale production and local trade. Contract enforcement problems have been obviated through repeated dealing and cultural and social homogeneity. African economies appear to be locked into this low developmental stage where "a dense social network leads to the development of fairly stable informal structures, such as customs, trust and normative rules that give an informal institutional framework for organizing activities" [Aron, 1997].

A critical question for African economic development is how to create conditions where private agents operating in informal institutional arrangements feel prepared to move to more formal institutions that are more conducive to productive activities promising higher social and private returns. A key to this may be found in searching for mechanisms to reduce the *transformation risks* and *costs* as well as transaction costs. This can be achieved only when African countries are able to commit to long-term investment in social, human, and information capital to build institutional frameworks for sustainable development.

This African development agenda requires a theory of dynamic structural and institutional embeddedness, where the interrelationships among different institutions and organizations can be explicitly analyzed. As Evans [1995] argues in his thesis of *embedded autonomy*, the state depends on the activities of the private sector for its development project. The much vaunted autonomy of the state in the "Asian miracle" countries is embedded in a dense web of ties with both non-state and other state actors (internal and external) through which the state has been able to coordinate the economy and implement developmental objectives. In this interpretation of East Asian economic development, economic performance is explicitly treated as the outcome of interactions among different economic and non-economic public and private institutions.

In this framework, predatory and developmental states are seen as polar opposites on a continuum. Unlike the public choice view that bureaucracy is the source of predacity, embedded autonomy sees the paucity of bureaucracy as the major impediment to development. The absence of a Weberian bureaucracy with institutionalized rules and established norms of status and professionalism inhibits private capital accumulation. Ironically, when the market has thoroughly penetrated social consciousness and everything is for sale, personalism rather than collectivism governs state behavior. However, for development to occur, the bureaucracy must be more than Weberian caretakers and must initiate a Gershenkronian or Hirschmanian transformation. The project of capital accumulation must be almost invented. Lowering risk

is not sufficient. Entrepreneurship must be generated, encouraged and complemented. Also ironically the implied autonomy of the ideal neo-liberal state is historically most often associated with predacity. It is the lack of a linkage to the private sector that encourages states to prey on civil society. In contrast the developmental state combines the insulation of the Weberian bureaucracy with an "intense connection to the surrounding social structure" [Evans, 1995].[19]

Thus, in place of the static equilibrium analysis underlying structural adjustment programs, we propose to base policies for institutional and structural transformation in Africa on a new theory of dynamic, structural and institutional embeddedness. By nature this alternative framework engenders strategies and policies which relate to the concrete conditions of each African country. However it is possible to briefly elaborate with some general comments on what this means in practical terms.

Africa has become increasingly marginalized from the international economy. Moreover, structural adjustment policies have at best encouraged static comparative advantage with an emphasis on monoculture, cash crops, and resource extraction. However, global production increasingly emphasizes technologically intensive production; already low demand elasticities exist for traditional African products. Both of these structural phenomena will continue to put downward pressure on traditional African export prices. African countries need to diversify their exports and to create new comparative advantages which will give them greater access to global markets.

To participate in global flows of trade, investment and communications, African countries need to generate new capacities, incentives, regulations, organizations, and institutions. The aim is towards the enhancement of competitiveness, economic diversity, economic depth and economic linkages. All of these dimensions are important. Competitiveness might mean increasing participation in the global economy, but unless there is depth, diversity and linkage effects, dualism or enclaves might arise (e.g., successful free trade zones are where mechanisms have been put in place to increase depth, diversity and linkages).

Policy must be both multifaceted and multi-leveled. For instance, competitiveness or increasing access to markets is really a product of the conditions that affect micro-, meso-, national and regional contexts. Policy must be formulated with each of these levels in mind. The starting point must be an assessment of existing conditions. The findings should provide input into private and public sector policy groups of economists and non-economists to derive concrete policy recommendations in each country. Public policy makers and private sector participation are important for legitimacy and the upward and downward flow of information that will permit policies to be effective. In some cases such as dealing with challenges of regional cooperation, a similar structure will be needed at the regional level.

To go beyond the donor-generated shor-termism of the adjustment period, every African country needs to have in place three operational medium and long-term policy frameworks for agriculture, for industry and for technology. While the latter is an important element of the first two, in the era of globalization it becomes a central part of the means to reverse Africa's marginalization. Policies, as they relate to education, labor, finance, foreign investment, trade etc., should be seen as feeding into the development of agriculture, industry, and technology in ways that increase competitiveness, depth, diversity, and linkages. The generation of policy frameworks allows one to transcend the arid often ideologically-driven dualities of states vs. markets, public vs. private, import substituting vs. export orientation, regulation vs. deregulation etc., to better reflect the complex relationships that are an integral part of economies that will generate an improved standard of living for the majority of its population (the ultimate test of a development strategy, which structural adjustment has badly failed).

