POLICY REFORMS AND ECONOMIC DEVELOPMENT: AN INSTITUTIONAL PERSPECTIVE ON THE NIGERIAN EXPERIENCE (1986 TO 1993)

by

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submitted in accordance with the requirements
for the degree of

DOCTOR OF COMMERCE

in the subject

ECONOMICS

at the

UNIVERSITY OF SOUTH AFRICA

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NOVEMBER 1998

DEDICATION

Dedicated to my family

Student No: 3051-614-5

I declare that ***Policy Reforms and Economic Development: An Institutional Perspective on the Nigerian Experience (1986 to1993)*** is my own work and that all the sources that I have used or quoted have been indicated and acknowledged by means of complete references.

A.O.K. Dipeolu

8 September 1998

ACKNOWLEDGMENTS

I hereby acknowledge the support, guidance and encouragement of:

- Prof. J. du P Smith, my promoter and Prof. J.A. Du Pisanie, my co-promoter;
- My parents, J.O. Dipeolu, C.A. Dipeolu, E.D Alalade , my wife, Omowale and children, Omowunmi, Odedeyi and Adediji;
- Friends who assisted in various ways, P. Onyebujoh, A.Oyateru, H-J. Chang, K. Elebute, Y. Osinbajo, F. Phillips; and
- Adri Labuschagne who assisted with editing.

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SUMMARY

Title: Policy Reforms and Economic Development: An Institutional Perspective on the Nigerian Experience

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Degree: Doctor of Commerce

Subject: Economics

Promoter: Prof. J. Du P Smith

Joint Promoter: Professor J.A. Du Pisane

African economies, including Nigeria continued to perform poorly despite the adoption of economic policy reforms in the 1980s. An explanation for the failure of economic policy reforms was therefore sought from an institutional perspective. Since active state intervention in the economy was the rationale given for the economic crisis of developing countries, the conventional case for an active state which rested on the need to correct for market failure was counterposed with the argument that the economy was best coordinated by market forces given that the state was not benevolent, omniscient or omnipotent. However, the state has played an important role in the transformation of late developers while a state-market dichotomy takes no account of institutional factors.

The widespread adoption of economic policy reforms owed more to an ideological shift in the development paradigm than to the debt crisis and there was a great deal of controversy about the theoretical foundations and impact of these reforms contrary to claims of a consensus. An institutionalist political economy which recognises that the market is not the only institution and that economic transformation requires the positive use of political power was proposed. Such an approach takes account of history, politics and the institutional diversity of capitalism. A more nuanced view of state intervention was therefore advocated. The importance of institutional arrangements in the quest for economic transformation underscored the inadequacy of structural adjustment which was hampered by the lack of price and institutional flexibility as well as other institutional constraints.

The Nigerian experience of structural adjustment shows that long term growth prospects were not enhanced and that the reforms tended to favour the financial sector over the real sector. The failure of economic policy reforms in Nigeria can be attributed to the continued presence of constraining institutional factors and the absence of a positive use of political power.

Title of Thesis:

POLICY REFORMS AND ECONOMIC DEVELOPMENT: AN INSTITUTIONAL PERSPECTIVE ON THE NIGERIAN EXPERIENCE

Key terms:

Economic policy reforms; Structural adjustment programmes; Role of the state; Institutional economics; State capacity; Institutional political economy; Institutional diversity of capitalism; Institutions and development; Policy reforms and institutions; Structural adjustment in Nigeria

CHAPTER ONE

COMPETING EXPLANATIONS FOR ECONOMIC STAGNATION IN DEVELOPING COUNTRIES

1.1 BACKGROUND

Over a decade and a half have elapsed since structural adjustment programmes became the standard response to the economic crisis which engulfed developing countries in the early 1980s (Mosley 1995: 700). In spite of this, economic growth has been elusive or patchy, especially in Africa. For instance, Gordon (1996: 1527) notes that: "While the successes of structural adjustment efforts[1] in Africa are important, the overall results of economic reform have been less than encouraging".

It is a matter of intellectual curiosity why this should be the case as structural adjustment policies were widely seen as a panacea for the economic problems of developing countries. Several arguments are usually advanced to explain the poor record of economic policy reforms in Africa. Explanations such as the need for more time, poor implementation and inadequate financing are not very convincing in the sense that they imply that the structural adjustment package is unsuitable and unpredictable without explaining why this should be the case.

An entirely different perspective is to explore the impact and interaction of economic policy reforms on the institutional arrangement and investigate possible outcomes. In other words, the success of economic policy reforms may be dependent on some minimum of institutional arrangements which in turn may need to be fostered by the state. This thesis proposes to examine these issues from the

[1]It is of interest to observe that the allusion to success here is to efforts, not results.

perspective of a particular African country - Nigeria. In order to do so, however, there is a need to understand what the objective of economic policy in developing countries is, or should be.

1.2 THE SEARCH FOR CONDENSED GROWTH

Economic development remains the desired objective of developing countries and that in spite of increased globalisation and the wide-spread emergence of regional groupings, the national state is still the main source of policy decisions in such countries.

As Meier (1989: 5) notes, economic development is not easy to define and quite often the level of national per capita income is taken as a proxy for economic development. This approach is fraught with dangers as per capita income itself is plagued with difficulties related to the measurement of Gross Domestic Product (GDP) such as the extent of coverage of economic activity and changes in relative prices. Moreover, per capita income excludes other indicators of welfare such as basic needs and civil liberties.

Meier (1989: 6) argues that any definition of economic development will ultimately derive from preferred policy goals. He then offers a definition of economic development as a process whereby real per capita income of a country increases over a long period of time provided the number of people below the absolute poverty line does not increase and the distribution of income does not become more unequal.

Another definition is offered by the World Bank (1991: 31):

> ***"economic development is ... a sustainable increase in living standards that encompasses material consumption, education, health and environmental protection"***;

while Adedeji (1998: 3) argues for a:

"paradigm shift from purely materialistic economism to holistic, sustainable human development which encompasses economic growth, empowerment of people, environmental regeneration and economic justice".

These definitions throw light on the fact that the objective of development should be people centred. In addition, however, empirical evidence indicates that the development process has almost always been accompanied by a shift in the sectoral composition of output with a falling share of agriculture in production and employment and an increasing share of manufacturing and services.

This probably explains why Ohiorhenuan (1989: 1) simply opts to state that economic development involves sustained growth in real per capita income and structural change. In a similar vein, Syrquin (1995:43) states that the "process of economic growth entails ... a radical transformation in the structure of the economy". The same writer goes on to present some stylised facts associated with economic development. These are:

(i) growth is dependent on increased capital accumulation particularly at lower levels of income and the reallocation of factors from lower to higher productivity activities;

(ii) there are certain structural characteristics associated with various levels of development. For instance, between per capita incomes of under $300 and over $4000 the following characteristics prevail (refer Table 1.1):

TABLE 1.1 Shares of economic structure associated with levels of per capita income %			
Component of Economic Structure	Income per capita <$300 actual[a]	Income per capita >$4000 actual average[b]	Total Change
A. Final Demand			
Private consumption	79	60	-19
Govt. consumption	12	14	2
Investment	14	26	12
Exports	16	23	7
Imports	21	23	2
Food consumption	39	15	-24
B. Trade			
Merchandise exports	14	18	4
Primary	13	7	-6
Fuels	3	2	-1
Other	10	5	-5
Manufacturing	1	11	10
Merchandise imports	16	19	3
Primary	5	7	2
Manufacturing	11	12	2
C. Production (value added)			
Agriculture	48	7	-41
Mining	1	1	0
Manufacturing	10	28	18
Construction	4	7	3
Utilities	6	10	4
Services	31	47	16
D. Labour force			
Agriculture	81	13	-68
Industry	7	40	33
Services	12	47	35

Source: Syrquin (1995: 46)

a) based on 1960-1972 period for countries with per capita income less than $300 in 1970

b) based on 1960-1972 period for countries with per capita income greater than $4000 in 1970

on the demand side:

- the share of private consumption in final demand tends to fall from an average of 79% of a $300 per capita income to 60% of a $4000 per capita income while the share of investment tends to rise from 14% to 26%, respectively
- the share of trade (imports and exports) tends to rise from 37% of final demand at the US$300 per capita income level to 46% at the $4000 per capita income level

on the trade side:

- the manufacturing share of merchandise exports tends to rise higher than the general rise in exports during the move from a $300 per capita income to a $4000 per capita income, changing by 10% as compared to a 4% increase in the latter

on the production side:

- the share of agriculture in production tends to fall sharply from 48% at the lower per capita income level to 7% at the higher per capita income level
- the share of manufacturing in production tends to rise sharply from 10% to 28% between both levels of per capita income
- the share of services in production also tends to rise sharply

on the employment side:

- the share of agriculture in employment tends to decline sharply from 81% of the workforce at the US$300 per capita income level to 13% of the workforce at the US$4000 per capita income level
- the share of manufacturing in employment tends to rise sharply from 7% to 40% of the workforce between both average income levels given in the table
- the share of services in employment also tends to rise sharply;

(iii) the overall economic and institutional environment is important in explaining general levels of productivity growth because time series and cross-sectional studies have shown that total factor productivity across sectors for a given country or period tends

to be highly uniform. The table does not show the amount of time required for the structural change associated with economic growth. However, Inukai (1993:16) demonstrates that the number of years required for latecomer economies to double per capita income (PCY) - condensed growth - has grown shorter and shorter over time. This process may be easier visualised in Table 1.2:

TABLE 1.2. An Illustration of Condensed Growth

Country	Years to double PCY	Period
United Kingdom	58	1780-1838
United States	47	1839-1886
Japan	34	1885-1919
Turkey	20	1957-1977
South Korea	11	1966-1977
China	10	1977-1987

Source: Inukai (1993:16)

Dore (1989:103-104) makes a similar observation when he reports that Germany grew faster than Britain in the first fifty years of industrialisation while Japan grew faster than Germany and Korea grew faster than Japan over a similar fifty year period.

Given that condensed growth is a major objective of developing economies, it becomes important to attempt to understand the role of economic policy in bringing about this outcome. It is of immediate concern, however, to outline economic performance in Nigeria against the background of this objective.

1.3 UNSATISFACTORY ECONOMIC PERFORMANCE IN NIGERIA

Economic performance in Nigeria has not lived up to the promise of the early post-independence years. Economic conditions have deteriorated sharply since 1980 in spite of a structural adjustment programme adopted in 1986.

Gross Domestic Product grew by a mere 2.7% between 1980 and 1993 as compared to a growth rate of 4.6% between 1970 and 1980[2]. More significantly, GDP per capita declined from $1010 in 1980 to $300 in 1993. This latter figure was lower than the per capita income of $430 which was obtained in 1970 (Mosley 1992: 228). Latest available figures indicate that Gross Domestic Product grew by 2.17% in 1995 (Federal Government of Nigeria 1996: 2). However, this modest growth is much lower than the estimated annual population growth rate of 2.9% in 1993.

Nigeria's total external debt rose from $8.9 billion in 1980 to $33.5 billion in 1991 before falling to $32.5 billion in 1993 (World Bank 1995: 200). The overall balance of payments has been in deficit since 1980, which may not be surprising given the sharp fall in total export revenues from $26 billion in 1980 to as low as $6.4 billion in 1986 (Faruqee 1994: 269). Petroleum exports, on which Nigeria is dependent for over 90% of export revenue, have been particularly hard hit, falling from $25 billion in 1980 to $7.89 billion in 1995 (Federal Government of Nigeria 1996: 25). The negative effect of such a sharp fall in exports on import capacity is self-evident.

Investment and socio-economic conditions were not any better. Investment as a share of GDP fell from an average of 18.5% in the period 1973 to 1980 to 12.4% from 1986 to 1990 (Faruqee 1994: 269). From another perspective, while gross domestic investment grew by an annual average of 11.4% between 1970 and 1980, it declined on average by 5.5% annually from 1980 to 1993. The primary school enrollment ratio fell from an average of 98% in 1978-80 to 70% in 1989 while that of secondary schools fell from a peak of 29% in 1985 to 19% in 1989 (Faruqee 1994: 279).

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[2]Figures in this section are obtained from the World Bank's World Development Report (1995) unless otherwise indicated.

In order to keep the discussion in context and as a basis for comparison, it is important to note that the situation was not much better for African countries as a whole.[3] The period 1980 to 1993 was a very dismal one for African economies.[4] For instance, in that period Gross Domestic Product grew by 1.6% as compared to a growth rate of 3.8% in the period 1970 to 1980. This growth performance also compared unfavourably with East Asia and South Asia which grew by 7.8% and 5.2%, respectively, in 1980 to 1993. The economic performance of Latin America, however, was only marginally better than Africa's at 1.9% (World Bank 1995: 165). In per capita terms the Gross National Product of African countries declined annually on average by 0.8% between 1980 and 1993 (World Bank 1995: 162). This was a result of the poor GDP growth rates as well as increased population growth rates. Africa's population during the period 1980 to 1993 grew by 2.9% as compared to 2.7% from 1970 to 1980 (World Bank 1995: 211).

Other economic indicators for Sub-Saharan Africa were similarly disappointing. Average inflation in the continent rose from an annual average of 13.8% in 1970-1980 to 16.1% in 1980-1993. External debt service as a percentage of exports rose from 11.6% in 1980 to 17.1% in 1993 while the total debt as a percentage of GNP was 47.4% in 1993 (World Bank 1995).

It is useful to investigate the reasons for Nigeria's poor economic performance, if only because the investigation of causes is a necessary prelude to the prescription of solutions. This is Moreno as there is the prospect of Nigeria, along with the rest of the continent, being left behind and mired in poverty while the rest of the developing world advances in leaps and bounds. Most worrisome, perhaps, is the fact that the period in which Africa's economic performance was most dismal was the era of structural adjustment. It remains a matter of intellectual curiosity why economic performance was not responding to prescribed solutions and to establish whether the prescriptions were actually implemented. Moreover, it is useful to know whether the institutional environment allowed for effective implementation.

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[3]Africa is used here and throughout the thesis as a basis for comparison because in spite of critical differences with our empirical case study, Nigeria, most African countries share certain similarities including elusive structural transformation, weak state structures, highly plural societies and monocultural economies

[4]For reasons of statistical and conventional convenience the term Africa is taken to refer only to Sub-Saharan Africa.

1.4 POSSIBLE EXPLANATIONS OF THE CRISIS

A number of explanations have been made for the poor performance of African economies, some of which can also be extended to Nigeria. These include historical circumstances, the negative impact of political conflict, a deteriorating external economic environment and poor policy choices.

1.4.1 Historical Circumstances: Colonialism

The immediate history of Africa is one of colonialism. Most of the countries in the continent experienced colonialism in one form or the other and only gained independence in the late 1950s and early 1960s. It has been argued that the colonial experience explains the poor economic situation of most African countries. This is ascribed to the fact that the colonising powers neglected the development of the human resource base and physical infrastructure of their colonial territories nor promoted the industrialisation of such colonies using them, instead, as a source of cheap primary commodities (Ade-Ajayi 1995: 39).

An extension of this view is that the economic structures left behind were neo-colonial and intended to keep African economies dependent on the industrial economies (Abdel Fadil 1989: 65-67). Such dependence was *inter alia* manifest in : trade links which made African economies dependent on the export of raw materials for their foreign exchange needs, financial ties which made African countries dependent on foreign direct investment, official development assistance and external loans, technological dependence arising from the demand for Western capital and consumer goods without the knowledge or skills required to produce or maintain such items (Szentes 1983: 205-247).

There are, of course, those who would question the notion that colonialism was a negative experience for African countries. After all, it was such contact that brought Africa the benefits of Western education, medicine and technology. The monetisation of the economy and the establishment of financial systems in colonies could also be mentioned in this regard. It could be pointed out, moreover, that the demand for commodity exports contributed to the economic development of colonies through the gains from trade. Moreover, obviously successful economies

such as the United States, Australia, Canada and the newly industrialising states of East Asia have been colonies sometime in their history (Bauer 1971: 145-150).

The colonial process in Africa began around 1886, the year of the Berlin Conference on the partition of Africa. This was just over seventy years to 1957 when the first Sub-Saharan African colony, Ghana, obtained independence. Defenders of colonialism could argue that the period was too short to enable the establishment of enduring socio-economic structures and institutions.

Holding colonialism solely responsible for Africa's economic woes may not be a very useful approach because it does not provide a basis for workable solutions. After all, many African countries have been independent for almost thirty years, about half of the period of colonialism on the continent. Surely, the criticisms of colonialism would apply with equal force to post-independence Africa. Nevertheless, it must be borne in mind that a critical result of colonialism was the creation of highly contested plural societies which have had an enduring impact on present day economic performance.

1.4.2 Historical Circumstances: Small Economies

Another historically related explanation offered for Africa's poor economic situation is the small size of most of its economies. The colonial partition of the continent resulted in small and weak economies which complicate developmental prospects.

Meier and Steel (1989: 6) point out that the small population and low per capita income of most countries in Africa does not give them much scope for industrial development. This is due to the fact that most industries require markets which are larger than the size of most African countries. For instance, the average Gross Domestic Product of an African country is about $3.4 billion while the per capita income is $311 (United Nations 1995: 38). The average GDP is minuscule compared to the annual turnover of some multilateral corporations.

Small African markets limit the potential economies of scale which encourage industrial production. Consequently, the amount of foreign direct investment which can be attracted to individual African

countries is unlikely to be substantial. The potential of regional economic integration has led to the conclusion of a number of treaties establishing regional groupings amongst African countries. These include the Economic Community of West African States (ECOWAS), the Common Market of East and Southern African States (COMESA), the Southern African Development Community (SADC) and, indeed, a continental effort in the African Economic Community. Not much progress, however, has been made in the integration of markets for factors and commodities. With a population of over 90 million people, Nigeria cannot, however, be said to face a similar constraint although its low per capita income still makes for a relatively small market.

1.4.3 Political Instability

Most, if not all, African countries have experienced some form of political instability or the other since independence. Such incidents include coups, civil wars, internal strife, internal conflict, external destabilisation or external wars. Nigeria, in particular, has experienced one civil war, six successful and several unsuccessful coup attempts, religious and communal riots as well as border clashes with neighbouring states.

Political conflict, of which wars are the ultimate example, has a number of consequences for economic performance. Apart from the obvious but unquantifiable effects of uncertainty, such as investments not undertaken, Green (1991: 245) identifies eight economic components of the cost of war. These are:

(i) excess military expenditure, especially its foreign exchange component;
(ii) direct war damage;
(iii) non-maintenance or non-replacement of capital stock as a result of competing war expenditure;
(iv) the multiplier (divider) effect of the three previous items on non-military GDP;
(v) economic spillover costs from wars in adjacent countries, such as transport blockages and refugee inflows;
(vi) the shock impact of a large, sudden leap in war costs with analogous effects to a sharp deterioration in the terms of trade;

(vii) strategic and policy distraction from macro and sectoral economic strategy; and,

(viii) priority allocation of skilled personnel to military institutions at the expense of the civil sector.

Green (1991: 243) also estimates that such costs may have, for example, resulted in Tanzania losing at least 2% to 3% of potential annual growth in GDP and Mozambique having a GDP that was half its achievable level.

In addition to macroeconomic costs, there are also human costs such as the loss of life and limb due to combat, starvation and epidemics. The problem of refugees, especially their protection and maintenance, is another aspect of the potential fall out from political conflicts.

Quite obviously, sustained economic development is highly unlikely to take place in the kind of circumstances described above. However, Green (1986: 258) makes an interesting attempt to find links between wars and the adoption of economic policy reforms in Africa and does not find any plausible links. He, nevertheless, concedes that lesser occurrences like civil disorder may have resulted from such reforms in Zambia in 1986 and Sudan in 1985 and 1989. This was certainly the case in Nigeria where the structural adjustment programme adopted in 1986 led to strikes, demonstrations and riots in 1988 and 1989 (Faruqee 1994: 246). It must be remembered, moreover, that the absence of war is, by itself, no guarantee of economic progress.

1.4.4 External Factors

African countries are highly dependent on the export of commodity products for their foreign exchange and government revenues. Onitiri (1995: 146) reports that a majority of African countries derive more than 80% of their export earnings from primary commodity exports. It is, therefore, argued that African economies are particularly vulnerable to the vagaries of the international economic environment. This is attributable to a number of factors, including one of the early paradigms of development economics, the Prebisch-Singer hypothesis. The hypothesis held that primary commodity exporters faced a secular decline in their terms of trade vis-à-vis exporters of manufactured goods. As such, developing countries were bound to face constraints in their foreign exchange requirements with particularly negative effects on their import capacity. The solution, therefore, was seen as import-substituting industrialisation (ISI).

Savings in developing countries were also considered inadequate to finance the investment for capital formation without which industrialisation could not take place. Accordingly, developing countries relied on foreign sources such as official development assistance, foreign direct investment and foreign loans to bridge the savings gap.

The vulnerability of developing countries to the international economic environment was exacerbated by the 1979 oil shock and the 1980/81 recession in the industrial economies. Increased import bills, reduced demand for primary commodity exports and historically high interest rates combined to squeeze the foreign exchange earnings of non-oil exporting African countries (Singh 1986: 280).