We contend that this approach will overcome the failures of adjustment outlined above. As we showed, behavioral and interactive failures are addressed by postulating the existence of *homo-sociologicus* which posits individuals as transformative social beings connected to the broader domain of institutional and structural transformation. The scope of development is expanded to incorporate a dense web of transformational prerequisites. Terms are carefully defined contextually to reflect the exigencies of the framework. Development is presented as a dynamic process in contrast to the static nature of adjustment. Finally, the approach avoids rational deductive interpretations of development and draws on a growing body of well-founded concrete studies of experience elsewhere.

Our agenda is challenging and imperative given the ongoing crisis in Africa and the failure of past policies. Future work should cover such issues as transforming trade, industry, agriculture and finance as well as the industrial-agricultural-financial nexus, firmly anchored in institutional development of markets, the state and entrepreneurship. Ultimately the cogency of our framework can only be tested through the generation of alternative policies that are proven to be viable. This is the daunting task ahead.

NOTES

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1. Approaches used in the empirical assessment of the impact of SAPs include: "before and after" comparison; the approach comparing program countries with non-program countries; the decomposition approach; and analysis based on CGE and SAM models with and without simulations [Stein, 1999b]. For a critical review of the statistical analysis employed in the Bank's assessments in the early 1990s, see Mosley, Subasat and Weeks [1995].
2. UNCTAD [1998] reports that there was a downward convergence of growth rates during these crisis years and that among 47 countries in sub-Saharan Africa, only nine countries had positive per capita growth and of these only in Botswana and Mauritius was growth sufficient to tackle the challenges of economic development and poverty alleviation.
3. For a more detailed discussion on summary statistics of these broad development indicators, see Nissanke and Aryeetey [1998a].
4. There are problems with the consistency between the subcomponents of these neoclassical microfoundations. It has been widely recognized as early as the 30s by people like Oskar Morgenstern and Friedrich Hayek, that equilibrium was not consistent with instrumental or substantive rationality due to self-referential problems. The argument was that any rational agent will base their decisions partly on the expectations or predictions of what other agents will do, but their predictions will be based partly on what the first agent will do and so on. This creates a self-referential problem, which leads to an infinite regress, a vicious circle or a dogmatic interruption. Thus there is no consistent, non-contradictory or non *ad hoc* solution. A good discussion of these issues is found in Knudsen [1993].