The strong impact of external factors on developing countries in an increasingly dependent world is undeniable. However, blaming the external environment for economic crisis in Africa does not address the need for the continent to review its policies and their implementation in the face of sustained crisis. Moreover, as Onitiri (1995: 151) has pointed out, Africa's share of the world market for its major exports has been falling since 1970. The question then is how did other developing countries avoid a similar fate?

In the specific case of Nigeria, external factors could have contributed to its economic crisis, if the view that falling oil prices had a negative effect on domestic growth is accepted. However, since the country benefitted from massive oil revenues which should have resolved any problems of a foreign exchange or savings constraint, blaming external factors is a weak argument. In any case, Indonesia which is also a major oil exporter with a large population of 187 million, managed to weather the storm. In the period from 1970 to 1993, Indonesia's Gross Domestic Product grew from $9.6 billion to $144.7 billion as compared with Nigeria where GDP only grew from $11.5 billion to $31.3 billion. Indonesia also managed an annual growth of GDP per capita of 4.2% from 1980 to 1993 (World Bank 1995).

1.4.5 Over-extended State

The World Bank publication, *Accelerated Development in Sub-Saharan Africa* (World Bank,1981), also known as the Berg Report, is typical of those who believe that Africa's poor performance was due mainly to its domestic policies which reflected a bias for state-led development. With regard to Nigeria in particular, the World Bank (1994: 32) explained its poor performance compared to Indonesia as being due to poor domestic policies.

There were two aspects to such criticism, namely, the dirigiste policies of African governments as well as the predatory nature of the African state. African economies were seen as being biased against agriculture and exports and favouring national planning, trade and exchange controls, marketing boards and price controls as well as state ownership of enterprises.

On the other hand, the African state was seen as being more concerned with regime survival than in implementing appropriate policies for development. Mars (1986: 16) concludes from the evidence of post-independence Africa, that:

> ***"There is first of all the perception of an inability to attain goals that public organisations have set. Secondly, there is the gross abuse of state resources for personal advantage...Thirdly, state activity is often not merely ineffective, but often startlingly disruptive and destructive, making life more difficult by undermining existing arrangements without putting anything in their place".***

1.5 UNANSWERED QUESTIONS

The last explanation for the origins of economic crisis in Africa appears to have prevailed. Structural adjustment policies urged by the international finance institutions and the international donor community have been adopted in many African countries. However, the statistical evidence produced at the beginning of this chapter shows that economic conditions remained poor and may actually have worsened from 1980. Yet, this was the period in which economic policy reforms based on stabilisation and structural adjustment policies became the norm in most African countries. The situation is not remedied by resorting to excuses such as 'lack of implementation'. As Toye (1994: 32) has pointed out, implementability must be an integral part of any proposed solutions to a policy problem. It is the height of eccentricity for a starving man in Alexandria (a Johannesburg township) to draw up elaborate plans to purchase a mansion in Hollywood, California. Stiglitz (1996: 155) describes such arguments in the following way: "To be sure, like medieval medicine, there was always the allegation that the patient had not followed the doctor's orders precisely, and it was this that accounted for the failure of the remedy".

To recapitulate, a number of questions remain to be answered. For instance, why have structural adjustment programmes not restored sustained economic growth in Africa? In particular, what are the consequences of weakening state capacities when the minimum conditions for efficient market exchange have not been established? One possible answer is that economic policy reforms are dependent on some minimum of institutional arrangements. For example, since one of the objectives of structural adjustment programmes is to restore economic growth, increased investment is a necessary condition for the success of such packages. However, investment is heavily dependent on the property rights structure and may be negatively affected by the higher transactions costs of increased uncertainty. Or to quote Coase (1991: 718):

> ***"It makes little sense for economists to discuss the process of exchange without specifying the institutional setting within which the trading takes place since this affects the incentives to produce and the costs of transacting".***

More generally, work in institutional economics has underscored the importance of institutions in the development process (North 1981, 1989, 1990; Chang 1994a; Evans 1995). Furthermore, it is

maintained that an institutional perspective may better explain the process of economic development in developing countries. This idea is well captured by Onis (1991: 110) when he states that:

> ***"the central thesis associated with the newly emerging counter-critique which we might classify as '<u>institutionalist</u>'*** **(emphasis added)** ***is that the phenomenon of late development should be understood as a process in which states have played a strategic role in taming domestic and international market forces and harnessing them to national ends".***

There is a whole array of institutions which impact on economic development including *inter alia* property relations, contractual relations, organisation of production, and the financial system. However, the important role of the state as a key shaper of institutions makes it an important contributor to the institutional environment (Bromley 1993: 138). Yet the proponents of economic policy reform placed great emphasis on reducing the role of the state (Bates and Krueger 1993: 5). Given the fact that economic policy reforms became the dominant economic paradigm of the period and institutional arrangements are deemed important in the development process, there were bound to be implications for the economic transformation of developing countries from the effort to reduce the role of the state. As such, this thesis will focus primarily on the institutional role of the state and its impact and interaction with economic policy reforms.

Again as Onis (1991: 110) puts it, there is need for focus on the:

> ***"differences in the ways that market oriented or capitalist economies are organised and towards how these organisational differences contribute to the contrasts in both policies implemented and subsequent economic performance".***

How can the insights of this approach help to explain the inadequacy of economic policy reform in Africa? For instance, how do economic reform policies impact on existing institutions? If opportunistic behaviour has assumed normative proportions, do structural adjustment policies help to reverse such instincts or serve to accentuate them? This thesis will investigate whether or not economic policy reforms were sufficient as a paradigm to bring about economic transformation using the Nigerian experience as a basis for empirical study. The hypothesis is that economic policy

reforms in a developing country like Nigeria is inadequate without taking account of institutional factors and constraints.

1.6 THE SIGNIFICANCE OF NIGERIA

This thesis proposes to look at these questions from the perspective of a particular African country - Nigeria. This country has been chosen because:

(i) it is a developing country which implemented economic policy reforms;

(ii) it has the largest population in Africa of 88.4 million (1991 census). This is about one-fifth of the continental population and gives Nigeria significant statistical weight in any assessment of Africa's economic performance;

(iii) it has been affected in one way or the other by all the factors usually advanced, namely colonialism, political strife, dependence on one export commodity and state-led development. Further, Nigeria cannot claim to have suffered from a small market or poor export earnings and should have proved the exception to the rule, if such excuses were valid;

(iv) it experienced continued economic crisis over ten years after adopting economic policy reforms in 1986; and,

(v) the first phase of policy reforms in Nigeria were carried out before being abruptly abandoned in January 1994 and thus provides a discrete period within which the impact of policy reforms could be analysed.

1.7 METHODOLOGY AND SCOPE OF STUDY

Arising from the dual interest of the thesis on the institutional role of the state and on economic policy reforms, the thesis will begin with a literature review on the conventional role of the state as well as on the debate on structural adjustment policy. This will be followed by an analytical assessment of conventional approaches and their inadequacies. Following from this, the thesis proposes to formulate two frameworks within which the impact of structural adjustment can be assessed. The first framework would be used for assessing the minimum institutional role of the state and whether this role was played during the period of economic policy reform while the second

framework will outline institutionalist considerations which may influence the outcome of structural adjustment policies in developing countries. Thereafter, the thesis will undertake an empirical study of Nigeria in the period 1986 to 1993 along these lines.

The period chosen for the thesis reflects a discrete period in which economic policy reforms were adopted in Nigeria before being abruptly abandoned in January 1994. It also roughly coincides with the period of the Babangida administration which bucked the trend of previous regimes by adopting a structural adjustment programme in the face of strong domestic opposition. Coincidentally, when the research was begun 1993 was also the latest period for which data was available.

The research will use data series beginning from 1979 for several reasons despite a brief summary of economic trends in Nigeria since independence in 1960. This is due to the fact that the intention is to highlight the sharp fall in Nigeria's economic fortunes from 1980 when it earned record revenues from oil exports to 1985 the period just before a structural adjustment programme was adopted. In any case, due to serious problems of data emanating from Nigeria, too long a series may be misleading without adding much to the analysis. In this respect, the work of Stolper (1966) entitled '*Planning Without Facts*' and Mosley (1992) '*Policy Making without Facts*' which show the difficulties of working with data in Nigeria are relevant. In any case, 1980 is identified with the beginning of economic policy reforms as a new development paradigm, while the global debt crisis is generally agreed to have emerged in 1982. This therefore makes the period a good starting point for addressing the emergence of economic crisis in Nigeria.

The scope of the thesis will be limited to economic outcomes as well as underlying political factors. Specifically, the adequacy of economic policy reforms as a means of bringing about structural change will be explored with the use of economic data. Most of the literature on Nigerian political economy is rather anecdotal and opinionated. For instance, Momoh (1996: 21) states that in Nigeria "... the current SAP policies have thrown up the so called 'New breed' politking against the 'old breed', and has created an opportunistic 'SAP political class' that was nothing other than a hallelujah political class having benefitted from the 'settlement' or largess and pilfering outlets created in the economy by Babangida". This statement may be true but there is no attempt to prove it or back it with concrete evidence. Similarly, the same author (Momoh 1996: 22) asserts that

"SAP has not improved the Nigerian economy and indeed has left it worse off, the debt crisis has assumed a monumental dimension, in industry there is low capacity utilisation, the peasantry has been further pauperized, the working class social condition has fast deteriorated ...". Again, there is no attempt to provide empirical evidence of these observations.

The data to be used in the study includes macroeconomic data such as growth in Gross Domestic Product (GDP), trend of per capita GDP, trend and changes in exchange rates, interest rates, inflation, unemployment, government revenue and expenditure patterns, external debt and external trade activity. These will illustrate the performance of the Nigerian economy prior to and during the period of structural adjustment. Additional data to be used will be oil sector data pertaining to Nigeria prior to and during structural adjustment. This is because of the importance of oil to the Nigerian economy particularly for government and export revenue. As such, data such as production figures, oil export figures and export revenue figures will be drawn upon to highlight role of oil in the Nigerian economy. The structure of the Nigerian economy prior to and during structural adjustment especially the share of agriculture, finance and manufacturing will be used to investigate whether structural adjustment policy favoured economic transformation and in which direction.

Data for the empirical part of the thesis will be sourced as much as possible, bearing in mind the institutional poverty of data in Nigeria, from the World Bank which has a fairly consistent data series on Nigeria in the World Development Report, African Development Indicators and specific country studies on Nigeria. In addition, data will be drawn from Moser et. al (1997) which is an IMF publication and provides additional data on Nigeria which is also consistent with World Bank data. The International Petroleum Encyclopedia an annual publication which compiles extensive data on the international petroleum industry will be used to source data on the oil sector in Nigeria. The thesis will also utilise secondary data where primary data is difficult to source and also to illustrate points made by other writers especially in the literature review and analytical sections of the paper.

1.8 OUTLINE OF THESIS

Chapter Two will focus on the debate on the role of the state. The conventional opposing views on state intervention will be examined and reasons will be proffered to explain why they are deemed inadequate for explaining or locating the full role of the state in the development process.

Chapter Three will re-examine the reasons for widespread adoption of economic policy reforms in developing countries, particularly in Africa, as well as the controversy surrounding such programmes.

In Chapter Four, it is intended to identify the core elements of an institutionalist political economy, especially the way in which the state assists or impedes the actualisation of the institutions which are crucial in the development process.

An attempt will be made in Chapter Five to investigate the linkages between the core elements of the policy reform package and institutional factors and to analyse the interaction between these two factors from theoretical and empirical perspectives.

In Chapter Six, the experience of Nigeria will be examined within the framework developed in the preceding chapters. The intention would be to derive a plausible explanation for the unsatisfactory results of Nigeria's structural adjustment programme.

The summary, conclusions and implications of the study will form Chapter Seven, which is the last chapter.

CHAPTER TWO

THE CONVENTIONAL DEBATE ON STATE INTERVENTION

It was noted in the previous chapter that structural adjustment programmes were urged on developing countries by economists and multilateral institutions who felt that over-extended state structures were responsible for their poor economic performance. This chapter seeks to review both sides of the conventional debate about the role of the state in economic development. The first section looks at the standard argument made for state intervention in developing countries which evolved from welfare economics in the post Second World War era. The second section is then devoted to understanding the type of policy regime brought about or attributed to the influence of the early development economics. This will be followed in the third part of the chapter by a restatement of the negative view of state intervention, especially its limited ability to influence events and on the questionable motives of state agents. The final section summarises the debate and sets the stage for an examination of the economic policy reforms which are discussed in chapter three.

2.1 THE STANDARD CASE FOR STATE INTERVENTION

The conventional case for state intervention in developing countries is theoretically grounded in the possibility of market failure and supported by the empirical evidence of successful state intervention in some industrialised countries as well as the moderating influence on state action.

2.1.1 Correcting for Market Failure

In order to discuss what market failure entails, it is useful to clarify in which sense the term is being used. A precise definition of the market is difficult because the term has geographical, product,

legal and time dimensions (Hahn 1982: 2-3). For present purposes, however, a market may be seen as an economic system wherein allocation takes place on the basis of the price mechanism.[5]

The idea of a properly functioning market in welfare economics is attainment of a Pareto-efficient allocation of resources. A Pareto-efficient outcome is dependent on a number of crucial assumptions:

(i) that a market exists for all products. In other words, anything someone wants should have a price;

(ii) producers and consumers should act competitively, which requires the rational pursuit of their self-interest by a large number of people in both categories; and,

(iii) the existence of an equilibrium price.

Market failure, therefore, arises from the failure to achieve a Pareto-efficient outcome due to the violation of some of these assumptions. As such, early development economists emphasised state intervention to prevent or allay the losses of welfare arising from market failure. Four main types of market failure are the occurrence of public goods, externalities, market power and informational asymmetries.

2.1.1.1 Public Goods

Public goods have been defined in economics literature as those that have the characteristic of jointness in supply or non-rivalness in consumption. This concept was explicitly formalised by Samuelson (1954). However, a more important characteristic of public goods may be that mentioned by Olson (1965: 37-38) which is non-excludability. This is a reminder that even when some people pay for a good it may not be economically feasible to exclude non-payers.

Public goods have two defining characteristics. These are a tendency for such goods to be under supplied and for a preference for such goods to be understated. If a person is sure that he can benefit

[5]North (1981) would disagree. He points out that it is erroneous to see the market as synonymous with a price making market as any form of voluntary contractual exchange involves a market (pg 42). However, in treatment of market failure or introduction of economic policy reforms such price considerations are paramount.

from a good if someone else pays for it (free riding) then he is likely give the impression that the good does not have much value for him. When preferences are understated in such a manner it is likely that the provision of the good in question maybe inadequate. In such circumstances, where the goods have perceived social benefits the state was expected to step in to provide such goods.

It has been pointed out that due to technological changes non-excludability may not be permanent. For instance, lighthouses which used to be regarded as a classic example of the public good have been replaced by radio signals. Also free-riding by not paying for a television licence can now be overcome by the possibility of scrambling. This is a valid point but as Chang (1994a: 8) has pointed out, excludability may be more of a property rights issue than a technological one. After all, once the signals have been unscrambled it is possible for an individual to make his television available to all his neighbours should he so desire.[6]

Another observation worth making about public goods is that nothing requires that they should be provided by the state. After all, if a group is small enough, a public good may be privately provided since there is the possibility that the benefits to the person who pays to provide the good may outweigh his perceived costs (Olson 1965: 22). For example, an individual may choose to tar the access road leading to his house and his neighbours may benefit without contributing to meet the costs. This is a valid insight but it takes no account of situations with require coercion for the provision of public goods (a form of Olson's selective sanctions). By its very definition, the state is the ultimate provider of such measures like law and order which have public good characteristics. As such, I may not pay my taxes but am still subject to policing.

2.1.1.2 Externalities

Externalities occur when an individual's actions or decisions have an effect on others, either negatively or positively. When an individual does not take into account the cost to others of certain actions, he may end up doing things that are socially unbeneficial. Similarly, if he is not compensated for the benefits which accrue to others from his actions, he may not carry out such

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[6]In many parts of the developing world, the owner of a radio usually allows his neighbours to listen in, sometimes involuntarily.

actions (Stigler 1975: 104). In other words, the individual's cost-benefit matrix may not tally with the social cost-benefit matrix. Familiar examples include the housewife whose washing is soiled by smoke from the neighbouring factory or the enterprise which imparts skills to workers who depart to work elsewhere.

The problem is not interaction or interdependence amongst economic actors, as such, but the fact that there is no compensation for such effects. Nath (1973: 43), therefore, defines externality as 'untraded interdependence'. In such a case, the obvious solution would be for the affected parties to negotiate some form of compensation. For instance, therefore, the owner of the smoke factory could compensate our housewife in the above example for dirtying her washing. However, the implication which can be drawn from the work of Coase (1961) is that it may not be economically feasible for such negotiations to take place because of the transactions costs involved. In such circumstances, the state may have to intervene to assign property rights, either to clean air, in which case the factory has to compensate the housewife, or to industrial production, in which case the housewife might have to bribe the factory not to soil her washing.

Of course, it can be argued that the solution to externalities does not necessarily lie in state intervention. Friedman (1982: 32) has argued, for instance, that state intervention to compensate for one set of externalities will only result in the emergence of another set of externalities due to inadequate charges or compensation. However, where the transactions costs of negotiating compensation is high and goods have beneficial externalities, the state may play a useful role in the provision of socially optimal amounts of such goods. Examples are the provision of health, education and social infrastructure. Similarly, the state may have to tax activities which create negative externalities like pollution (Chang 1994a: 11).

2.1.1.3 Market Power

The existence of increasing returns to scale and the possibility of a single producer can lead to market power in the form of a monopolist. Apart from the deadweight costs to society that arise from the operation of a monopolist, Wolf (1982: 109) has noted the possibility of dynamic inefficiencies. This may arise from the fact that the monopolist feels no pressure to innovate (à la

Schumpeter). Moreover, the existence of small numbers also gives rise to the possibility that the behaviour of firms is not competitive but strategic. Thus firms may collude or form cartels to fix prices.

On such grounds, state intervention may be justified to ensure optimal production. This, for example, may take the form of direct regulation of prices, anti-trust or regulation policy, or public ownership of such enterprises (Wolf 1982: 109).

The theory of the second best has been adduced as an argument against state intervention to counter the effects of market power. In this context, it is argued that anti-trust legislation may be ineffective since it does not eliminate distortions from all markets (Peacock and Rowley 1979: 52). However, the theory of the second best does not imply that intervention to correct distortions cannot lead to welfare gains, but that it cannot be not guaranteed in the presence of other distortions (Toye 1987: 73-74).

Friedman (1982: 28) insists that state intervention to remove market power is misplaced since the state itself is the major source of such market failure. This point may be conceded given the possibility that state-administered entry barriers may be the cause of a monopoly. Chang (1994a: 10) notes, nonetheless, that ***"...many, if not all, initially competitive markets - through business cycles, structural changes or even sheer luck - have been transformed into non-competitive ones without collusion or state intervention".***

2.1.1.4 Information Asymmetry

Wolf (1982: 110) mentions that a particular type of market failure can occur when prices do not indicate relative scarcities and when economic actors do no have equal access to information about products, markets and technology. Stigler (1975: 108) thought that the main basis of what he called 'erroneous decisions' was with regard to information about the future. A good example is provided by Scitovsky (1954) of such a situation occurring between the steel industry and railroad industry.

In order for the steel industry to operate profitably, it will need to know if the railroad industry would begin within five years. On the other hand, for the rail industry to begin operation it would require the existence of a steel industry.

In such instances, in order to promote efficiency, the state could act to improve the availability of such information in order to promote efficiency. Of course, the criticism from the theory of the second best applies again. However, the result of any such intervention remains ambiguous. State intervention may, nevertheless, be justified in cases where short term efficiency is being reduced in order to promote long term efficiency. Wolf (1982: 110) demonstrates this point with the example of patents which restrict access to technological information in a manner which appears to be inefficient in the short term but may promote long term efficiency. It is also possible to use futures markets to overcome some of the problems associated with information asymmetry.

2.1.1.5 Market Inadequacies

There are two types of market inadequacies not usually considered in the theoretical treatment of market failure. First, states may intervene to provide merit goods or deter demerit goods (Chang 1994a: 12). Second, states may act to correct the income distribution provided by a market outcome if it is considered socially desirable to do so (Wolf 1982: 111). These arguments for state intervention are based on morality as distinct from efficiency considerations of market failure.

Examples of society acting to prevent a demerit good are the prohibitions placed on the sale of narcotics and the censorship of pornographic material. The very existence of welfare policies in the industrial countries is proof that the distributional consequences of market outcomes may not be socially acceptable. In the case of developing countries, the possibility of increased growth with either increasing poverty or improved equity provides grounds for governments to have distributional goals (Rueschemeyer and Putterman 1992: 249).

2.2 DIRIGISTE DEVELOPMENT POLICIES

The idea that markets could fail was one part of the conventional thinking that state intervention was necessary to assist the development process. The other part was the empirical evidence of successful state intervention which could be ascribed to the successes of the Keynesian revolution, the rapid process of Soviet industrialisation under Stalin, war-time planning during the Second World War and the subsequent implementation of the Marshall Plan in Western Europe (see Toye 1987: 22; Datta-Chauduri 1990: 26; Shapiro and Taylor 1990: 862).

The conjuncture of these two factors at a time that developing countries were just gaining independence, led to the newly emerging discipline of development economics dispensing policy advice that emphasised the central role of the state in accelerating the transformation process. Such policies which came to be associated with dirigiste development included price controls, foreign exchange controls, foreign exchange rationing, trade restrictions, import substituting industrialisation involving the protection of industry across the board; state ownership of enterprise whenever there was a perceived need for particular industries; and financial repression including directed credit and fixed and negative real interest rates. Very often, these policies were justified by the need for the state to make up for the market failures mentioned earlier.

The advocates of such policies, however, failed to take account of a number of critical factors crucial to the success of their policy advice. In the first place, while it must be admitted that the idea of market failure contains useful insights that would otherwise be neglected in theoretical constructs of market equilibrium, it must also be noted that the very notion of market failure may be misleading. This is because it implies the existence of an ideal perfectly functioning market with which real conditions may be compared (Chang 1994b: 295). Since the world is not perfect, attempting to correct for market failure may be no more than chasing a mirage. Secondly, while relying on empirical evidence is useful, the conclusions drawn can be quite misleading. This is due to the fact that the institutional underpinnings of economies differ and what is realisable in one country may not be practicable in another. For instance, not many developing countries that chose the path of communism were able to repeat the technological achievements of the Soviet Union as typified, for example by its space programme and nuclear industry.

Thirdly, and perhaps most critically, as subsequent events showed, early development economists took no account of the fact that the state was not necessarily benign, omniscient or omnipotent. And, it was on these grounds mainly that the neo-liberal 'counter-revolution' (Toye 1987: 5) based its attack on state-led development.

2.3 NEGATIVE VIEWS OF STATE INTERVENTION

Even at the time when state-led economic development was at the height of its theoretical and empirical popularity there were economists who did not view the active role of the state in economic development as a positive thing. Those who Friedman (1982: 5) describes as liberals, including himself, have for ideological and theoretical reasons argued that the individual and not the group (state) should be the basic repository of rights and obligations.[7]

Hayek (1946) states the libertarian case passionately and argued that the trend towards centrally controlled economies was the 'Road to Serfdom'. He emphasised the role of individual freedom in the scientific and cultural progress made by Western civilisation which would not have been possible under collectivism (Hayek 1946: 12). He also insisted that competition was the best means of coordination due to the complexity of economic interaction (Hayek 1946: 36).

The basic argument of the liberals is that since the individual knows his own situation best including the best options available to him, it is ethically wrong for anyone else to seek to make decisions for him. Moreover, the invisible hand of the market was better able to perform the coordination function than central allocation. On this basis, therefore, the state is expected to limit its involvement in economic activity.

Apart from ideological considerations there were other factors which contributed to the negative view of the state's role in the development process. For instance, changes in the theoretical core of

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7 This is still the usage in the European sense as distinct from the American sense which implies left leaning on issues of social policy.

economics led to a breakdown in the Keynesian consensus. Friedman (1970) led this attack and the emergence of stagflation in the advanced industrial economies lent credence to his critique (Killick 1989: 10).

In the area of development economics itself, work by Solow (1957) undermined the idea that capital formation was important in the growth process. He showed that only a small part of the growth performance of economies could be ascribed to capital formation. Since the state was expected to intervene to mobilise capital in order to bring about industrialisation, the implication of Solow's findings was that such an intervention could be in vain. Datta-Chauduri (1990: 29) also points out that traditional development economics took no account of the importance of industrial organisation and the policy environment.

The emphasis placed on industrialisation by the early development economists was further weakened by the fact that agriculture turned out to be capable of huge productivity gains. This was due to the Green Revolution and the fact that the pre-1950 stagnation in primary commodity trade was reversed over the next two decades (Datta-Chauduri 1990: 28).

The case against state intervention in the development process was also buttressed by empirical factors. The success of economies like Korea and Taiwan was ascribed to limited state intervention while the poor performance of other developing countries was ascribed to an over-extended state (Balassa 1988a: 286-288). The subsequent poor economic performance of the Soviet Union and the other Eastern European countries which contributed to the collapse of communism were also considered examples of the failure of state-led development.

Attempts were made to provide a theoretical framework for the ideological and intuitive dissatisfaction with the primacy of the state in the development process of developing countries. A body of literature developed around two main themes, that the motives for state intervention in economic activity were questionable and that its influence was often limited or even negative.

2.3.1 Questionable Motives

There are two main approaches which question the motives of state intervention. One approach is society centred in which the state is viewed as ***"an arena within which economic interest groups or normative social movements contended or allied with one another to shape making of public policy decisions"*** (Skcopol 1985: 4). The other view is to see the state as an autonomous rather than passive actor. Skcopol (1985: 9) identifies three factors as allowing for state autonomy. These include the location of the state as an actor in the international context, its need to maintain domestic control and order, and the immunity of the state bureaucratic apparatus from hitherto dominant economic classes.

2.3.1.1 Society-centred arguments

A conclusion which is readily drawn from Olson's book *The Logic of Collective Action* (1965) is that free riding and the costs of organising large groups may lead to the emergence of small narrowly focused interest groups. These interest groups then act to influence the adoption of public policies that favour the allocation and use of public resources in a manner that favours their members.

A variant of such society-centred arguments for state intervention is the theory of regulatory capture associated with Stigler (1975). The regulatory capture theory is based on the belief that regulation takes place because some groups stand to benefit from such state intervention. In the words of Stigler (1975: 114) ***"... as a rule, regulation is acquired by the industry and is designed and operated primarily for its benefit".*** Such benefits include direct monetary subsidies, restrictions on new entry, support or discouragement of complementary or competitive goods, and price controls. Interestingly enough, these ideas are close to the Marxist view of the state as an agent of the capitalist class (see Tollison 1982: 591; Chang 1994a: 20). Neo-Marxist scholars reject the pluralist view that the state acts ultimately in the interests of all contending groups in society and view it as no more than an instrument of the capitalist class. Miliband (1973: 7) underscores this position by quoting Marx who said in the Communist Manifesto that: ***"the executive of the modern state is but a committee for managing the common affairs of the whole bourgeoisie".***

Such interest group approaches are useful if only because they remind us that society consists of many heterogeneous and contending parties each with their own objectives (Chang 1994a: 20). In addition, the society-centred approach underscores the fact that individuals may sometimes have to resort to collective action to achieve their self interest (Grindle 1989: 11).

There are, nevertheless, a number of limitations to the society-centred theories of state intervention. First, there is the reality that individuals have multiple objectives and associations. As such there is bound to be a limit to the intensity with which they pursue single goals. For instance, if the power base of an interest group is small, then there is the likelihood that it would need to build coalitions with other groups in order to achieve its objectives. Where this is the case there inevitably has to be some compromise which may lead to a moderation of the objectives of the coalescing groups (Grindle 1989: 13).

Second, as Grindle (1989: 24-26) points out, policy making in developing countries is less visible or accessible to the general public than in developed countries. Society-centred analysis, while useful for the advanced capitalist societies, may not take account of the fact that such activity is possible because there are clearly laid down rules for political activity. This may not be the case in developing countries as their governments often try to prevent the creation of interest groups in the process of consolidating their power base.

Third, it has been pointed out that despite the reliance on Olson's work, most of society-centred analysis does not extend the argument to its logical conclusion. Problems and difficulties associated with the formation of interest groups such as selective sanction and incentive schemes as well as frequency and duration of interaction amongst members are not well addressed (Chang 1994a: 21).

Chang (1994a: 21) also notes that the interest group approach ignores the problem of 'agenda formation'. This refers to the fact that the type of interest groups that arise in each society must necessarily be affected by existing social norms and political institutions. For example, extremely self-centred and narrowly focused interest groups may not readily develop in societies that place emphasis on collective solutions.

Finally, it has been noted that the interest group approach is static in the sense that it does not elaborate on the processes by which an interest group manages to gain dominance. Chang (1994a: 21) stresses the importance of such investigation as opposed to a mere study of who has appropriated the surplus because of the implications of the process of interest group formation for capitalist accumulation.

2.3.1.2 State-centred arguments

State-centred approaches are based on the recognition of the fact that the state can be an autonomous actor in the economy. The state is perceived as being able to act independently within the economy either in its own interest or that of its component parts. This approach is particularly useful in discarding the notion that the state is a passive or benign actor in economic activity. Arguments on questionable motives of state actors may be reviewed from the perspective of the patrimonial state and self-seeking bureaucrats.

The patrimonial state can be said to exist when political leaders use policy and state resources to seek support and thereby maintain their hold on power. This occurs often in developing countries where autocratic rulers exist in abundance. In Africa, for example, Sandbrook (1986: 321) has asserted that ***"...in the context of the legitimacy crisis of postcolonial Africa, the political requirements of regime and personal survival take precedence".*** Therefore, acknowledging the existence of the patrimonial state is a useful reminder that the preferences of certain elites are central to policy making in developing countries.

While the existence of the patrimonial state may not be in doubt, it is possible to question the ability of policy makers in such states to clearly identify policies which favour powerful groups and foresee the effects of such policies. Conversely, decision makers may not be in a position to know the interests of each particular group or limits of their tolerance for certain policy actions. It may also be unduly cynical to attribute most policy decisions to a desire by the political rulers to stay in power. After all, policy making in developing countries is not idea free and some policy decisions already taken by developing countries have nothing to do with regime perpetuation (Grindle 1989:

28-30). In any case, it may be more useful to investigate how the preferences of political leaders are formed instead of just assuming that their sole motive is to remain in power.

Niskanen (1973: 20) describes the behaviour of public office holders who use their access to the policy making process and public resources for their own ends as 'self-seeking'. This approach questions the idea of an individual who is expected to be altruistic when he reports for work in the morning and then becomes a rational self-interested person when he closes for the day. Bureaucrats, it is argued, usually substitute the profit motive with a desire to expand their agencies or increase its budget.

There is some merit in this idea which underscores the fact that governments are not necessarily benevolent in their actions. This is particularly important in developing countries where bureaucrats are responsible for implementing activist economic policies.

Chang (1994a: 23), however, takes issue with the idea that bureaucrats are incapable of acting as guardians of the public interest. That writer asserts that bureaucrats have been known to act in pursuit of the general good and would agree with McPherson (1984: 76-77) that to describe such moral considerations as just another expression of self-interest is reductionist.

In any case, it must be accepted that there are several institutional means of checking the excesses of public servants. For instance, there are options like the auditing of government accounts, executive and legislative supervision of government departments, and the use of public committees of enquiry as means of controlling individual bureaucratic agendas. Similarly, it is not always possible for bureaucrats to act as budget maximisers since the expansion of their bureaus is not always under their control. Countries such as Korea, Japan and Britain, where examinations are taken to join the civil service, provide evidence of such checks. Moreover, the bureaucracy may be vulnerable to voice type checks.[8] That is, the ability of members of the public to speak out against bureaucratic action or inaction through the media, may act as a constraint on the behaviour of bureaucrats (Chang 1994a: 23).

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[80]See Hirschman (1970) on the concept of voice.

The questionable motives ascribed to state intervention seek to answer the question posed by Bates (1981: 3) as to "why reasonable men adopt public policies that have harmful consequences for the societies they govern". It would seem, however, that the answers provided are not very helpful. The theories reviewed above spend more time explaining existing situations rather than the process of change and bad policy choices rather than the good ones.

While the approaches that stress the potential for negative use of the state apparatus highlight the risks of abuse of office by different state actors such as bureaucrats and rulers, they do not tie the analysis together in the sense that they do not account for the combined and possibly conflicting effect of such self interested actions. In any case, the relevance or otherwise of autonomous state actors must be situated in the context of space, time and sector. For instance, while the Korean state may have been autonomous in the 1970s it certainly wasn't in the 1950s. Alternatively, the autonomy of the Korean state could be compared to a lack of autonomy in the Indian state. Even within the same country and at the same time a sector may be more autonomous in relation to another. For instance, a state may show more autonomy in the running of public enterprises than it shows in tax collection (Chang 1994a: 19). Finally, as would be argued in subsequent chapters, a certain degree of state autonomy is crucial for successful economic transformation.

2.3.2 Negative or Limited Influence

Even if the state may be considered benevolent or benign in its intentions, there is another set of arguments made about its ability. It is argued that there are limits to the information available to governments and their capacity to act. Furthermore, these limitations may cause distortions when governments intervene in the economy. Such distortions are considered to be the negative consequences of attempts by government to correct market failure.

2.3.2.1 Lack of Omniscience

In order to formulate appropriate policies, governments need information on the alternative options available to them. In addition, they would also need information on compliance with such policy

measures. However, as the Austrian School has argued, governments simply cannot obtain all the information required for central planning and, moreover, such information is costly to obtain.

Indeed, even if such information were available it would be impossible to process it timeously and efficiently. A good example is provided by Nove (1992: 40) when he reports that: ***"As... Nikolai Fedorenko, one time director of the Mathematical Economics Institute of the Soviet Academy of Sciences, once put it, a fully coherent and all inclusive plan for the next year would, with the help of computers, be ready in 30,000 years' time".***

The lack of omniscience of governments also arises from the problem of information asymmetry (Chang 1994a: 26). This may take the form of the principal-agent problem between policy makers and lower level bureaucrats as a result of their having different objectives, or because of the problem of ensuring that the latter carry out tasks assigned to them. In other words, there is a monitoring constraint. Information asymmetry may also arise between policy makers and policy targets such as individuals or firms. For instance, some policies intended to encourage savings in the private sector such as tax cuts may not necessarily lead to the desired outcome, as the additional resources made available to individuals and firms may be spent on consumption instead of being saved.

Given such difficulties, state intervention in economic activity may be considered inefficient or ill-advised. However, Chang (1994a: 27) has argued persuasively that the problems of bounded rationality and information asymmetry are not exclusive to governments. That writer points out that the reason for the existence of organisations including the state and large private enterprises is in order to overcome the problem of bounded rationality, through the use of procedures and rules.

2.3.2.2 Lack of Capacity

Apart from the fact that the state may not be benevolent in its intentions nor omniscient in its perspectives, it has also been observed that it is not omnipotent. In many countries, especially developing ones, governments tend to have only partial control over the consequences of their actions and lack the skilled manpower to implement their policies (Killick 1989: 12). The term 'government failure' has wider connotations but it is in the context of a lack of capacity that the

criticism is most telling. Krueger (1990: 10) identifies two types of government failure as failures of commission and failures of omission.

Failures of commission refer to what the government undertook and did not succeed in implementing properly. Examples include inefficient public enterprises, inefficient public investment, public sector deficits and costly private sector controls.

Failures of omission on the other hand refers to things that the governments should have done but did not address. Included in this group are repair of deteriorating transport and communication infrastructure, removal of fixed exchange rates, exchange controls, and import licensing and negative real interest rates.

Undoubtedly, some of the observation about government failure are valid. Government intervention can obviously be costly and inefficient and certainly the empirical evidence from some countries where the state was active in all spheres of the economy is persuasive. Nevertheless, the government failure arguments suffer from a number of drawbacks.

The idea of government failure itself may be circular since it relies on empirical evidence. In other words, it seems that the point being made is that governments fail because they do not do well. As such, the concept of government failure may be no more than a description of economic crisis. After all, in the 1960s and early 1970s most developing countries performed well in terms of GDP growth under the very policy regime that was later held responsible for failure. In such instances how would government failure have been defined?

Krueger's (1990: 12) claim that African countries performed better in the colonial period (under laissez-faire) than they did after independence (when the state began to play a more active economic role) is debatable. Even if exogenous factors like the oil shocks are ignored, the period of colonialism in Africa was when the much maligned marketing boards were introduced. (See Brett 1986: 23.) Also, Datta-Chauduri (1990: 25) writing in the same issue as Krueger wonders why India did not do well under the purported laissez-faire of British rule.

2.3.2.3 Rent-Seeking

A central theme in the arguments for reducing the role of the state in economic activity is that such intervention gives rise to distortions in the form of rent-seeking. Rent, it may be recalled, is defined as the returns in excess of opportunity cost of resources to the owner (see Tollison 1982: 575).

The term rent-seeking, however, is not intended to refer to the competitive dissipation of rents that arise naturally in the price system, but to the process of competing for rents that are artificially contrived through government intervention (Tollison 1982: 575). To quote Chang (1994a: 28), ***"...when the state intervenes to create artificial rents the resources spent to capture them ... may be worth expending from the individual point of view but are wasted from a social point of view, since they are spent in resource allocation rather than in resource creation".***

The popular use of the term "rent-seeking" derives from Krueger (1974) who was trying to show in international trade theory that the efficiency costs of protection were larger than the dead weight losses associated with the Harbeger triangles. She estimated that in India such costs amounted to 7.3% of national income and in Turkey, import licensing alone led to costs of rent-seeking equivalent to 15% of GNP (Krueger 1974: 294).

The position of the public choice school is that monopoly and other distortions impose more than deadweight losses on the economy and are caused by public policies. This school favours the term rent-seeking to describe the competition to corner the benefit of such policies (Colander 1984: 7). However, Bhagwati (1982: 990) has pointed out that rent-seeking is a subset of activities which he describes as Directly Unproductive Profit Seeking (DUP). Examples of such activities are tariff seeking, tariff evasion, revenue seeking, monopoly seeking, premium seeking (import licensing falls under this), and lobbying.

To summarise, therefore, state intervention is perceived as being the source of distortions such as the granting of monopoly rights which in turn leads to socially unproductive competition to corner such privileges. Rent-seeking theory is admittedly interesting and insightful. Apart from reminding us that state intervention does not necessarily lead to efficient outcomes it is also useful in pointing

out that state actions may affect the operating environment of other economic players (Shapiro and Taylor 1990: 865). There are, however, a number of observations worth re-stating about the rent-seeking literature.

There is an assumption in the rent-seeking literature that the resources lost in the process would otherwise have been used in productive activity. This is not necessarily the case since the owners of the resources spent seeking for rents may not have the entrepreneurial skills with which to deploy resources in a productive manner (Streeten 1993: 1292). Ironically, therefore, rent-seeking may, in fact, not account for a major part of state created costs. If an inefficient producer benefitted from the rent-seeking process, the losses arising from his operations may be more than what was expended competing for the advantage.

Another debatable assumption in the rent-seeking literature postulates that restrictions on entry and thereby on competition arise solely from government action. Of course, this is not necessarily the case since firms endeavour to keep competitors out by developing barriers such as secret production techniques and brand loyalty. As such, rent-seeking cannot be said to be confined to the public sector and Streeten (1993: 1292) also reminds us that the process of sub-contracting in large firms may also lead to rent-seeking although laws do provide additional opportunities for rent-seeking.

Lipton (1989: 1563) has observed the anomaly in the fact that the objection is not to the capture of the rent itself, which reduces the share of labour and profits, but to the competition for such rent. After all, it is quite possible to imagine a situation in which the rent is not competed for. For instance, there are no rent-seeking costs involved in awarding an import license to the Minister's brother without competition. Indeed, as Toye (1991: 327) observes, licences are usually allocated on the basis of patronage. Moreover, where rules exist for allocation such as auctioning or queuing there may be no social cost and in the case of auctioning a gain may even result from the process.

Another criticism of the rent-seeking literature made by Lipton (1989: 1563) is that it tends to ignore the role of rent-avoiding transactions (RATS). This refers to the emergence of smuggling and black markets as a response by other members of society to their exclusion, as a result of central rationing, from import licences or foreign exchange allocations. Such rent-avoiding transactions serve to

reduce the gains of the beneficiaries of rationing. Quite clearly, by bringing in goods without paying duty, a smuggler can underprice the beneficiary of a quota and thus reduce the amount of rent accruable to the latter. This, of course, should not imply that smuggling or related activities are a desirable solution to the problem of rent-seeking.

Bhagwati (1982: 966) acknowledges that, in a second best situation, seemingly unproductive activities may lead to beneficial outcomes. For instance, a tariff destroying lobby may have a socially beneficial outcome. Colander (1984: 8) follows up on this idea with the observation that where trade restrictions already exist the imposition of additional measures may actually improve societal welfare. In such circumstances, it may not be realistic, *a priori*, to oppose all rent-seeking behaviour.

The solution to rent-seeking is usually linked to a need to reduce the size of government. However, empirical evidence in the form of cross-sectional and time series data provided by Ram (1986: 202) shows that government size and public expenditure are positively correlated to economic size, which would imply that rent-seeking is more prevalent in larger, industrialised economies.

2.3.2.4 Corruption

Another phenomenon closely linked to the negative view of the state is corruption which is often associated with abuse of office by public servants. Increased interest in the investigation of corruption is partly due to growing acceptance that it is more pervasive and widespread than was assumed. In this context, Harriss-White and White (1996: 1) point out that corruption remains entrenched in poor countries like those of Sub-Saharan Africa and South Asia; more successful late developers such as those in East Asia and Latin America; the post communist states of Eastern Europe and indeed major industrialised countries including Japan, Belgium, Italy, France, Spain and the United Kingdom. Moreover, attempts at analysis of corruption were made easier by the emergence of subjective data on corruption provided by Business International, the World Competitiveness Report and Transparency International (Ades and Di Tella 1996: 7; Khan 1996: 684).