5. The literature on economic methodology has become very rich in recent decades. It is widely recognized that neoclassical economics almost never practices Popperian falsificationism and has a core set of propositions that are never altered in the face of counter evidence. Some explain this in terms of Lakatos' work on the methodology of scientific research programs, which consists of a hard core of irrefutable propositions, positive heuristics which give instructions on what tools and questions should be selected and finally a protective belt of theories, empirical conventions and auxilary hypotheses. For a discussion of the merit of Lakatos' work and related issues see Weintraub [1985], Hands [1993,] Knudsen [1993], and Hausman [1994]. Perhaps the more relevant question posed by Rosenberg [1994] is why economists continue to use a poor set of core propositions. He suggests the reasons are normative, e.g., general equilibrium theory shows how self-interest ought to lead to a coherent disposition of resources. Like Euclidian geometry, it provides an axiomatic system that can explain some phenomena for reasons that have little to do with its microfoundations, e.g., higher prices can lead to lower demand even though consumer preference theory is conceptually problematic.
6. Neoclassical economics, of course, has an extensive empirical literature. In the face of empirical studies which challenge fundamental theories, economists operating in this tradition try to generate alternative studies to present countervailing evidence to support the theories, come up with new explanations that are aimed at rescuing theories, or simply ignore the evidence. A good example is the massive literature spawned in the wake of the Leontief paradox. However literature that affirms the axioms is quickly incorporated into the liturgy. The World Bank frequently has taken a similar approach (See for example their selective citations on financial liberalization in World Bank[1994, ch. 4]).
7. This line of reasoning includes the standard neo-classical trade theory and the financial repression theory.
8. From 1984 to 1996 aggregate net private capital flows (FDI, portfolio capital and private bank loans for export credit) to sub-Saharan Africa (excluding South Africa) from OECD countries were only $79 million. This is a pathetic response to the supposed incentives for foreign investment created by adjustment [Stein, 1999a].
9. The recent United Nations Conference on Trade and Development Report estimates that world prices for most commodities exported by sub-Saharan Africa were at historically low levels in the late 1980s and early 1990s. The terms of trade of the sub-Saharan African non-oil countries fell by more than one third between 1977 and 1993. Thus, in 1993, the sub-Saharan African countries would have needed to increase the volume of their exports by more than 50 percent above their 1977 level in order to be able to import the same volume of goods as in that year. Furthermore, for the region as a whole and for most sub-Saharan African countries individually, the additional resource flows were not sufficient to offset the impact of terms-of-trade losses on foreign exchange earnings, let alone the increased debt service. Between 1980 and 1990, there was a GDP loss in sub-Saharan Africa of $16.4 billion due to the terms of trade, and an ODA net inflow of $2.4 billion, which shows that less than 15 per cent of the terms-of-trade losses were compensated by ODA [UNCTAD, 1998 pp.121-123].
10. The financial repression school challenged the Keynesian proposition that lower interest rates lead to increased investment and a high rate of output/income growth and savings. It argued the reverse causality: a higher market-determined interest would induce higher savings, leading to increased quality and quantity of investment and to faster output growth and consequently more financial savings and eventually a lower equilibrium interest rate.
11. Weeks [1998] shows that the adjustment period in Africa has been associated with a statistically significant rise in inflation compared to earlier periods.
12. For instance, see the examples provided by Barrows and Roth [1990].
13. Thus Robert Bates [1991], a prominent rational choice theorist, argues that kinship arises in semi-arid regions among cattle owners such as the Luo where risk diversification is useful, but private property and household accumulation occurs in low-risk fertile areas such as the highland regions of Kenya. But Pauline Peters points out "Bates' propositions are..empirically unfounded...In Southern Africa, the high-risk environment produces a range of adaptation among cattle-keepers, from Heroro with patrilocal homesteads and a social organization where individuals gain rights to pastures...to

Tswana with their hierarchical kingdoms where access to resources was as much through subordination and servitude as through peer relationship through kin or residential groups...If the different socio-political systems of the Tswana kingdoms or the Nuer or Luo lineage types can be explained as the outcomes of risk avoidance, we have not explained much!" [Peters 1993, 1073].

14. For instance, all of non-tariff barriers must be translated into tariffs that are then lowered and equalized to avoid distortions. See the discussion of protectionism in Meier and Steel [1987].
15. In a 1993 speech, Edward Jaycox, the former World Bank vice president for Africa, admitted that the state retraction strategy simply "ha[d]n't worked" [Jaycox 1993, 26]. Money had not been saved and laid-off labor had not stimulated economic growth. Dia [1994] argued in another Bank document that retrenchment seriously undermined the already problematic operational capacity of African states. Retrenchment often retired the most experienced personnel, limited the entry of youthfully energetic and inexpensive new recruits, and compressed and reduced wages, making the civil service unattractive to the most talented people while generating apathy and discontent.
16. The reasoning is syllogistic because if undistorted markets are what underlies successful growth and development, since areas like East Asia have 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 specialize according to their comparative advantage. 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 "East Asian Miracle" study and has been used by the World Bank to justify using structural adjustment in Africa. A detailed discussion of these issues can be found in Stein [1995b].
17. For a summary discussion of how these issues are treated in the "market enhancing view" and within institutional economics, see Nissanke and Aryeetey [1998a].
18. According to Harriss *et al.* [1995] and Stein [1995a], there are two schools of institutionalism in economics: the old institutional economics and the new institutional economics. In contrast to the position taken by the latter school, the old institutional economics rejects the neoclassical assumption of rational-maximizing atomistic agents and takes organizations and entities, operating in a complex historically specific environment of social, economic and legal institutions, as the unit of analysis.
19. Evans [1995] lays out a useful set of governmental roles for understanding the potential intervention of the developmental state. This includes the state as "custodian" which formulates rules which are both promotional and preventative and as "demiurge" which provides for the direct intervention in the production of private goods due to gaps in the private sector. The state should also be involved in "midwifery" which deals with the birth of new entrepreneurial groups and in "husbandry" which deals with cajoling and assisting private sector groups in meeting the ongoing challenges of a dynamic world. This is a much richer set of concepts for understanding the nature of the state in developing countries than the Banks' very passive-neutral framework, which includes "accountability", "transparency" and the "rule of law".

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