It would seem that economists had attempted to analyse corruption within the ambit of rent-seeking theories in the belief that competition and deregulation were means of reducing the powers of a bureaucrat (see Ades and Di Tella 1996: 7; Harris-White and White 1996: 2). Moreover, bribery was viewed as a pure transfer without any social effects (see for instance Chang 1994a: 29). In reality, however, as Khan (1996: 689) points out, bribes change incentives and therefore have effects on production as well as transactions costs. Rent-seeking strictly speaking may involve legal activities such as lobbying and queuing whereas corruption is illegal. Rent-seeking approaches, therefore, failed to capture the essence of corruption and ignored the possibility of systemic or institutionalised corruption. As a result of the association of corruption with the regulatory powers of bureaucrats and the belief that corruption could be reduced by rolling back the frontiers of the state, the emergence of economic liberalisation and democratic governance in the development agenda 'brought renewed hopes for an effective root and branch cure for corruption' (Harriss-White and White 1996: 2).

In spite of its widespread prevalence and increasing interest in the subject, corruption has not proved easy to define. Some analysts have treated it in an ethical or moralistic manner, an approach which Khan (1996: 684) and Caiden and Caiden (1977: 301) have taken issue with on the grounds that it is subjective. Instead, it is proposed that corruption be defined as deviations from the formal rules governing the allocative decisions of public officials in response to offers to them of financial gain or political support (Khan 1996: 684). The point of interest, however, is the effect or impact of corruption on development. The assumption is that corruption has a negative effect on economic development.

As Caiden and Caiden (1977: 304) note, there are some who would see corruption as positive in the sense that it allows entrepreneurs to avoid the costs of bureaucratically imposed restrictions through for instance queue reduction and the avoidance of cumbersome rules and red tape (see also Khan 1996: 686). On the other hand the view attributed to Myrdal (Ades and Tella 1996: 9; Khan 1996: 686) is that allowing for the possibility of corruption would lead bureaucrats to deliberately create restrictions to facilitate bribe taking. Corruption, when it becomes systemic, increases information asymmetry and transactions costs in the sense that entrepreneurs have to spend resources determining if a bribe is required, how much would need to be paid, who should be paid and at what

stage payment is required. Moreover, by distorting incentives it leads to a diversion of resources from productive to less productive uses. Empirical work (see Ades and Di Tella 1996: 9-10) appears to indicate that corruption has a negative effect on investment.

On closer study, however, it would seem that the relationship between corruption and investment is more complicated and not necessarily inverse and as Khan (1996: 683) notes, why did the presence of wide-spread corruption not do greater damage to the development prospects of countries like South Korea? Furthermore, as Harriss-White and White (1996: 2) report, in certain contexts economic liberalisation acts to displace corruption rather than eradicate it. It is such difficulties that lead Khan (1996: 691) to argue that the efficiency implications of corruption depend critically on the distribution of power between the state and society. He argues that where the state is more powerful than society it is better able to enforce property rights at low costs, whereas when it is weak in relation to society and the range of rights to be allocated is wider, the struggle to secure such rights is more fierce. In such cases which represent the typical developing country, clientelist groups with superior organisational power obtain their pay-off through the allocation of rights at the expense of high value adding users of such rights. In other words, therefore, the additional costs and distortion of incentives brought about by corruption appear to be worse in countries where political contestation is high and the state finds it difficult to impose its allocative decisions on society.

2.4 LIMITATIONS OF THE CONVENTIONAL DEBATE

There are fundamental weaknesses in the conventional debate as conducted by both sides that will be elaborated upon in greater detail in Chapter Four. It is nevertheless useful at this stage to highlight some issues which arise from the preceding review.

The insights of neo-liberalism on state intervention are useful especially on the omission of the state as an actor, the motives of state agents and related problems of agency. Indeed, as Shapiro and Taylor (1990: 865) point out: ***"... the omission of the state as an explicit actor is a fundamental flaw in the development theorists argument since they relied on the state as an agent of change".***

Moreover, the neo-liberal assertion that the state or its agents are not necessarily well-intentioned, all-powerful or all-knowing is a powerful argument. It is not enough, however, to demonstrate the possible consequences of state intervention and then retreat to promoting state minimalism as a solution. This flies in the face of available theoretical and empirical evidence of the possibility of successful state intervention.

Furthermore, the existence of state failure does not necessarily disprove the existence of market failure. As Streeten (1993: 1284) has noted, there is a peculiar logic in arguing that market failure is not an argument for government intervention and then ignoring the equally valid observation that government failure is no argument for private markets.

Retreating to a position of state minimalism also fails to take account of the fact that in the real world there are moderating influences on state power. For instance, public action can support private provision in several ways and vice versa through complementarity and symbiosis (Streeten 1993: 1285). There are complementarities between public provision and private finance such as state-owned universities which charge students fees or raise endowment funds. Conversely, there are also examples of private provision and public support such as grant-aided schools. Symbiosis can be exemplified by the dependence of commodity farmers on government provision of irrigation and access roads, whilst the government levies export taxes on their produce to raise revenue.

Another moderating force on state behaviour is the presence of civil society. Lipton (1991: 24) underscores the important role of civil society as a mediating influence between the market and the state. This occurs because civil society can exercise 'voice' checks on government by criticising certain policies and exhorting it to carry out others. In addition, civil society can assist by providing certain services in place of government. Therefore, instead of being always viewed as a negative influence on the state, organisations with religious, political, professional and educational objectives can act as 'voice' to check government behaviour or provide services in areas like technical assistance and disaster relief (Streeten 1993: 1286).

A further example of moderating influence on state action is the international environment. Apart from international public opinion or the asymmetrical distribution of power amongst states which

may constrain state behaviour, there is the globalisation of economic activity which has reduced the possibility of policy autonomy in certain areas. An obvious example is the accession to multilateral treaties that govern economic integration and world trade.

While it is true that the decisions made by a collective invariably reflect the priorities of those who control the group, it must be noted as Chang (1994a: 15) points out, that individualism itself is no more than a moral position. In any case, not all individuals can act in their own self interest as evidenced by the fact that other people make decisions on behalf of the mentally handicapped and small children.

In any event, both the welfare and neo-liberal treatment of state intervention are fundamentally flawed by their shared approach of treating the market as the only key institution. As such, they only disagree on where state intervention to rectify market failure should begin and end. However, this can lead to an outcome requiring total state intervention since the production process is almost always linked to externalities of one kind or another. This was indeed the basis on which Lange made his argument on the feasibility of central planning (Chang 1997b: 6-7).

2.5 CONCLUSION

Theoretical constructs of market failure coupled with empirical evidence of successful state intervention led early development economics to advocate an active state role in developing economies. This led to widespread and often inefficient state intervention and controls in areas like trade policy, foreign exchange markets, price controls and public enterprises.

These policies, however, were always opposed on ideological grounds by liberal scholars who felt that such an extensive state role did not augur well for the economic rights of individuals or the benefits arising out of the coordination of their activities by the 'invisible hand'. Moreover, it was felt that the state and its agents were not benevolent, omnipotent or omniscient and as such its dirigiste policies would lead to government failure, self-seeking and rent-seeking behaviour.

The insights of the development counter-revolutionaries are powerful in recognising the motivational and informational constraints on successful state intervention. There are, nevertheless, weaknesses in not recognising that state action is often moderated and complemented by civil society and private sector institutions.

In any case, by concentrating on the merits or demerits of market failure, both the early development economists and the counter-revolutionaries ignore the existence of other economic institutions which influence the development process. However, the neo-liberal position seemed to have prevailed and economic policy reforms with the explicit objective of reducing the role of the state in economic activity were accepted by many developing countries as a panacea for their economic crisis. The next chapter explores in further detail the origins, content and controversy surrounding economic policy reforms prior to discussing the important role of institutions in economic growth and development.

CHAPTER THREE

ECONOMIC POLICY REFORMS: UBIQUITY AND CONTROVERSY

It was maintained in the previous chapter that the conventional approaches to the role of the state in development shared a common weakness of treating the market as the sole economic institution. The prevailing ideas behind the negative view of state intervention appeared, however, to have prevailed with the introduction of structural adjustment programmes with the clearly stated intention of reducing the role of the state.

This chapter explores the issues involved in the structural adjustment debate and begins with an attempt to unravel definitional issues in the first section. The second section shows the ubiquity of economic policy reforms and the fact that they formed a new economic paradigm. Section three outlines the main elements of economic policy reform and the following section underscores the on-going controversy on such programmes despite claims of a consensus. The fifth section concludes the chapter.

3.1 DEFINITIONAL ISSUES

It is useful to begin with a definition of what is meant by 'economic policy reform' since the phrase itself is wide enough to mean any policy changes undertaken by governments. Two definitions are offered to specify what is meant by economic policy reforms in the present context. The first is a definition provided by Bates and Krueger (1993: 5):

> ***"The term is used to describe significant changes in a sizable number of economic policies as part of a package of policy changes ... (This) usually involves a major adjustment of the extent to which the state interferes with market forces, which in turn entails institutional and administrative change, stabilisation efforts and removal or relaxation of controls and greater reliance on market mechanisms for allocation of resources".***

Toye (1994: 34) provides, in tabular form, a definition of structural adjustment policy that covers the intended field of study. In his definition, Structural Adjustment Policy consists of :

(i) stabilisation which includes fiscal policy, monetary policy and devaluation; and,

(ii) structural adjustment which includes resource mobilisation, public sectoral resource allocation, market liberalisation and institutional reform.

Both definitions are useful because they clearly indicate that economic policy reform usually entails stabilisation and structural adjustment. More importantly, for this study, the first definition reveals that a major objective of economic policy reform is a reduction of the role of the state in economic activity. These definitions also avoid the pitfalls and difficulties that may be caused by the blurring of distinctions between stabilisation and structural adjustment. (See Husain 1994: 151; Krueger 1992; Stewart 1994; Streeten 1987: 1470.)

It may, however, be confusing to try as Toye (1994: 23) does to distinguish between 'structural adjustment policy' and 'structural adjustment'. In which case the term used by Bates and Krueger (1993) would seem preferable. Sinha (1995: 558) takes a similar position sharing Streeten's (1987: 1469) view that the term structural adjustment is synonymous with development.[9]

3.2 UBIQUITY

The economic policy reforms under consideration were a widespread phenomenon in the 1980s. Such policy reforms cut across geographical boundaries of the developing world and countries in Africa, Asia and Latin America were engaged in the implementation of such polices.[10] After the fall of the communist regimes in Eastern Europe, countries in that region also began to implement economic policy reforms.

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[9]For reasons of expositional convenience, however, the phrases 'economic policy reforms' and 'structural adjustment programmes' are used interchangeably despite the preference given to the former.

[10]A short listing provided by Grindle (1989) gives a good indication of the continental spread of policy reforms; Costa Rica, Bolivia, Thailand, Korea, Ghana, Turkey, Indonesia, Colombia, India, Jamaica, Malawi, China, Sri Lanka, Mexico, Morocco, Brazil, Cote d' Ivoire, Mauritius and this list is not exhaustive.

In the case of Africa, the Economic Commission for Africa (1989: 16) reports that by 1988, thirty-three out of its fifty member states were implementing economic reforms of some sort. Figures given by Krueger (1992: 74-75) show that in comparison to an annual average of 17 stand-by and other agreements reached with the IMF between 1970 and 1979, there were a total of 297 such agreements between 1980 and 1990. The World Bank also concluded a combined total of 130 Structural Adjustment Loans (SALs) and Sectoral Adjustment Loans (SECALs) between 1980 and 1990, which is quite substantial given that these programmes were new.

A number of reasons may be advanced for such a widespread adoption of economic policy reforms. These include the adoption of reforms as:

(i) a response to crisis

(ii) a requirement for debt rescheduling

(iii) a shift in the development paradigm.

3.2.1 Response to Crisis

The extent of economic crisis in developing countries prior to the adoption of reforms is clearly illustrated in the case of Sub-Saharan Africa by Green (1986: 3-4), the World Bank (1994: 17) and Toye (1994: 18-21). The crisis was typified by:

(i) declining per capita Gross Domestic Product

(ii) declining GDP growth rates

(iii) increasing external debt burdens

(iv) deteriorating terms of trade

(v) sharply reduced financial inflows

(vi) poor sectoral performance in exports, agriculture, mining, manufacturing, etc.

The causes of this crisis have been the source of extensive debate. Some writers have ascribed the root causes of the economic crisis in developing countries to the inappropriate policies pursued by their governments. In such a case, therefore, the logical solution was to replace the inappropriate policies with the reform package.

Krueger (1992) and the World Bank (1994: 20-31) are representative of those who view the adoption of economic policy reforms by developing countries as a necessary response to the poor economic performance caused by the previous policy regime. In their view, external factors were only responsible for the timing and not the severity of the crisis. The blame was to be laid on governments who had not only failed to provide public goods but had adopted 'wrong macroeconomics' and 'wrong microeconomics'. Specifically included in such a list of wrong policies are over-valued exchange rates, fixed interest rates, quotas, import substitution, unsustainable budget deficits, price controls, state ownership of productive and financial enterprises, and non-provision of infrastructure.

The same group of writers have also pointed out that some developing countries faced the same external conditions and did not have to contend with economic crises. The World Bank (1994b: 28) argues, moreover, that losses from declining terms of trade were off-set by external transfers and that, in any case, developing countries failed to capitalise on previous opportunities provided by less onerous terms of trade.

In direct contrast, Singh (1986: 280-283) and Banuri (1991: 20-21)[11] have emphasised the role of external factors in the crisis that engulfed developing countries in the late 1970s and early 1980s. The external factors identified include the two oil shocks of 1973 and 1979, recession in the developed economies in the early 1980s as well as the impact of the external debt crisis which began in 1982.

These external factors had a combined negative effect on the current and capital accounts of developing countries. Increased import bills arising from higher oil prices along with reduced earnings from commodity exports resulted in declining terms of trade of developing countries. The reduction in imports occasioned by foreign exchange shortages often meant a fall in capacity utilisation in domestic industry with attendant consequences for employment. In the same vein, the point is made that developing countries had the same set of policies during the first and second oil shocks and that they adapted better to the former than to the latter.

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[11]Other writers in the same volume also have the same opinion, especially Hughes and Singh (1991).

A debate on the relative importance of external or internal causes of the economic crisis in developing countries is futile. As Streeten (1987: 1471) has pointed out the distinction between internal and external factors can be blurred. Moreover, an approach that concentrates on the origins of the crisis may have its uses if there are several remedial options under consideration. In the present context, however, structural adjustment policies have been implemented in some form or the other in many countries and the debate over internal and external causes has become moot. This would imply an acceptance that previous policies were responsible for the crisis or reflects other reasons for adopting the policy reforms.

3.2.2 Debt Rescheduling

Many developing countries interpreted the oil price increases of the 1970s as a temporary shock which could be financed and they found willing partners in international capital markets which were anxious to recycle the OPEC (Organisation of Petroleum Exporting Countries) surpluses. This process came to an abrupt end in August 1982 when Mexico announced that it would no longer be able to service its outstanding debt obligations, thus formally initiating the debt crisis of the developing countries. Sachs (1989: 5-14) has identified a number of broad causes of the debt crisis.

First, was the role of global economic shocks especially the oil price increases of 1973 and 1979, usually referred to as Oil Shock I and II. When these shocks occurred, most developing countries chose to finance rather than adjust to them. This may have been because the shocks were perceived as temporary or because the terms of borrowing were relatively attractive. Low interest rates and booming commodity prices made borrowing an attractive option.

Second, was the behaviour of the debtor countries themselves in the utilisation of the loans. Most of the loans were utilised to finance consumption and provide social services. As such, little consideration was given to the rate of return on such loans. Even in cases where the loans were used for capital investments, the objective was often import substitution and not export orientation by which foreign exchange could have been earned to service the debts.

Third, was the lending behaviour of the money centre banks. These banks were awash with OPEC surpluses which they were only too eager to re-cycle. In addition, most of them took the position that sovereigns could not go bankrupt and often ignored basic banking rules in cross-border loan agreements.

Fourth, was the 1980 recession in financial centres like the United States and the United Kingdom. In an attempt to rein in inflation, real interest rates were raised to high levels resulting in the recession. This, in turn, contributed to a collapse of primary commodity prices with a consequent negative effect on the export earnings of most developing countries.

The main feature of the debt crisis was a sharp reduction in international financial flows which left many developing countries with huge and unserviceable external financial obligations. In such circumstances, many of them had to resort to international financial institutions such as the World Bank and the IMF for balance of payments support. Similarly, creditors in the London Group (of private international banks) and the Paris Group (of official creditors) usually required a stamp of approval on a country's policies from the IMF and/or the World Bank before agreeing to reschedule or resume lending (Sachs 1989: 25).

The Fund's practice of imposing conditionalities prior to lending meant that its views on appropriate policies had to be accepted by countries which approached it for stand-by facilities. The World Bank also began to impose conditionalities on its loans with the introduction of SALs and SECALs by 1980 (see Bacha and Feinberg 1986: 340). In such circumstances it is not surprising that the economic policy reforms adopted by most developing countries bore more than a passing resemblance to the policies advocated by these two institutions. Even if the government of a debtor country was reluctant to implement the policy package recommended by the IMF and the World Bank it was unlikely to resist such changes when faced with the option of financial strangulation.

Although there were a substantial number of developing countries with huge debt burdens, this by itself does not explain the ubiquity of economic policy reforms. After all, prior to the 1980s, the IMF had seldom concerned itself with issues of long-term development and had been supervising stabilisation policies since the 1950s. The World Bank for its part was hardly the primary institution

used in the resolution of the debt crisis and it introduced SALs and SECALs in 1980 well before the debt problem of developing countries assumed crisis proportions. In any case, the unmanageable debt burdens of developing countries was part of the crisis and could not have been the only reason for the adoption of policy reforms.

3.2.3 A New Development Paradigm

Williamson (1990) has referred to the economic policy reform package as the 'Washington Consensus'. This claim is contested by Kahler (1990: 33), Demery (1994: 25), and Sinha (1995: 557-558), among others. At best, it is possible to agree with Toye (1994: 24-25) that economic policy reforms constitute a new development paradigm.

The idea of economic policy reforms constituting a new development paradigm can be ascribed to a coincidence of factors such as the counter-revolution in development theory (Toye 1987, especially chapter 4), economic crisis in developing countries and the evolution of thinking in international financial institutions.

The counter-revolution in development economics owed much to the ascendancy of monetarism and supply side economics in the advanced industrial countries as a result of the crisis arising from the first oil shock and the collapse of the Bretton Woods system of fixed exchange rates. (See Krugman (1994: chapters two and three) for a popular account of this process.) Orthodox development economics was seen as an extension of neo-Keynesian ideas and was attacked in a similar vein. The main feature of the attack on orthodox development economics was an assertion of monoeconomics (Hirschman 1981: 3). Monoeconomics rejected the structuralist foundations of orthodox development economics and the idea that developing economies functioned in a different way from the industrial countries and, as such, required a distinct set of policies to promote rapid development (Toye 1994: 22). Implicit in such a rejection was the identification and denial of certain ideas viewed as central to structuralism.

Some of the 'fallacies' mentioned by Lal (1983: 5) as being propagated by orthodox development economists included: a belief that the price mechanism should be supplanted; that the case for free

trade is not valid in developing countries; that the gains in efficiency from improved allocation are small; and that government controls on wages, prices, imports and distribution of productive assets are necessary for relief of poverty in developing countries.
The views of the counter-revolutionaries[12] were reinforced by empirical studies which showed that trade liberalisation had a positive effect in spurring growth and thus favoured outward orientation over the import substitution policies associated with structuralism.

The economic crisis in developing countries has already been examined as a reason for the adoption of economic policy reforms. However, it was argued that the crucial role of the economic crisis was that it provided justification for the proponents of the policy reform package (Toye 1994: 21). This was, Moreno, as the Newly Industrialising Countries (NICs) of East Asia appeared at that time to be good examples of the fact that the economic policies being advocated by the counter-revolution could lead to rapid growth.

The attempt by the international financial institutions to evolve their lending practices in the face of wide-spread economic problems in developing countries also contributed to the enthronement of the new development paradigm. Although the IMF had been involved in stabilisation arrangements since the 1950s it was not until the 1970s that, in an attempt to meet the requests of developing countries, it introduced the Extended Fund Facility (EFF) (Kahler 1990: 42). The EFF emphasised policies which came to be part of the economic reform package such as trade liberalisation and public enterprise rationalisation measures.

The World Bank in the late 1970s was faced with the increasing unsuitability of project finance which had been its modus operandi (Demery 1994: 29; Toye 1994: 27). Apart from the fact that the disbursement of project finance was slow and could not meet the financial emergencies facing developing countries in the late 1970s it was also apparent that developing countries were not in need of more project finance as they were facing difficulties in completing existing projects. Moreover, as Toye (1994: 27-28) points out there was pressure on the Bank to get prices right

[12]The name given to this group of writers varies and a precise label may prove problematic. Examples are; mainstream (Killick 1989), orthodox (Kahler 1990;Taylor 1988; Toye 1994), neoclassical (Shapiro & Taylor 1989; Stein 1989; Sinha 1995), neo-liberal (Colcough 1991). All these terms will therefore be used interchangeably.

because domestic price distortions arising from extensive government controls had made project design exceedingly difficult. Thus, faced with an increased urgency in the external payments position of developing countries as a result of the 1979 oil price increases, the World Bank moved into providing conditional programme aid (Jahed 1995: 17).

It is instructive to note that our empirical case study, Nigeria did not belong to the first group of countries to adopt economic policy reforms for several reasons. This includes the fact that as an oil exporter it was a major beneficiary of the oil shocks of 1973 and 1979. Moreover, it was initially insulated from the debt crisis which emerged in 1982 because its external debt had not yet assumed crisis proportions until it tripled from $6.1 billion in 1981 to $17.8 billion in 1983 (Moser et. al. 1997: 9). These factors meant that Nigeria could ignore the new development paradigm because it had not come under fiscal or balance of payments pressures that would compel it to seek relief from its creditors and the international financial institutions who would have insisted on some modicum of economic policy reform prior to rendering any assistance.

The main strands of the new development paradigm were macroeconomic stability, getting prices right, outward orientation and a reduction in the role of the state, especially privatisation (Demery 1994: 30; Kahler 1990: 42; Streeten 1993: 1294; Toye 1994: 34). It is useful, however, to outline in greater detail the objectives and content of the economic policy reforms.

3.3 THE POLICY REFORM PACKAGE

The objectives of economic policy reform can be grouped under four broad headings:

(i) the correction of internal and external imbalance;

(ii) the achievement of structural changes to prevent future stabilisation problems;

(iii) the resumption and increase in the rate of long-term economic growth; and

(iv) the removal of impediments caused by state interference in the operation of markets.

(See Khan and Knight 1985; IMF 1987: 29; Streeten 1987: 1470.)

In order to achieve these objectives, there is in fact no fixed set of policies which comprise a reform package. By its very nature, stabilisation policy tends to rely on expenditure-reducing and expenditure-switching policies while structural adjustment policies may vary from country to country. As was noted earlier in the chapter, the line between stabilisation policies and structural adjustment policies have become increasingly blurred. This is mostly due to the fact that most borrower countries approach both the World Bank and the IMF and have to comply with cross-conditionality. In other words, a borrower from one of the agencies not only has to comply with its conditionalities, but is also required to implement the conditionalities of the other agency.

As such, while the specific package of individual countries and the two agencies may differ in content, there is a core of policies which can be considered to comprise the economic policy package being considered here. For instance, Mosley et al. (1991: 44) show that in over 50% of the cases the condition attached to obtaining Structural Adjustment Loans (SALs) included the removal of import quotas, reform of budget or taxes, reform of interest rate policy, revision of agricultural prices. On the other hand Killick (1984: 191) notes that a core set of policies were regularly included in IMF stabilisation programmes and included exchange rate action, pricing policies, interest rate policies, liberalisation of trade and payments and tax measures.

The variation in the content of country reform packages is not surprising since existing conditions may differ. For instance, there is no point in a country adopting measures to abolish marketing boards if it did not have such agencies in the first place. Certain policies, nevertheless, tended to dominate the policy reform package either as an integral part of stabilisation or for the purposes of structural adjustment.

It is useful to group the policies integral to the economic policy reforms process under the following broad headings:

(i) Macroeconomic Policies
(ii) Trade Reform Policies
(iii) Financial Sector Reform Policies
(iv) Public Sector Reform Policies
(v) Policies to reduce the role of the State

There may be considerable overlap in these groupings as some individual policies may fall under more than one heading. The devaluation of an over-valued exchange rate is for instance a macroeconomic policy instrument to redress payments imbalance. It may, however, also be a key element of trade policy reform since it removes a perceived barrier to improved export performance.

Real sector policy reforms (agriculture, industry) are sometimes grouped under separate headings. This is particularly the case where African countries are concerned (see World Bank 1994: 76; Meier and Steel 1987). However, since both sectors are the object of structural adjustment it may not be necessary to group policies affecting these sectors separately. For instance, reforms in the agricultural sector usually consist of changes in other areas such as macroeconomic policy (devaluation, agricultural taxes), trade reform (protectionism), and deregulation (marketing boards and price controls). A similar case can be made for industrial policy reforms.

3.3.1 Macroeconomic Policies

The macroeconomic policies that form part of the economic reform package are the expenditure reducing and expenditure switching policies used in stabilisation. The broad term macroeconomic policies may be preferable because it captures the requirement for developing countries to continue to maintain low fiscal deficits, contain monetary expansion and prevent over-valuation of exchange rates even after stabilisation might have been achieved.

When a country is faced with a balance of payments deficit, the options are to finance it using reserves, borrow from external sources or reduce the deficit through adjustment. Since declining financial flows was one of the causes of the crisis which confronted developing countries it is evident that the option of borrowing was not available. Expenditure-reducing policies are adopted as a means of reducing domestic demand and, through it, national income. The reduction of national income in turn is expected to dampen demand for imports. There are two types of expenditure reducing policies, viz.: fiscal policy and monetary policy.

Fiscal policies are geared towards a reduction of the budget deficit by increasing tax revenue relative to expenditure. This can include increasing tax rates, widening the tax base, cutting capital

expenditure, reducing the public sector wage bill or eliminating subsidies. These policies tend to reduce aggregate income and thus effective demand for imports. Because of the time required to increase tax revenues, stabilisation policies have tended to focus more on the reduction of government expenditure. Monetary policy involves using the instruments of interest rates and money supply to encourage savings and discourage credit creation. A reduction in domestic credit creation discourages expenditure and thereby reduces import demand.

Expenditure switching policies work by changing the relative prices of tradable goods. In other words, such policies act to switch demand from imports to import competing goods in the home market and to encourage foreign demand for exports over export competing goods. In practice, exchange rate policy has meant devaluation since balance of payments deficits are usually a major aspect of the crisis. The case for devaluation is often premised on a reduction of domestic demand for imports in favour of import substitutes and increasing foreign demand for domestic tradables by reducing the relative price. Other merits of devaluation are administrative simplicity, neutrality across sectors and the reflection of scarcity of foreign exchange in the economy.

Strictly speaking, commercial policy could be used as an expenditure switching device. For example, higher tariffs could be used to discourage imports while subsidies could be used to promote export competitiveness. Such policies are, however, not favoured by the IMF and the World Bank because they run counter to the liberal principles which influence the working of both institutions. Commercial policies are also criticised as being inefficient and administratively cumbersome. (For more detailed discussions of the macroeconomic policies outlined in this section see Krugman 1988: 68-70; Khan and Knight 1985.)

3.3.2 Trade Policy Reforms

Trade reform policies are often at the heart of economic reform packages because, without a fundamental restructuring of this sector, balance of payments problems may recur. Also, a belief in the benefits of free trade is a tenet of faith for the proponents of the economic reform package.

In addition to devaluation, which has already been mentioned and could also be considered a trade policy measure, there are a number of other measures intended to restructure national economies from inward orientation to outward orientation. Some of the specific policies used include (World Bank 1994b: 62-76; World Bank 1987: 9):

(i) The abolition of foreign exchange rationing and controls usually imposed in the face of prior balance of payments crises.

(ii) The removal of quantitative restrictions like import quotas, import licenses and other non-tariff barriers. Some of these barriers were not only erected to discourage imports as a means of conserving foreign exchange but also to protect domestic import substituting industries.

(iii) The rationalisation and reduction of tariff barriers including the reduction in the number of rates, abolition of ad hoc exemptions and additional levies, reduction in the range between maximum and minimum rates and the reduction in the overall level of tariffs to reduce the level of protection of industries.

(iv) The promotion of exports by removing obstacles such as export licenses, export taxes and marketing boards as well as introducing incentives such as retention of export proceeds and duty-drawback schemes.

3.3.3 Financial Sector Reforms

Reforms in the financial sector are usually geared toward financial liberalisation and the removal of financial repression (World Bank 1994b: 110-120). Such reforms usually involve:

(i) deregulating interest rates, in order to promote savings and increase the efficiency of investment;

(ii) scrapping credit allocation guidelines, which are inefficient means of redistributing income;

(iii) reducing the high costs of financial intermediation;

(iv) improving mechanisms for resource mobilisation in order to develop a more broadly based financial system that will include money and capital markets as well as non-bank financial intermediaries; and,

(v) restructuring banking institutions including recapitalisation, liquidation and privatisation of banks.

3.3.4 Public Sector Reforms

The World Bank (1994b: 99) states bluntly that 'the public sector lies at the core of the stagnation and decline in growth in Africa.' Not surprisingly, therefore, public sector reforms are often considered a necessary component of economic policy reform package.

Public sector reforms are also intended to reduce the size of government, improve the provision of government services and introduce civil service reforms. A crucial component of public sector reform involves improving the financial performance of state owned companies. This usually involves making the enterprise financially independent by removing the soft budget constraint. In the provision of government services, user fees are introduced partly as a means of reducing the government deficit but also to reflect the relative scarcity of the services being provided. The private provision of such services is also encouraged.

3.3.5 Policies to Reduce the Role of the State

Some of the policies already listed involve deregulation of foreign exchange, financial or agricultural markets. However, there are three clearly stated aims of reformers which were to be applied as yardsticks:

(i) unleashing markets to allow for competition and the improved allocation of economic resources;

(ii) getting prices right by removing price controls in goods, financial and factor markets; and,

(iii) reducing the role of the state in the financial and productive sectors of the economy through privatisation, de-monopolisation and the termination of state administered controls.

3.4 CONTROVERSY

There has been considerable debate about the utility of stabilisation and structural adjustment programmes. Williamson (1983), Killick (1984), Green (1986), Streeten (1987), Taylor (1988), Mosley, Harrigan and Toye (1991) Bates and Krueger (1993) have, amongst others, all produced or edited useful surveys. Some of the arguments and observations made are outlined below because of their relevance to later chapters. In addition, however, highlighting some of the deficiencies of the economic policy reform package may provide insight into why the reform process remains so troubled after fifteen years of the new development paradigm.

Critiques of the economic policy reform package are outlined here under four separate headings, viz:

(i) critiques of theoretical origins
(ii) critiques of outcome
(iii) critiques of policy advocacy
(iv) critiques of policy omission

3.4.1 Critiques of Theoretical Origins

The conventional economic reform package consisting of stabilisation and structural adjustment policies, has been the subject of dissatisfaction due to perceived theoretical limitations associated with them as well as inappropriateness for the economic structures of developing countries.

3.4.1.1 Theoretical Limitations and Value Biases

The economic policy reform package has been criticised for being theoretically inadequate as well as inappropriate for developing countries. Green (1986: 7), for instance, has argued that the IMF stabilisation package (a fundamental part of policy reforms) is monetary since it derives from the 1957 Polak model. He argues further that the monetarist approach relies on the equation of

exchange (MV= PQ) which is only solvable when V and Q are constant.[13] Green (1986: 8) reasons that V is far from constant in Africa, which is quite possible once overdrafts and inter-firm debts enter the picture.

Another criticism of the policy reform package is that it reflects the value biases of orthodox economics, especially its reliance on individual rationality and taking no account of distributional outcomes in the quest for efficiency. Since each income distribution possibility has its own Pareto efficient allocation of resources, if a given income distribution is considered inappropriate, then maximising on that basis may be less preferable to a Pareto inferior situation with a preferred income distribution (Stewart 1985: 286).

3.4.1.2 Inappropriateness

The link between mainstream economics and the policy reform package has also meant that the perceived inappropriateness of the former for developing economies has been advanced as an argument against the latter. As Green (1986: 9) reminds, many developing countries especially in Africa, have fragmented production structures and inflexible economies. In such instances, it may not be easy for resources to be shifted from one area of the economy to another. As such, after policy reforms are introduced, imports may be reduced without an accompanying increase in exports because of the difficulty of shifting resources between sectors.

By not acknowledging the possible existence of dualism in developing countries, the policy reform package is clearly limited. Quite clearly, where there are differences in interest and wage rates in the formal and informal sectors, policies intended to influence such variables in the formal sector may have unpredictable consequences on other sectors of the economy (Killick 1989: 50).

In the case of Africa, the perceived inappropriateness of the economic policy reform package was responsible for the response by the Economic Commission for Africa in the form of the African Alternative Framework for Structural Adjustment Programmes (ECA 1989).

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[13]M is money supply, V is velocity, P is price and Q is output.

3.4.2 Critiques of Outcome

The performance of countries implementing policy reforms has been viewed as unsatisfactory in several respects including empirically tested consequences, impact on human development and impairment of long-term growth.

3.4.2.1 Empirical Considerations

The international financial institutions have carried out extensive empirical work to show that economic reforms were achieving their objectives and have had the desired positive impact on developing countries (World Bank 1988(a); 1988(b); 1992; 1994b; IMF 1993).

A useful summary of the World Bank's assessment of the impact of structural adjustment is provided in Mosley (1994: 72) and is reproduced in Table 3.1. The broad results show, not surprisingly, that adjusting countries as a whole did better than non-adjusting countries especially in the areas of real growth of GDP and export performance. For instance, between 1982 and 1987 while growth of 4.7% of Gross Domestic Product in intensive adjustment countries (IAL) was marginally less than in non-adjustment lending countries (NAL) which was 4.8%, exports as a share of GDP in the IAL group was 8.5% as compared to 7.1% in the NAL countries. In later years, IAL countries were shown to have done better than NAL countries in growth and export performance. Between 1985 and 1988, IAL countries recorded an average GDP growth rate of 4.2% as compared to 2.7% in the NAL group. Similarly, the table shows that in the period 1986 to 1990 intensive adjustment lending countries performed better than the other group with a growth rate of GDP of 4.2% as compared to 2.4%.

TABLE 3.1 World Bank Assessments of Impact of Structural Adjustment

Study	Country Group	Real Growth Rate of GDP			Investment/ GDP		Exports/ GDP			Growth of real per capita private consumption		Nutri-tion
		82-87	85-88	86-90	85-88	86-90	82-87	85-88	86-90	85-88	86-90	80-86
1988	IAL	4.7					8.5					
	NAL	4.8					7.1					
1990	IAL											
	All countries		4.2		18.6			28.1		1.4		5.7
	Low income		3.9		16.6			29.6		1		-5.3
	NAL											
	All countries		2.7		20			24.6		-0.7		5.4
	Low income		2.7		15.5			15.5		0.2		-5.5
1992	IAL											
	All countries			4.2		17.9			28.4		1.6	
	Low income			3.5		16.3			28			
	NAL											
	All countries			2.4		18.4			28.4		0.6	
	Low income			3.8		15.6			31.7			

Source: Mosley (1994: 72)

IAL - Intensive Adjustment Lending; NAL - Non-Adjustment Lending

Exports as a share of GDP was 28.1% in IAL countries in the 1990 study which was higher than in the NAL countries where the ratio was 24.6%. By the 1992 study, however, the export ratio in both groups of countries was exactly the same indicating that NAL countries had managed to improve their export performance whilst IAL performance had stagnated. Similarly, the investment performance of the IAL countries as compared to the other group was worse. In the period 1985 to 1988 investment as a ratio of GDP was 18.6% in intensive adjustment countries whereas it was 20% in non-adjusting countries. The situation was not better in the latter period between 1986 and 1990 as the NAL countries had an investment ratio of 18.4% as compared to 17.9% in IAL countries. The impact of structural adjustment in low income countries, most of which are in Africa, was somewhat different as the NAL countries grew faster than the IAL ones. Similarly, the export performance of NAL low income countries was 31.7% of GDP compared to 28% of GDP in IAL low income countries. In IAL low income countries, however, investment as a share of GDP was 16.3% which was higher than 15.6% in NAL low income countries. This figure is of no consolation given that both investment ratios were lower than both group averages for all developing countries.

There are, in any case, considerable problems with the methods used in comparing the performance of these two groups of countries. In the first place, aggregation masks the performance of individual countries. As Toye (1994: 30) notes, the Bank is eager to exaggerate diversity of programme design but minimizes it when evaluating the impact of implementation. Yet as Mosley (1994: 95) has shown, there were extensive variations in the policy packages adopted by individual countries.

Second, there was diversity in the extent of implementation by countries. Using examples from Africa, Mosley (1994: 71) argues that while countries like Mauritius had a good record, implementation was virtually non-existent in Sierra Leone, Sudan and Zaire.

Third, as the World Bank (1988a) itself admits, the effect of other factors may becloud the analysis. Apart from differing initial conditions, external shocks may affect the performance of adjusting

countries. Similarly, non-adjusters may well have implemented some policies which, in effect, were a form of adjustment (Mosley 1994: 71).

In a specific study of Africa, the World Bank (1994: Chapter 5) attempts to show that adjustment was working in that region by comparing the performance of adjusting countries to non-adjusting countries in the period 1987-91. The areas in which the adjusting countries are shown to have performed better included growth in GDP per capita, exports, industry and agriculture.

Mosley et al. (1995) provide a devastating assessment of the 1994 World Bank study on 'Adjustment in Africa'. Their conclusion on the regressions carried out in the study can be summarised as theoretically doubtful, procedurally questionable, empirically unverifiable. Consequently, the outcome is debatable. These writers do not only question the theoretical and procedural basis for some of the World Bank's regressions but also claim that using the same statistics the ***'attempt at duplication was not entirely successful'*** (Mosley et al. 1995:1464).

Finally, the World Bank further weakens its own case by warning that most African countries still lack policies that are sound by international standards. Ghana is the only country mentioned as coming close to having adequate macroeconomic policies. If so, then what is the extent of adjustment in Africa that is worth comparing to non-adjustment?

3.4.2.2 The Human Dimension

In a widely acknowledged report entitled *Adjustment with a Human Face* Cornia et al. (1987) pointed out that economic policy reforms have often impacted negatively on the poor and vulnerable sections of society. Empirical surveys indicated that adjustment had entailed an unfavourable re-allocation of national income from the poor and occasioned cuts in government expenditure that impacted severely on the provision of basic needs. Reductions in the public provision of education, health care and other social services was compounded by the removal of subsidies in food prices and utility charges.

Even in the unlikely case that distributional concerns are considered unimportant, increased poverty can hardly be considered a legitimate goal of policy. Inevitably, problems such as crime which may result from worsening socio-economic conditions may prove costly to society in terms of its prevention, detection and punishment.

The standard response that the responsibility for such cuts lies with implementing governments is not totally convincing. The international financial institutions in their zeal to reduce deficits have often insisted on cuts in food subsidies and prescribed minimum wages. Conversely, there is not much evidence that these institutions used their considerable influence to make governments carry out similar cuts in defence expenditure (Green 1986: 22).

3.4.2.3 Impairment of Long-Term Growth

An important question often raised in the context of economic policy reforms is whether such policies do not, in fact, impair long-term growth. Stewart (1994: 113) has further broken the question into two parts, viz:

(i) Do structural adjustment programmes re-introduce non-crisis conditions under which the process of growth, investment and importation can resume in developing countries?

(ii) Are economic reform policies moving developing countries towards structures appropriate for long-term development?

In both instances, her unambiguous answer is no. Stewart identifies cuts in public expenditures on important variables like health, education and infrastructure as a major problem for long-term growth. In Africa, already backward in these areas, real per capita expenditure on health and education was reported to have fallen in two thirds of all African countries.

The same writer reports that, in Africa, investment as a ratio of Gross Domestic Product declined from an average of 20.9% in the pre-reform period, 1973-80, to 17.8% in 1992 when reforms

programmes had been implemented in most countries. Similar observations have been made by Mosley (1994: 72) and Rodrik (1990: 933) and are confirmed by the World Bank's own estimates summarised in Table 3.1 above.

Rodrik (1990: 933-937) makes the interesting observation that economic policy reforms engender uncertainty and by that means discourage private investment which is so crucial for long-term development. It is argued that the central dilemma of policy reforms is that by their very nature they tend to be dramatic departures from the recent past which tends to make investors wary about sustainability, yet the success of policy reforms relies a great deal on a positive response from the private sector.

3.4.3 Critiques of Policy Advocacy

The economic policy reform package has a particular orientation reflected in terms like liberalisation, outward orientation, privatisation, getting prices right, reducing the role of the state, freeing markets, etc.

This orientation has been reflected in the extension of financial assistance by the IMF and World Bank on the basis of conditionality. The imposition of conditionalities has been criticised alongside the emphasis on outward orientation and private ownership. The policy package is even said to be contradictory in certain respects.

3.4.3.1 Unnecessary Conditionality

The provision of loans to developing countries on the condition that they implement a particular policy package has been subject to criticism including, for instance, whether conditionality causes governments to change their policies and, indeed, ponder whether or not such policies actually work (Mosley 1992: 1). Some other writers have also criticised the provision of conditional finance by the international financial institutions on the grounds that private international capital markets are more efficient sources of lending (Vaubel 1983: 298).

Streeten (1993: 1294) makes at least six other observations about the process of conditionality:

(i) Are foreign lenders in a better position to know what is best for a particular country?

(ii) Why would a country not pay to receive the good advice and receive instead extra resources?

(iii) Adjustment aid is in reality made to lenders.

(iv) Policies are fungible in the sense that, after the conditions have been laid down and funds received, other policies may circumvent the intended result. For instance, extrabudgetary expenditure may be used to overcome fiscal retrenchment.

(v) There is the possibility that the ability of developing countries to implement the desired reforms may be inadequate.

(vi) There is no real knowledge about the impact of conditional policies on the economies of developing countries.

The problem of moral hazard may arise from some of the above factors in the sense that governments may use the resources made available to them under conditionality to postpone change instead of implementing reforms.

The point ascribed to Vaubel (1983) above is not valid since most of the debt incurred in the 1970s and early 1980s was due to borrowing from private lenders partly to avoid adjustment. It is the resulting crisis that the international finance institutions are trying to manage. After all, if it is so pleasant to borrow from the Fund, why have not all its member states followed that route?

3.4.3.2 Limitations to Outward Orientation

The World Bank (1987) in its World Development Report for 1987 makes a strong case for outward orientation in developing countries as a positive influence on growth. Apart from the problems of an asymmetry in the way outward orientation is defined,[14]there are a number of questionable claims made about it and other important factors are ignored.

The claim that export performance is a source of growth is debatable since the link to total factor productivity on which the assertion is based is still to be conclusively established (Bruton 1988: 1635; Helleiner 1990). In any case such claims are more likely to refer to manufacturing exports than the primary commodity exports on which most developing countries are dependent.

Balassa (1988b: 1681) has asserted that outward orientation makes it easier for developing countries to adapt to external shocks. This is based on the belief that countries adopting import substitution policies have so reduced imports over the years that when confronted with external shocks, any further import cuts begin to affect production. This may well be so. However, since the advocates of outward orientation concentrate only on the trade sector and neglect capital, labour and non-factor services this analysis is vulnerable to the argument by Hughes and Singh (1991: 75) that it was the open financial system in Latin America that allowed for the capital flight, which worsened the debt crisis and reduced import capacity. In any case, where there is pent-up demand for imported goods, the onset of trade liberalisation may lead to large increases in imports thus further reducing the stock of foreign exchange. Taylor (1988: 89-91) reports that this happened in Ghana and led to the World Bank becoming a temporary defender of central allocation of foreign exchange in that country.

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[14]The 1987 World Development Report defines outward orientation as a neutral policy regime between production for the domestic market and the external market. This is curious since the same document defines inward orientation as a policy bias towards production for the domestic market. Outward orientation should in this sense refer to an export promotion strategy.

The international environment is also important for the success of an outward orientation strategy. The ubiquitous nature of economic policy reforms has resulted in many developing countries attempting to expand their primary commodity exports at the same time (the fallacy of composition). This led to over-supply and collapse in primary commodity prices as attested to by the figures provided in the 1991 World Development Report (World Bank 1991: 189) which show that the terms of trade of low and middle income economies fell on average by 3.7% annually between 1980 and 1987. In addition, as Helleiner (1990: 889) has pointed out, exporting depends to a large extent on the ability to penetrate overseas markets in terms of tastes and regulatory requirements. Few developing countries have the necessary expertise in this area.

The advocates of outward orientation also assume that protection in developing countries is for the purposes of import substitution. In reality, tariff revenue and balance of payments considerations have also been factors determining the imposition of trade barriers. Moreover, much of the policy making process in developing countries is ad hoc and uncoordinated (Bruton 1988: 1618-1619).

The claims made for outward orientation are based on empirically unsustainable criticisms of import substitution. Korea and Japan, two late developers, maintained policies which protected domestic industry. Bruton (1988: 1622), citing another study, reports that in Korea by 1970, of 1312 major import items, 70 were banned while 524 were subject to some kind of restrictions.

Finally, import substitution policies could also be a means of inducing learning which is a crucial element in the development process. India was for instance one of the most technologically advanced developing countries even at the time it was associated with an import substitution strategy (Bruton 1988: 1631-1632). Even in the so-called outward oriented countries of East Asia there is no unambiguous case. Protection may ease penetration of exports in other markets by allowing profits to be used to absorb fixed costs or allow for the selling price in the world market to be maintained below average production costs.

3.4.3.3 Debatable Benefits of Privatisation

Very often the case for privatisation has been based on the empirical evidence of poor performance of public enterprises (World Bank 1995: 33-50). Even if we set aside the useful observation made by Vickers and Yarrow (1991: 112) and Streeten (1993: 1288) that the distinction between public and private enterprises is often a matter of degree, the empirical claim of poorly performing public enterprises has also been questioned. Chang and Singh (1993) provide evidence from industrial and developing countries alike to show that this is not necessarily the case and, like most writers making a similar observation, point to the good performance of Posco, the Korean public enterprise (pg 47). (See also Streeten 1993: 1286.)

A useful outline of the theoretical claims made for privatisation is provided by Van De Walle (1989: 603-606) and includes fiscal benefits, allocative efficiency, productive efficiency and non-market efficiency gains.

The fiscal benefits of privatisation are a reduction in the budgetary claims made by public enterprises on government and the revenue streams derivable from the sale of such assets. It is often claimed that public enterprises often perform poorly because they face a soft-budget constraint. In other words, public enterprises do not economise on resources because they have access to budgetary support from governments. In such cases, privatisation becomes a means of eliminating such demands on central government expenditure.

It is not entirely obvious why the solution to the soft-budget constraint should not be a hardening of the constraint instead of privatisation. After all, it should theoretically be possible for governments to show some autonomy by refusing to provide budgetary support to inefficient enterprises. Furthermore, governments in industrial countries have been known to bail out troubled private enterprises such as Volkswagen (Germany), Chrysler (United States), and British Leyland (United Kingdom). (See Vickers and Yarrow 1991: 114; Chang and Singh 1993: 54.)

The potential revenue stream accruable to governments from the sale of public enterprises is another possible benefit of privatisation. Such a benefit is, however, once off and, as Van De Walle (1989: 603-604) has noted, the long-term benefits are doubtful if such resources are just used to repay debt instead of being invested to improve the long term capability of the economy. He also pointed out that the present sale price is theoretically equal to the discounted income stream and as such there has to be an identifiable time value of expenditure to make the sale worthwhile.

Privatisation is usually said to promote economic efficiency. This is either in the form of allocative efficiency, productive efficiency or non-market efficiency. Gains in allocative efficiency may arise when prices are allowed to determine the distribution of scarce resources while productive efficiency may be attained by a reduction in X-inefficiencies. The possibility of gains in allocative efficiency from the privatisation of public enterprises are more likely when such a firm has market power. In such circumstances, the more relevant issue may not be ownership but reforms such as the removal of subsidies or the introduction of competition.

The case for privatisation leading to productive efficiency is based on the idea that private owners are more likely to have an incentive to maximise profit than government authorities. This is because the private owner as a manager has a direct benefit from the profit which government appointed managers do not have. There is merit in this view but it does not tell the whole story. As Rowthorn and Chang (1991: 3) have pointed out, most modern corporations are joint stock companies and the position of shareholders in such enterprises in relation to managers may be no different from public ownership. Vickers and Yarrow (1991: 115) make a similar observation and go on to argue that market structure remains important, in which case, competition remains a major factor in enterprise performance.

On the claims of non-market efficiency gains from privatisation, Van De Walle (1989: 605) states that the central plank of this argument is that the state can never adequately replicate the markets ability to process information in a decentralised manner. Rowthorn and Chang (1991: 6) ascribe this view to the 'dispersed knowledge theory' of the Austrian School. These writers usefully point

out, nonetheless, that the problem of dispersed knowledge is not restricted only to public enterprises but also to large private companies.

It is important to remember that the privatisation process also has costs in terms of time and management resources utilised in the process of preparing the public enterprise for sale (Bienen and Waterbury 1989: 619). In sum, as Van De Walle (1989: 607) has noted, 'many inefficiencies may be less a function of ownership than of government regulation and market structure'.

3.4.3.4 Inconsistencies in the Policy Package

In certain respects, the effects of the economic reform package may be inconsistent with or contradict desired objectives. Examples have already been provided of the possibility of the fallacy of composition or the negative impact of reduced public investment.

Stewart (1994: 115) has pointed out that indiscriminate import liberalisation may cause industrial stagnation as scarce foreign exchange resources may be diverted from being used to import essential industrial inputs to import luxury items. A similar point is made by Stein (1992: 89) who observed that while factories were being starved of imported inputs, a skewed income distribution often allowed for scarce foreign exchange to be used to support the consumption habits of the elite.

More generally, Stein (1992: 88-89) identifies several other aspects in which policy reforms appear inconsistent with their ultimate objectives, viz:

(i) devaluation, interest rate increases and rising agricultural prices tend to increase prices at a time when credit controls are being used to rein in inflation;

(ii) repayment of foreign loans is burdensome after devaluation and has negative effects, across the board, on economic activities;

(iii) cutbacks in government expenditure on infrastructure and the consequent poor state of such facilities, including roads and rail, may hamper the effort to increase exports;

(iv) price liberalisation or a reflection of scarcity values in the provision of government services may undermine production in certain sectors. This may include, for instance, reduced access by smallholders to vital inputs like tractors or to the foreign exchange market;

(v) unprofitability of conditions created by structural adjustment policies may encourage some companies to shift from production for profit to trade for profit; and,

(vi) foreign direct investment is unlikely to be attracted by the removal of 'distortions' under economic reform programmes for the simple reason that such measures were, very often, demanded by multinational corporations as a precondition for inward investment.

3.4.4 Critiques of Omission

The final critique of economic policy reforms to be briefly reviewed at this stage is that it takes no account of certain import factors like politics, the continued importance of the state and the insights of institutional economics.

3.4.4.1 Politics and Unsustainability

There has been extensive research carried out on the impact of and influence of politics on the economic policy reform process. (See for instance Nelson 1989; 1990; Haggard and Kaufman 1992.) These studies are useful in providing a picture of the political issues involved in the policy reform process such as the political conditions allowing for reform, the difficulties of implementation and the commitment of implementing governments to the programme. It suffices here to summarise two points raised by Hawkins (1991).

First, two states with similar economic conditions may have similar structural adjustment programmes with entirely different outcomes because of *varying degrees of state autonomy* (Hawkins 1991: 840).

Second, there is a need for intelligent assessment of who benefits and who loses from the economic reform process in order to maximise the support from beneficiaries and minimise the potential political damage which can be wrought by losers. Hawkins argues that initial attempts at structural adjustment in Zambia failed because the programme attacked the existing political and economic order without creating the basis of political support for the new one (Hawkins 1991: 847).

3.4.4.2 Undermining the State

Virtually all commentators, including the proponents and opponents of economic policy reform, are agreed on the fact that one of its primary purposes is to reduce the role of the state (Krueger 1992; World Bank 1987; Toye 1994: 24; Demery 1994: 33; Singh 1994; Kahler 1990: 41; Streeten 1993: 1292).

It was pointed out earlier that the economic reform package owes it origins to the neo-classical counter-revolution in development economics. This view sees the state as the cause of distortions which detract from the efficiency of markets and the price mechanism. Furthermore, the point is made that governments were the cause of the economic crisis in developing countries because they introduced the policies that caused the problems.

There is, however, a need to look more closely at the arguments made for reducing the role of the state in developing countries. The observation made by Gerschenkron (1962: 44, 355) is sometimes forgotten. He had pointed out in a study of European industrialisation that the degree of state intervention in a country was often a direct consequence of its position relative to more advanced economies. More recent empirical evidence from the East Asian Newly Industrialising Countries lends credence to the view that the state plays an active role in the development process of late industrialisers. This was certainly so in the case of Korea (Amsden 1989; Chang 1994) and Taiwan (Wade 1990).

Of equal importance is the fact that the zeal of reformers to reduce the role of the state runs into the paradox of implementation (Toye 1994: 31) or the orthodox paradox (Kahler 1990: 55). Policy reforms are economy wide and expected to be implemented by the very governments which have been accused *a priori* as the very source of distortions (Bauer 1971: 85-88) or, less stridently, as lacking the capacity to implement the policies they introduce (Krueger 1990: 15).

Similarly incongruous is the fact that structural adjustment policies as conceived are expected to redress the urban bias against the rural sector which Bates (1981:) attempts to demonstrate in the case of Africa. As Kahler (1990: 56) has pointed out it is the very beneficiaries of such policies who are expected to implement policies aimed against their own interests.

3.4.4.3 Institutional Neutrality

A major source of dissatisfaction with the economic policy package is that it does not take into account the role of institutions in development, or more precisely it assumes that the institutional framework in developing countries is adequate or efficient. Stein (1994: 83) has argued, for instance, that ***"structural adjustment because it is derived from neoclassical economic theory, is basically ainstitutional and therefore ill-equipped to promote the development of market institutions in Africa".***

There are two strands to this criticism which may be identified at this stage. First, is that due to its neo-classical antecedents the economic policy reform package fails to take into account the fact that markets can only function fully within a framework of legal, religious, moral and conventional institutions which are designed to ensure a coincidence between self interest and community interest.

Second, is that in the haste to reduce the role of the state the proponents of economic policy reform do not take into account its role in the development of legal systems which might encourage and enforce market exchanges. As North (1981: 17) points out: ***"A theory of the state is essential***

because it is the state that specifies the property rights structure ... which causes (economic) growth, stagnation or decline". These issues are explored in further detail in the following chapter.

3.5 CONCLUSION

Economic policy reforms have been widely adopted in the developing world as a result of a paradigm shift in economic development and to a lesser extent the debt crisis and generalised economic crises in developing countries. After a brief outline of the contents of the conventional structural adjustment programme it was seen that there is in fact no consensus on the new development paradigm as claimed by some of its proponents. Rather, the adoption of economic policy reforms appeared to have generated controversy.

The purpose of outlining the criticisms made of the economic policy reform package is not to deny that it lacks any merit. Indeed, there are substantial insights derivable from the work of those who advocate economic policy reforms. As Streeten (1993: 1293) reminds us the criticisms of governments and states by neoclassical political economists are useful in 'explaining bad policies and the absence of reform'. Certainly the empirical evidence of government failure in Africa appears convincing and pervasive. (See Bates 1981; World Bank 1981a for broad critiques.)

Some of the criticisms of economic policy reforms outlined in this chapter are also problematic when taken individually. They lack a coherent structure and do not provide evident alternatives. Moreover, they do not always take account of institutions. For instance, it is not enough to ask for structural adjustment with a human face or criticise privatisation because the state sometimes rescues big companies. What is important is the economic role being played by the state when it carries out such actions.

This chapter clearly shows that there is still considerable disagreement on the utility of economic policy reforms as defined and dissatisfaction with the impact of the package on implementing

economies. Most important from the perspective of this study is the omission of the state and institutions from the policy reform framework. The next step, therefore, is to identify the institutional weaknesses in mainstream approaches and attempt to construct an institutionalist political economy as a basis for assessing the potential impact of economic policy reforms on developing countries.

CHAPTER FOUR

THE IMPORTANCE OF INSTITUTIONS IN ECONOMIC TRANSFORMATION

In the preceding chapter economic policy reforms were considered inadequate as a development paradigm because they took little or no account of politics and other institutional factors. This shortcoming arises from the fact that structural adjustment owes its antecedents to neo-liberal thought and its emphasis on individual action. The intention in this chapter is to highlight the weaknesses inherent in theory underpinning economic policy reforms and propose an institutionalist approach to the political economy of developing countries.

The perceived limitations of neoclassical theory will be outlined in the first section and followed in the second section by a consideration of some of the differences in institutional approaches. The third section is devoted to developing the building blocks for an institutionalist political economy and following from this the fourth section discusses the important institutional role of the state. The last section articulates a framework for how state intervention may take place in an economy in search of condensed growth.

4.1 INADEQUACY OF NEOCLASSICAL ECONOMICS

As Bromley (1993: 132) concedes, neoclassical economics is powerful and elegant when confronted with the problem of constrained maximisation within a given institutional arrangement. The problem, especially with regard to developing countries, is that it is the changes in taste and preferences, endowments, and institutional arrangements that are of crucial importance. As such, "economics that is preoccupied with constrained choice is incomplete and often badly suited to a serious discussion of national economic development" (Bromley 1993: 134).

In particular, such inadequacy is manifest in a number of implicit assumptions including a tendency to treat the market as the only institution, over-concentration on the price mechanism, neglect of institutions underpinning exchange, the rationality postulate, hidden value biases and a failure to recognise the institutional diversity of capitalism.

4.1.1 Assumption of Market Primacy

Neoclassical economics tends to place the market at the centre stage of economic activity (Simon 1991: 25) and other institutions are seen as only emerging in response to market failure (Chang 1997b: 26). Such an exclusive focus ignores the fact that other institutions exist which also serve a coordination function or through which an economy could be organised as demonstrated in several works (North 1981; Schotter 1981; Langlois 1986; Matthews 1986; Simon 1991; Chang 1994b; Samuels 1995). Such institutions do not only include firms but what has been more broadly referred to as constructed order, including organisations, networks and state intervention (Chang and Rowthorn 1995: 34)

According exclusivity or primacy to the market has a number of consequences. In the first place, it overlooks what goes on in firms which as Simon (1991: 28) notes, function through a process of administrative decisions and yet are responsible for most of the economic activity going on in the world.

Secondly, the existence of large units like business conglomerates and labour unions means that most economies may not have the large numbers of actors on which the model of a perfectly competitive market depends. The possibility of strategic behaviour therefore emerges. Thirdly, and equally important, because of its preoccupation with markets, neoclassical thought tends to belittle the role of state intervention which, whatever form it takes, is pervasive. This attitude has resulted for instance in a shift of attention from the very important aspect of state capacity and has led to undue weight being attached to market failures. Moreover, because the contribution of other institutions is ignored, market failure (real or perceived) tends to be equated with a failure of the

entire economy in the sense that, once the economy is synonymous with the market and the market fails, then the economy is also in failure (see Chang 1997a: 16).

4.1.2 Preoccupation with the Price Mechanism

As a result of its over-concentration on markets, neoclassical economics has tended to be preoccupied with the price mechanism and the assumption that prices contain all the information that economic agents need to know. However, this is not necessarily the case as products have quality and time dimensions which cannot be encapsulated by price. In other words, the information available to economic agents is often asymmetrical as exemplified by the market for second hand goods (see Hahn 1981: 6-7).

Furthermore, Coase (1992: 714) argues that concentrating on the price mechanism ignores the process that takes place between the purchase of factors of production and the sale of goods produced by such factors (see also Liebenstein 1989: 1362). In other words, treating the firm as a production function takes no account of transactions costs and the role of hierarchies in the organisation of production.

Moreover, as North (1981: 5) has pointed out, economic activity is not "frictionless". There are costs associated with the search for productive and allocative efficiency as well as in the creation, maintenance and enforcement of property rights. While the pursuit of productive efficiency has costs associated with the process of learning new technologies and the monitoring of workers, the search for allocative efficiency has costs of preventing opportunistic behaviour in the process of exchange as well as costs of processing information relevant to making choices (Chang 1994a: 48-49).

The over-concentration on the price mechanism has also contributed to a high level of abstraction in economic analysis that does not allow for a detailed knowledge of the economic system. In this context, and considering that growth is of primary concern to developing countries, the

preoccupation of orthodox economics with equilibrium and its failure to incorporate technical progress must be seen as a serious limitation. It is this difficulty that has led some economists to the assertion that competitive markets bring about short run allocative efficiency as well as structural transformation (see Evans 1995: 25). However, as Lazonick (1991: 64-65) has pointed out, the theory of the market economy is not a theory of value creation but one of value allocation in the sense that it does not explain how the use of the same quantity of factors can create greater output.

One of the consequences of focussing on the price mechanism is the emphasis on price liberalisation in reforming economies without taking into account the important role of other factors. For instance, North (1989: 1320) asserts that transactions costs have accounted for the greater incidence of stagnation instead of growth in economic history. It may, therefore, be necessary to bring about institutional change in order to lower transactions costs and allow for better performing economies.

4.1.3 Neglect of Institutions Governing Exchange

In spite of its concentration on markets, neoclassical economics has tended to neglect the institutional arrangements which govern the process of exchange. In some countries, the institutions that underpin the market still have to be created and maintained. If we agree with Coase (1991: 717) that exchange is the trading of property rights, then the legal system underpinning such exchange is important. As such, it may be important for the state as the ultimate designer of the legal system to bring about institutional structures to allow the market to flourish.

The importance of this point becomes clearer when the empirical experience of other countries, especially the developed economies, is examined. Polanyi's book *The Great Transformation* (1957) has shown that the development of market institutions in the free-market economy of Britain required wide-ranging state intervention as typified by the enclosure laws, new poor laws and municipal reform. Similarly, Kozul-Wright (1995) devotes an entire article to demonstrating that the United States government played an active role in the structural transformation of that country through active infant industry protection, the provision of physical infrastructure and the funding

of research. The experience of the former Communist countries of Europe also clearly shows that a capitalist economy requires certain institutions in order to function well. Bromley (1993: 137) contends that the economies of such countries will not flourish until the political system decides on the institutional structure that will guide the economy.

4.1.4 Dissatisfaction with the Rationality Postulate

A bedrock of neoclassical economic theory is the rationality postulate which requires that individuals consciously maximise utility within well defined constraints. This is, however, a source of dissatisfaction among several writers, including those such as North (1981: 4) who accept the basic framework of neo-classical economics. Instead, some propose the notion of bounded rationality associated with Simon (1957; 1979), which postulates that due to limited knowledge of all possible options and computational limitations, an individual cannot maximise his utility and instead satisfices..

Simon (1979: 501) characterises a bounded rationality model as one that:

> ***"would describe how decisions could be ... made when the alternatives of search had to be sought out, the consequences of choosing particular alternatives were only very imperfectly known both because of limited computational power and because of uncertainty in the external world, and the decision maker did not possess a general and consistent utility function for comparing heterogeneous alternatives".***

Another criticism levelled against the rationality postulate is that it takes no account of variety in human behaviour. Even North (1981: 7) who speaks of "a theory of institutions... to fill the gaps in the neoclassical model" expressed dissatisfaction with the rationality postulate because it does not explain altruism or stability. For instance what would motivate self-seeking individuals to do things from which they derive no obvious benefit? And, why do individuals obey laws when they can easily evade them to their benefit or conversely disobey them despite obvious social benefits?

An example of altruistic behaviour is the free donation of blood, while the habit of obedience is easily demonstrated by the fact that many people obey traffic lights at two o'clock a.m. without the risk of being apprehended or of being involved in an accident. Conversely, as Williamson (1975:7) has noted, opportunism, i.e. self-seeking with guile, is not well addressed in conventional economic models. As such, there is a presumption that the rational man does not cheat or steal.

The critical point here is that the learning of societal norms plays a crucial role in decision making by economic agents and that there are situations in which the benefits of individual action are not unambiguous. The concept of individual rationality is likely to prove problematic when addressing situations in which cooperative solutions are unambiguously better than the pursuit of individual interest.

4.1.5 Assumption of Institutional Uniformity of Capitalism

Neoclassical economics has also been criticised for hiding its value-biases behind a facade of elaborate mathematics and statistics which seem to provide evidence of its being scientific and objective (Bromley 1993: 132). In welfare economics, the notion of efficiency as defined by Pareto-optimality has, in particular, been advanced as a neutral means of evaluating economic performance. As Vira (1997: 762) has pointed out, even on a given welfare frontier there are several Pareto-optimal points. Moreover, as was noted in the previous chapter, Pareto-optimality varies with each income distribution as it does with the legal and political structure.

In a related context, Chang (1997a: 39) notes that "in the conceptual construction of the model economy, some country specific institutions and behavioural patterns ... are uncritically taken as 'universal' ". For instance, therefore, the notion that an enterprise should be run in the interest of shareholders may be country specific (to the United States and United Kingdom) as compared to the practice in some other countries (Germany, Japan) which expect that enterprise should be run for the benefit of all stakeholders.

There is also a mistaken tendency of equating capitalism (a market economy) with the market which is only one of its institutions. Following from this is an inclination to see capitalism as being uniform across countries based on the belief that there is only one set of scientific laws in economics which can be applied to all economies. This links back to the point made in Chapter Three: the umbilical link of structural adjustment to the idea of 'monoeconomics'.

There is, however, ample evidence available to demonstrate the institutional diversity of capitalism. From an empirical perspective, Chang (1997a: 36) shows, for instance, that capitalism in the industrial policy states of East Asia differs from the capitalism which evolved in the social corporatist states of Scandinavia. The success of one was typified by "conscious coordination and promotion of selected industries by a competent elite bureaucracy" while the other owed its superior employment record to the "tripartite bargaining structure between the centralised union, the employers' organisation and the government". In like manner, the differences in the financial system of Anglo-Saxon economies has been contrasted to that of Japan and Germany. In the latter case, it has been argued that the close relationship between the banks and industry allowed them to be more patient in a manner which favours long-term investment.

Two points need to be emphasised in this context. First is that the outcome of policies is very dependent on the institutional structure of a given economy. Simply put, industrial policy which works in East Asia may, admittedly, be unworkable in Africa, where state structures are weak. This, however, leads to the second point which is that the 'replicability problem' works both ways. In other words, while the preceding characterisation of African countries vis-à-vis their East Asian counterparts is undoubtedly true, so also is the fact that the free market structures of advanced capitalist countries are not easily replicable in developing countries (Chang 1997a: 38).

This section has focused upon some deficiencies in neoclassical economics and in its related branch of welfare economics. The next section attempts to highlight responses to these deficiencies from the perspective of new institutional economics and is followed by an attempt to elaborate the pillars of an alternative approach based on political economy.

4.2 NEW INSTITUTIONAL ECONOMICS: A MISSING LINK?

The interest in the study of institutions in economics has increased in recent times.[15] This is mainly as a response to the gaps and inadequacies of the neoclassical paradigm. It would seem, however, that different economists have concentrated on filling in different gaps. This is inevitable, partly due to the fact that they have different interests and motives and partly due to the breadth of the subject itself. We look first at attempts to fill the gaps in neoclassical theory and then at the inadequacies of new institutional economics.

4.2.1 Attempts to Rectify Neoclassical Inadequacy

As a result of the perceived inadequacies of neoclassical economics, attempts were made to rectify some of the shortcomings while remaining within the same methodological framework. In particular, as Simon (1991: 27) notes, a wider set of exogenous assumptions were introduced to enable the workability of neoclassical theory. As such, the existence of moral risk, insurance contracts and information asymmetry was acknowledged and incorporated into the framework.

In addition, the importance of transactions costs and its impact on the efficiency of resource allocation was recognised. In other words, it was accepted that economic growth required the lowering of transactions costs. This, in turn, led to a breakdown of the idea that equity and efficiency considerations could be separated. After all, if transacting is costly, then existing distribution of wealth and income would determine the nature of contracts that are negotiated which, sequentially affects the efficiency of resource use (Bardhan 1989: 1389).

There was also an acknowledgement that institutions which define the choice set of individuals and firms may change, and such institutional changes were ascribed to relative price changes. Broadly

[15]At least two writers interested in this topic have been recent winners of the Nobel Memorial Prize in Economic Sciences, viz.: R.H. Coase-1991; D.C. North-1993.

speaking, this attempt to reform neo-classical economics became known as 'new institutional economics', a term popularised by Williamson (1975). The name itself was probably an attempt to distinguish the approach from the 'old institutionalists' such as Veblen, Commons, and Ayres whom Langlois (1986: 5) accused of wanting "an economics with institutions but without theory". Matthews (1986: 903) is similarly dismissive and describes the doctrines of 'old institutionalists' as too ill-defined. However, the reason for choosing the name may not have been readily achieved. Like 'new, improved' versions of popular detergents, 'new institutional economics' sounds like more of the same thing in a new package, a fact which Langlois (1986: 2) admits to.

Indeed, the term new institutional economics may be too narrow to cover the intended field of study as it may be taken to reflect the usage intended by Williamson. Even Langlois (1986: 1) who elects to use the term points out that institutional economics extends beyond transactions costs (Williamson), to property rights (Coase), behaviouralist (Simon), evolutionary (Schumpeter) and Austrian (Hayek). This only differs slightly from the scope provided by Eggertsson (1990: 6) who includes the following schools in the economics of institutions, viz.: Property Rights School, Transaction Costs Economics, the New Economic History, the New Industrial Organisation, the New Comparative Economic Systems, Law and Economics.

The breadth in the study of institutions in economics may have resulted in differences of approach and focus. All these approaches would, nonetheless, seem to be united by a recognition that several institutions affect economic performance across space and time. There are, however, substantial criticisms of the attempt to reform neoclassical economics through the new institutional economics.

4.2.2 Limitations of New Institutional Economics

A major drawback of new institutional economics is that it still uses what Vira (1997: 771) describes as the logic of the bargained exchange. In other words, it still tends to treat all transactions as negotiated contracts and is therefore vulnerable to the same criticism of neoclassical economics

especially the primacy given to exchange and ignorance of the role of authority and procedure or even donations and gift giving.

As noted earlier, new institutional economics has attempted to strengthen neoclassical theory by introducing information costs, transactions costs and motivational concerns. However, while the utility of some of this work has been recognised[16] concern has been expressed that these factors are still treated as exogenous and not requiring further explanation. Simon (1991: 26) is critical of this deficiency mainly because new institutional economics has not supported its auxiliary assumptions with available empirical work in the study of organisations and decision-making.

Bardhan (1989: 1390) comments on the fact that new institutional economics seems to believe that institutions will evolve once individuals come to realise their benefits. This implicit belief probably derives from transferring the coordination role expected of the invisible hand of the price mechanism to the evolution of institutions. Institutions, however, have collective good characteristics and collective action problems ensue from the belief that beneficial institutions will evolve once individuals realise their uses.

Some writers in the new institutionalist tradition believe that institutional change is brought about by changes in relative prices. This is thought to occur through changing factor proportions, such as increases in population given fixed land resources. This would lead to changes in their relative prices and bring about pressure for institutional change. The problem with this view is that it is demand induced and ignores the supply side of politically introduced institutional change. It is not possible, as Bardhan (1989: 1391) notes, for relative prices to determine the balance of class forces or the outcome of social conflict. Moreover, he also notes that there is empirical evidence to demonstrate that changes in relative prices brought about by trade have equally led to economic stagnation as well as economic growth.

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[16]Bardhan (1989: 1390) is appreciative of the work done in imperfect information especially in the area of risk aversion, information asymmetry and moral hazard.

Another view common to new institutional economics is that institutions are necessarily efficient. This is, however, unlikely for several reasons. First, as was noted earlier, the notion of efficiency depends critically on the constraints chosen. It would, therefore, seem redundant to expect institutions to be efficient since they define the constraints within which efficiency is being sought (see Vira 1997: 765). Second, there is empirical evidence of the continued existence of dysfunctional institutions or the adoption of new institutional arrangements that are not collectively beneficial. Bardhan (1989: 1391) refers, for example, to the persistence of economically unprofitable activities due to fear of social sanction and to the "persistence of socially sub-optimal institutions" due to path dependence.

In some cases, where new institutional economics, especially its related branch of positive political economy, accepts that new institutions can be brought about by political factors, it tends to treat such events as always being a binding constraint in the sense that political choices are based on the individual rationality of those who make such choices. Of course, it is not that politics cannot impact negatively on institutional design, the point is that it remains a source of different varieties of institutional change. As Bromley (1993: 145-146) explains, it is possible for politics to be used to establish institutions that re-allocate economic opportunity or to redistribute economic advantage. As he puts it: ***"The difference between institutional change that redistributes economic advantage, and that which re-allocates economic opportunity is to be found in the nature of the social utility function".*** Put differently, economic agents may use their power to create institutional arrangement that redistribute or maintain their economic advantage, but then they may also bring about new rules to re-allocate economic opportunity as a result of shifting ideological and moral considerations.

In sum, therefore, new institutional economics is useful in highlighting the importance of factors like property rights, transactions costs, and costs of imperfect information in economic analysis. It, nevertheless, suffers from a fundamental problem of treating institutional factors as either given or demand induced, thus neglecting the crucial problem of politics in the economic process. The approach taken in the next section is that ***"the polity and economy are inextricably interlinked in***

any understanding of the performance of an economy and therefore we must develop a true political economy discipline" (North 1990: 112).

4.3 INSTITUTIONALIST POLITICAL ECONOMY

A number of weaknesses were identified in the attempts of the new institutional economics to introduce institutional considerations into economic analysis. In this section, the broad bases of an institutionalist political economy is outlined. This is intended to address the critical points made above as well as to acknowledge the institutional diversity of capitalism and the importance of history and politics in evaluating the economic performance of different countries (see also Chang 1997b).

4.3.1 Institutional Diversity of Capitalism

It is important to underscore the fact that capitalism is an economic system which incorporates the market as the main institution of exchange. However, there are other institutions which determine economic activity within the capitalist system. For instance, the firm is an institution of production, the state an institution of political action, the financial system an institution for facilitating the various uses of money. Moreover, the arrangement of all these institutions varies in the same country over time as well as between countries. In addition, the effect of their mutual interaction also varies. As Chang (1997a: 36) puts it, there is "not one but many middle ways".

Earlier reference was made to the differences in institutional arrangements between East Asia and Scandinavia. Variety may be added to this by recalling the bureaucratic-authoritarian Latin American states and the fragmented and dysfunctional African state. At the level of the firm, the small niche oriented firms of Emilia-Romagna in Italy, Baden-Wurttemberg in Germany, and Hong Kong (see Chang 1997a: 36) can be contrasted to the large Japanese *keiretsu* and the Korean *chaebol*. The different organisation of the financial system in different countries has already been

mentioned and can also be seen clearly from the experiences of Sweden, Korea and Germany (see Chang and Kozul-Wright 1994: 869-873 and 878-883; Gerschenkron 1962: 11-16).

4.3.2 Importance of History

In addition to the diversity emphasised in the preceding section, history matters to the extent that the initial conditions or previous institutional arrangements continue to exert an influence on present day activities or attempt at reform. Even the theory of comparative advantage gives implicit recognition to the importance of history given its reliance on existing resource and factor endowments. In other words, the theory is used to advocate that a country should concentrate on what it produces most efficiently. However, what it produces best in comparative terms at a particular point in time is the outcome of a historical process which determined existing resource and factor endowments.

History also matters because it is the origin of the inherited institutional setting. The norms, formal rules and organisational arrangements of the present are all the outcome of past events. As such, the type of firm, system of government, sophistication of the financial system and structure of labour unions a country has are a result of its specific history and impact, not only on economic performance but also on the policy making process.

In South Africa, for instance, where labour unions were in the forefront of the struggle against *apartheid* and thus produced many of the present leaders in government, unions may be more influential than in Singapore or Japan. Similarly, the nature of the bureaucracy inherited from colonial masters may have a bearing on present bureaucratic attitudes and practices. As Evans (1995: 29) notes: ***"If historically derived institutional patterns define individual interest and constrain the way they are pursued, then 'One size fits all' diagnoses will not work".***

History matters to the extent that initial or previous economic arrangements continue to exert an influence on present day institutions or attempts to reform them. In other words, institutions are

path dependent.[17] Path dependence - historical antecedents from which present day norms and formal rules have developed - is readily demonstrated, for instance, by the continued survival of inefficient technological forms arising from infrastructural and network externalities as well as learning and coordination effects (Bardhan 1989: 1392). Common examples of such path dependence include the QWERTY typewriter keyboard, narrow gauge British rail lines and the United States colour television system.

In this context, David (1994) further underscores the importance of history. First, the need for coordination amongst individuals requires the emergence of common knowledge and consistent expectations in the form of conventions. Such expectations may be brought about through shared history as a result of precedence or by sheer accident and are reinforced by socialisation and ethical education. Adherence to such conventions, be they negative or positive, then becomes ingrained and difficult to change (David 1994: 209-210).

Second, organisations require channels for processing information and codes to make the transmission of such information more efficient. However, the learning of such codes brings about 'asset specificity' in individuals. In such instances, since the code in use is introduced according to 'best expectations' at the time the organisation is being created history enters the equation. The use of codes then becomes path dependent because of the need for mutual intelligibility of codes over time (David 1994: 212).

The third reason is that since institutions have various functions such as: establishing information channels, providing procedures for recruiting and educating, specifying rewards and sanctions, creating means of monitoring performance, and preventing entry or providing for exit, there needs to be some compatibility and complementarity amongst such arrangements. History therefore matters because the shape of these institutional clusters is determined over time. This point is vividly demonstrated by the following passage from (David 1994: 214) which states that:

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[17]On path dependence, see David (1985).

> ***"...the historical context in which institutions or organisations are formed can become enduring constraints ... and can result in the selection of a particular solution for what is perceived at the time to be the crucial generic function, for example, recruitment of participants and this can limit the design of other rules and procedures so that even if the original rationale were to become irrelevant, altering the organisation's recruitment policy would possibly disturb many other aspects of its operations and so impose reasonable readjustment costs".***

Institutions are therefore a product of the historical process and the "negative impact of past distortions will persist" (Aron 1996: 111). This, as will be maintained later on, is critically important when assessing the impact of reform programmes in developing countries.

4.3.3 Significance of Politics

A major contribution of neo-liberal economic thought is that politics matters in evaluating economic performance. This approach has been carried over into new institutional economics through the view that politics is a negative supply side factor in institutional change. As such, North (1981: 28) views the state as predatory in the sense that it sought to maximise revenues accruing to it within the political constraints it faced. Similarly, Ruttan and Hayami (1984: 213) argue that political entrepreneurs introduce institutional changes on the basis of expected private returns.

These approaches, while useful in acknowledging the importance of politics as a source of institutional change, are deficient from the standpoint of uncritically accepting the efficiency notion of institutions. This is in the sense that exogenous factors are seen as bringing about demand for institutional innovation and political actors supply such change in accordance with their perceived interest. Efficient institutions are then seen to emerge from this interplay of demand and supply factors. However, we had pointed out earlier that institutions are not necessarily efficient and, more critically, the idea of efficiency may not be applicable to constraints, which is what institutions are.

The positive political economy approach suffers from the fact that it treats the demand side as the driving force for institutional change with the supply side of politics seen as a constraint in the negative sense (Vira 1997: 767). It is proposed here, instead, that the polity has a role as an active and sometimes positive supplier of institutions. In the first place, as Chang (1997b: 27) emphasises, the market is a 'political construction' in the sense that it is defined by the rights and obligations which underpin it. These, in turn, are determined by changing views on what is politically and ethically acceptable. For instance, Bromley (1993: 143) points out that the emergence of the welfare state may have arisen from new collective concerns abut relative income shares. Legislation to limit the effects of pollution on the environment is another example of how the political process has responded to changing attitudes. As such, the drive for industrialisation which implicitly gave manufacturers the right to pollute has given way in many developed economies to concerns about degradation of the environment. The role of politics in the abolition of slavery or the right to own another human being is another example.

Secondly, as Vira (1997: 769) argues, political differences are real and may not be due to the pursuit of self-interest but to genuinely different ideological positions. In such cases, Vira suggests that "if the state is relatively isolated from demand groups and has the power to implement change, it can play an important role in the creation of institutions". In a similar vein, Nelson (1981: 110) asserts that even in the developed countries the main issue is "about where to supplement or supplant the institutions of private enterprise with others which involve more ascription of roles, more centralised information channels and more higher order monitoring and regulation".

If politics matters, then the state as a critical player in the polity matters, and the last element of the institutionalist political economy being outlined here is the need for a more nuanced view of the role of state intervention.

4.3.4 A More Nuanced View of State Intervention

The new political economy has shown the limits of entrusting too much to the state. However, the market has its own limitations and the issue is not one of a state-market dichotomy but one of how both can complement each other. As such, given the centrality of institutions to development as well as the importance of history and politics, it follows that there is a need to develop a more balanced view of state intervention. After all, even the minimum uncontested areas of state intervention require a certain level of state capacity which cannot be taken for granted. This is readily demonstrated by looking at some elements in the list of areas of state intervention conceded by Friedman (1982: 34), viz.: the maintenance of law and order, definition of property rights, adjudication of disputes, enforcement of contracts, promotion of competition, provision of monetary framework, etc.

This is a crucial point also made by the World Bank (1997: 3) when it states that ***"... reducing or diluting the state's role cannot be the end of the reform story. Even with more selectivity and greater reliance on the citizenry and on private firms, meeting a broad range of collective needs more effectively will still mean making the state's central institutions work better".***

Furthermore, the state intervenes in all economies and as such its role needs to be better understood, since the difference between what constitutes state intervention and what is considered as an institution underpinning the free market varies over time and space. Chang (1997b: 8-9) notes, for example, that few people in member states of the Organisation for Economic Cooperation and Development perceive a ban on child labour as a form of state intervention intended to restrict entry into the labour market. Whereas, in many developing countries a substantial number of people would interpret any such laws in these terms.

The crucial point is that the state has a major role to play in the formation of institutional arrangements which underpin good economic performance. As such, where the state is able to mitigate, through appropriate institutional arrangements, the motivational, information and capacity

problems of state intervention, then it can clearly contribute positively to the development process. Chang (1994a: 35) points out that improving such capability would require a rational decision-making procedure to reduce the costs of collecting and processing information. In addition, there has to be a means of overcoming information asymmetry between the top of the hierarchy and the subordinate levels as well as between agents and their clients.

This section has sought to pinpoint crucial elements in an institutionalist political economy which attempts to overcome the institutional limitations of neoclassical economics as well as the shortcomings of the new institutional economics. The next section is devoted to a closer examination of the institutional role of the state.

4.4 THE STATE AND ECONOMIC TRANSFORMATION

This section attempts to articulate the importance of a particular institutional form, that of state intervention, in the process of economic transformation. The state can in certain circumstances act as a creator, designer and defender of institutions in order to bring about condensed growth. As such, the emphasis placed by the new political economy on reducing the role of the state while useful in highlighting negative possibilities may have gone too far in actual implementation in the form of economic policy reforms.

Reference was made earlier to empirical examples of successful state intervention. To recapitulate, these include infant industry protection in Germany and the United States, social corporatism in Scandinavia and Austria and industrial policy in Japan and the rest of East Asia. In a more generalised form, it is possible to see state intervention in the form of its coordinating role, management of political conflict and creation of institutions of exchange. This perspective, as Amadeo and Banuri (1991: 30) point out, is not new and is similar to the Keynsian approach.

4.4.1 Coordination of Economic Activity

The process of condensed structural change requires the coordination of economic activity in a manner that reduces transactions costs and minimises economic waste even more efficiently than its predecessors. There are usually two extremes counter-posed as the most efficient means of economic organisation. These are the working of the market mechanism as envisaged under perfect competition and the command economy of central planning.

It was noted in Chapter Two that state intervention was justified by market failure and had in turn drawn a reaction which highlighted the possibility of government failure. There is another aspect to the debate which is over the better means of coordinating economic activity between the market and state intervention in the form of central planning.

It is important to stress that in matters of policy it is not very helpful to undertake an extensive comparison of two ideal states. Nevertheless, such an approach may provide a good starting point for discussion. In particular, it is worth recalling that market prices play an important informational role and the price mechanism does not require the huge administrative apparatus of central planning. Moreover, in perfect decentralisation models, there is no need for *ex ante* coordination of economic activity because, given the very large number of individuals, the unilateral action of a single agent is unable to change aggregate outcomes. In strictly static terms, however, Barone among others had shown that central planning could lead to a similar outcome as perfect competition under the Walrasian auctioneer.

This was the precursor to the familiar Lange/von Mises debate on the possibility of central planning (see Lavoie 1985: 1-5; Pagano 1985: 138 for summaries). Following from this, one writer has dismissed the arguments of those who would, within the framework of static equilibrium analysis, still insist on the administrative parsimony of markets over central planning by pointing out that ***"under steady state conditions, resources are already basically allocated and there is not much information flowing in the system to suggest that resource allocation needs to be changed. Big***

computational machinery is not needed and the communication channels can be rather thin" (Nelson 1981: 99).

Market failure under static conditions has been reviewed in Chapter Two. It was noted at that stage that the very notion of market failure was difficult to sustain since it implied the existence of an impossible ideal against which real conditions could be compared. It would seem, therefore, that Hayek (1949: 82) was correct when he noted that unpredicted change and response to unforeseen variations in demand and supply rather than attaining neoclassical competitive economy are at the core of the economic problem.

Following from this, the issue is whether the *ex post* coordination of economic activity by the market is by itself sufficient when the intention is to bring about or speed up the process of structural change. Marx, for one, saw the *ex post* allocation of the market as wasteful given the lack of coordination in the short-run which causes, among other things, over-production or incompatibility with consumer choices (Lavoie 1985: 43).

In a similar vein, Chang (1994a: 62) also notes that under constant returns to scale, there is no guarantee that the market will clear since individual firms are not bound by production technology. Moreover, even where output can be predicted by each firm, Nelson (1981: 103) predicts that, in the absence of collusion or a central allocation mechanism, chaos would ensue on how to share increases or decreases in capacity.

In addition to the possibility of waste, markets may also work too slowly for condensed growth. Arndt (1988: 227) notes that even in developed economies where large changes have to be accomplished quickly, such as in the movement from a peace to a war economy, this is not left to the workings of the market. A similar observation is made by Simon (1991: 39-40) that there is a tendency to move to more centralised coordination when there is need for rapid change. This is due to the fact that prices can only play an informational role when they are certain, otherwise they produce unpredictable shifts which then make rational choice difficult.

The coordination problem may also be compounded in developing countries by the fact that capital markets are imperfect and may not provide the finance for large investments and there might also not be entrepreneurs willing to accept the huge risks associated with such projects (Stiglitz 1996: 160).

The market mechanism is also unlikely to solve inter-industry coordination problems well in the sense that *ex post* coordination cannot handle the demand relationship between complementary industries. Nelson (1981: 103) notes the possibility of such a problem between the automobile industry which needs to respond to an increase in demand but is itself dependent on a speedy response from the steel industry. It is useful to recall in this context, Scitovsky's emphasis on the 'communication of desirable interactions' and the 'coordination of timing'.

This foregoing argument is, however, dismissed by Stiglitz (1996: 160) because it ignores the possibility of resolving the problem by importing intermediate goods. He argues instead that it is externalities from proximate access to an intermediate good that matters because of the easier two-way flow of information between producer and user that is accorded by physical proximity (see also Simon 1991: 41). This is a useful observation demonstrated for instance by the close relationships between suppliers of components and manufacturers in Japan which allows for the exchange of information on technical specifications and other requirements (Dore 1986: 77).

Of course, it may be argued that such market coordination failures will inevitably be sorted out by correct price signals and the elimination of excess capacity through competition. The key issue, however, is that such coordination failures may be deemed wasteful because there is no guarantee that resources expended in production by unsuccessful firms prior to *ex post* coordination can be costlessly shifted to other activities. This may be more so where there is 'asset specificity' and factors of production cannot be shifted to other uses without costs. (See Chang 1994a: 65.)

Central planning, no doubt, can similarly be found wanting in the search for *ex ante* coordination. Perhaps most telling is the criticism made by Hayek about the large and complex information

requirements of central planning and the massive computational exercise that would be needed (see Pagano 1985:140). Central planning would also suffer from the problems of questionable motives of individuals acting in the name of the state which were reviewed in chapter three. In any case, irrespective of protestations to the contrary, the empirical example of the failure of attempts at central planning in Eastern Europe does not provide any basis for optimism about that method of coordination. The point, therefore, is that for purposes of economic development while central planning is very problematic, the market mechanism may need to be complemented by other forms of coordination.

4.4.2 Political Management of Economic Change

There are inherent conflicts in any economy, such as those between the suppliers and employers of labour or those between the suppliers and users of capital. However, these conflicts are sharper in developing countries because of the demands of economic growth. Likely sources of such conflict include increased inequality or sharper class divisions arising from capitalist accumulation as distinct from small holder agriculture. Even if the share of the surplus accruing to workers is increasing, proportions vis-à-vis other sectors may be contested. Similarly, the skill requirements of a changing economic structure may not readily be provided by labour which will cause capitalists to use more capital intensive means of production. This for instance, may be the case in South Africa where there is jobless growth in the presence of high unemployment. As Amsden (1989: 13) puts it,

> ***"productive entrepreneurship ... contributes to destruction of existing capabilities and institutional routines and threatens the livelihood of groups of individuals who have invested in particular jobs, fixed capital assets, specific skills, local ties ... some groups will (therefore) be at odds with (those) whose real incomes would be raised by technological innovation, structural reorganisation and introduction of new products".***

This process is further sharpened when a new property rights regime is introduced to bring about rapid transformation. For instance, those who lose out in the process through loss of jobs or the shift of income from owners of manufacturing plants in old sectors to those in new sectors may resist such change. As such, Inukai (1993: 17) speaks of the frictions arising from a shorter transformation process which would need to be addressed if the effort is to succeed.

Indeed, the difficulties of structural change do not only manifest themselves in developing countries. Zysman (1983: 24-26) provides examples of the political challenges which may arise when developed economies are undergoing structural change. These include pressures from firms forced to exit declining sectors and the fact that growth in new jobs may not be as fast as the increasing displacement of workers in declining sectors. Perhaps more crucial is the problem of asset specificity whereby displaced factors like machines and workers may not have techniques or skills that allow for their re-deployment in new sectors. The result may be the writing off of specific skills so graphically illustrated by the image of a redundant steel worker flipping hamburgers in a fast food outlet (Chang 1994b: 302).

The key point here is that where there is social conflict, policies which change the income shares of factors of production may not be particularly successful. Amadeo and Banuri (1991:37) make the same point when they state that:

> ***"In particular, policies which seek to alter key relative prices- the real wage rate, the real exchange rate and the real interest rate- which in turn affect the income shares of labour, capital and finance will be less effective, and often counter-productive in more conflict-ridden societies".***

Where the possibility of such social conflict exists, especially as a result of developmental change, institutions are required to manage them and lead to more cooperative outcomes. The institutional practice of life-time employment in Japan is a good example of this. Another useful attempt is the establishment by the South African government of the National Economic Development and Labour Council (NEDLAC) which attempts to bring labour, government and business together in order to

develop a broad consensus on matters related to national economic policy. This arrangement lends credence to the view of Amadeo and Banuri (1990:36) that, "the state is the paramount social agency which can contribute to such institutionalisation".

4.4.3 Creating Institutions of Exchange

The process of structural change can be inhibited by social conflict or hastened by *ex ante* coordination. However, it also requires the provision of a certain class of goods to facilitate the process. In other words, the provision of public goods or other classes of collective action goods may be crucial ingredients for condensed economic transformation. This class of goods may include for instance physical goods such as national defence, roads, power stations, waterworks and intangibles such as taxes, tariffs, subsidies and import quotas (see Nabli and Nugent 1989: 84).

The point has been made in earlier chapters that the market relies on the maintenance of law and order. Certainly, as Whitehead (1993: 1375) states, market systems require peace or at least the maintenance of order without which contracts may not be honoured or as Max Weber put it: ***"... the rationalisation and systemisation of the law in general and ... the increasing calculability of the functioning of the legal process in particular constituted one of the most important conditions for the existence of ... capitalistic enterprise which cannot do without legal security"*** (quoted in Karst and Rosenn 1975: 631). The challenge then is to understand how best to bring about such conditions in countries striving to become market economies.

The movement of a society from simple tribal forms to more complex arrangements is also accompanied by a change in the nature of exchange. In tribal societies, individuals engage in personalised exchange with repeat dealings which enable them to know the personality traits of those whom they deal with. As such cheating, opportunism and shirking do not pay and transactions costs of exchange are low. Production costs are, however, high because specialisation and division of labour are limited by the small extent of the market allowed for by personalised exchange (North 1989:1320).

At the other end of the spectrum, with increasing specialisation and division of labour, the size and scope of exchange is greater. As such, exchange is impersonal and takes place across time and space. In this type of society, exchange is not reliant on repeat dealings and the transactions costs of ensuring the attributes of the good being exchanged and, of enforcing the exchange, are high. In such instances, in order for structural change to take place institutional arrangements are required to reduce such transactions costs.

As the nature of exchange changes with the increased opportunities of gains from trade, it becomes necessary to develop institutions to constrain the behaviour of participants due to the need to reduce transactions costs in order to permit growth arising from specialisation and division of labour. This view is supported by North (1990: 119-120) who observes that the nature of exchange changes with structural transformation. As he puts it the objective is to "examine what kinds of institutions are necessary to enable the cost of transacting and transforming to be at a level that will permit this increasing specialisation and division of labour to occur".

Here again, it may not be practical to leave the establishment of institutions to voluntary co-operation because of the transactions costs of establishing such arrangements as well as the danger of losing the potential economies of scale which could derive from using the state. As North (1990: 57) put it, ***"the inevitable conclusion ... is that complex contracting that would allow one to capture the gains from trade in a world of impersonal exchange must be accompanied by ... third party enforcement".***

Some of the features of developing economies that contribute to high transactions costs mentioned by North (1990: 69) include high interest rates, telephone systems that do not work, inability to obtain spare parts, endless production interruptions, long queues and waiting times to get permits, product variability, costs of acquiring information and widespread bribery. Soto (1989) provides several examples of such problems in his empirical study of the informal sector in Peru.

In such circumstances, institutional foundation for structural change would require:

(i) a well functioning legal system which minimises the transactions costs of enforcing contracts and protecting property rights;

(ii) effective financial intermediation with currency stability and enforcement of repayments;

(iii) ensuring availability of information on goods and services including prices, availability and quantity; and,

(iv) good transport and communications infrastructure which reduces transactions costs and facilitates trade (see Gordon 1996: 1535; Klitgaard 1991: 5).

The state or its agents and organisations in developing countries have an important role to play in bringing about such an effective institutional regime, not least because of the transactions costs and free-rider problems associated with the development process. As neoliberal economists have shown, not all states are able to overcome agency and informational problems or that of capacity but this is certainly not the same as showing that the state has only a minimal role to play in the process of economic transformation.

4.5 AN INSTITUTIONALIST FRAMEWORK FOR STATE INTERVENTION

Following from a realisation that the state has an important role to play in the process of economic transformation it becomes necessary to outline an institutionalist framework for such intervention. In other words, after identifying areas of potential state intervention it remains to outline what ought to be the broad policy objectives in the search for economic transformation.

It is important to stress again, as Chang and Rowthorn (1995: 37) note "...it will be naive to assume that all existing states have the organisational coherence, the political desire or the power to exploit such a strategic position to national advantage". Hirschman (1958: 65) underscores the importance of this point when he argues that: "the fact that private entrepreneurs will be unable or unwilling to do certain jobs which we would like to see done does not in itself ensure that the government can

handle them". However, where these conditions can be met, the state has an important role to play in the search for condensed growth by bringing about institutional arrangements which reduce transactions and monitoring costs, risk and information asymmetry through *ex ante* coordination, providing social stability, public goods and institutions of exchange.

The state in industrialised countries and the Newly Industrialising Countries (NICs) of East Asia, South East Asia and Latin America have demonstrated such capability in varying extent at different times. As such, the framework we propose to outline will be developed within the parameters of experiences. In so doing, however, the importance of the replicability problem must be borne in mind. In other words, the framework proffered only outlines the broad tasks a state should set itself and not how these should be specifically carried out. For example, while some states may be able to mobilise investment resources through directed credit others may be better placed to do so by attracting foreign direct investment. The important thing is to glean the lessons that can be learnt from the purpose of a particular institutional arrangement. For instance, while the practice of lifetime employment in Japan and the Scandinavian full employment arrangements are different institutional forms they both had the intention of reducing worker resistance to the introduction of new technology (Chang 1995a: 385).

Proceeding in the tradition of Hirschman (1958), Gerschenkron (1962), Shapiro and Taylor (1990), Chang (1994a; 1994b), Chang and Rowthorn (1995) and Evans (1995), a state in search of condensed growth should:

(i) provide macroeconomic stability
(ii) play an entrepreneurial role
(iii) specify property rights
(iv) act as a conflict manager
(v) provide normative standards.

4.5.1 Provision of Macroeconomic Stability

One area in which the coordination role of the state is self-evident is in the provision of macroeconomic stability. Agents with bounded rationality require a stable economic environment in order to be able to undertake the long-term investments needed for structural change and the state with its control over fiscal and monetary policy has a central role to play in this regard.

Macroeconomic stability must be understood to mean avoidance of sudden and rapid changes in indicators like the price level, exchange rates, interest rates, budget deficits and the balance of payments. This is clearly distinct from price distortions which are the difference between domestic prices and world prices which may be due to factors other than transportation costs such as government controls.

Where economic agents are faced with macroeconomic instability they will restrict themselves to short term commitments and spend resources to create micro-environments. For instance, preference for liquidity, trading and speculative activities would be favoured over long term commitments. In addition, however, more resources would be spent to create micro-environments such as drafting, monitoring and enforcing of contracts for individual protection (Chang 1994a: 49).

Amsden (1989: 94) records that in the face of economic crisis, the Korean government always supported the private sector in order to sustain fast economic growth. In other words, it provided them with certainty by accommodating their needs instead of imposing austerity. This practice is described by Chang (1993: 139) in the following way, "...even when the increase in the overall money supply is contained, the priority sectors are guaranteed financing, at the cost of non-priority sectors" (see also Wade 1990: 27).

Macroeconomic stability in a country may be assessed by analysing the average annual changes in growth rates of national income, investment as a percentage of GDP, the budget deficit, inflation,

exchange rates and interest rates over a particular period compared to another period or to other countries over a similar time frame.

4.5.2 Playing an Entrepreneurial Role

The interdependent use of separately owned factors of production requires coordination which is the role of the entrepreneur. However, private entrepreneurs may not have the vision or resources to undertake activities with long-term potential or they may be faced with strategic uncertainty about the behaviour of other agents. As such, their activities may lock the economy into industries with poor future prospects.

In such circumstances, the state as a coordinator of economic activity may play the role of the entrepreneur by providing a vision, mobilising resources and assuming risk. Due to its position, the state may gain a broader overview of the economy than is possible for individual investors. This role is much more than the idea of coordination in order to move from one equilibrium position to another. Rather, it is closer to Hirschman's (1958: 5) notion of unbalanced growth which would entail "calling forth and enlisting for development purposes, resources and abilities that are hidden, scattered or badly utilised". Similarly, the state may also act as a focal point for decision making through, for instance, indicative or development planning.

Where projects are capital intensive or lumpy, the state may act to mobilise resources to implement its vision. Such resource mobilisation could be financial or human resources. Where economies of scale and learning benefits exist but the private sector is unable to undertake the risk of investment the state may assume the risk to assist the investment process. This could take the form of establishing state owned enterprises or the provision of finance on favourable terms to enable the private sector to expand and acquire the necessary economies of scale.

Stiglitz and Uy (1996: 250) record that the state in East Asia played an active role in the mobilisation of finance by promoting savings, regulating financial institutions, creating development

banks and, indeed, using directed credit to priority sectors. The Japanese Government has expressed particular concern about the fact that economic policy reforms have discouraged state provision of directed credit (Killick 1994: 70). Similarly in Korea, the banking system was nationalised and used as a vehicle for the allocation of credit on preferential terms to firms operating in priority sectors (Amsden 1989: 80). In the case of Taiwan, the preferred method was the formation of public enterprises in sectors such as fuels, chemicals, mining and metal working, fertiliser and food processing, textiles and utilities before handing some of them over to the private sector (Wade 1990: 78).

One clearly established role which the state played in East Asia was the provision of human resources for the economy. This was not only in terms of the level of education but also the type. There was a lot of emphasis on science and technology subjects. In the specific case of Taiwan, Wade (1995: 120) notes that "science and engineering students together accounted for over one-third of post-high school graduates during the 1960s and over a half by the 1980s". The key issue here is that the availability of such skilled manpower in East Asia was not a result of public preferences but a reflection of government policy. In fact, very often the manpower targets of the government ran counter to citizen demand (Wade 1995: 121).

In order therefore to establish the entrepreneurial role of the state it would be necessary to look at its efforts to provide a vision, assume risk, mobilise financial resources and promote human resources for development.

4.5.3 Specification of Property Rights

Coase (1991: 718) stated that one of the most important duties of the state is to assign property rights to those who can use them most productively while Chang (1994b: 300) sees the property rights regime as providing the institutional reality for entrepreneurial vision. The point is that not

only do well specified property rights reduce the transactions costs of economic interaction, they also provide an incentive for the kind of productive (or unproductive) activities undertaken.

In an interesting historical study of the influence of property rights regimes on economic activity, Baumol (1990: 918) concludes that:

> ***"...rules of the game that specify the relative payoffs to different entrepreneurial activities play a key role in determining whether entrepreneurship will be allocated in productive or unproductive directions and that this can significantly affect the vigor of the economy's productivity growth".***

For instance, tax rules can be used to re-channel entrepreneurial effort as can the regulations governing the business environment or the use of resources. An interesting example of how a change in the property rights regime can be used to promote productive investments is provided by Jones and Sakong (1980) in the case of Korea. After General Park took over in 1961, those deemed to have acquired wealth through corrupt means were imprisoned and only released on the condition that they build factories in state designated sectors (obtained from Chang 1993: 151). This was an imaginative institutional arrangement in the sense that those who acquired illicit wealth were made to use such resources productively instead of being required to make refunds to the state with the possibility of secondary illegal acquisition.

Quoting Baumol (1990: 919) again:

> ***"the overall moral ... is that we do not have to wait patiently for slow cultural change in order to find measures to redirect the flow of entrepreneurial activity toward more productive goals. ...[It] may be possible to change the rules in ways that help to offset undesired institutional influences or that supplement other influences that are taken to work in beneficial directions".***

Another perspective from which to look at the issue of property rights is that of stability. An empirical study by Borner et al. (1994) shows that frequent and sometimes contradictory changes

in policy, the degree of discretion granted to bureaucrats and the failure of governments to show commitment to declared policy goals impact negatively on national economic growth (see especially pp 51-58). As such, the state has an important part to play in reducing uncertainties in the property rights regime.

It may be difficult to predict *a priori* which property rights regime will work in which society. However, since changes in private investment are the best means of analysing the trend of productive activity, this may be the best means to assessing the property rights regime promoted by any particular development paradigm. Also uncertainty in the property rights regime may be demonstrated by the frequency of legislative changes affecting the economic operating environment as well as the extent of discretionary powers granted to state agents.

4.5.4 Acting as a Conflict Manager

It was pointed out earlier that the process of structural change brings about the possibility of clashes between the gainers and losers in the process. Where technological changes have taken place, the losers may be workers displaced by new machines. However, these are not the only possible losers. Where there is asset specificity, labour and capital deployed in declining sectors may be losers in the process of structural change. The affected actors may try to disrupt the process by resorting to industrial action, rioting, lobbying and petitioning amongst other things. In such circumstances, the state has a conflict resolution role to play by guaranteeing a "fair level of income to all under even the most adverse circumstance" (Chang 1994b: 304).

Of course, it is quite possible for the state to take a passive role as a conflict manager and allow the market place to resolve matters. This can take place for instance by subjecting firms in losing sectors to the severe rules of domestic and international competition. This may, however, be costly as it assumes full labour and capital market flexibility. In other words, since not all workers or machines can be readily deployed to other uses, few economies can afford the loss of such productive capacity.

Another possibility is that the state could attempt to modify market outcomes by introducing trade restrictions such as the voluntary export restraints (vers) imposed on Japanese car exports by the European Union or the bailout of bankrupt big companies such as happened with Volkswagen in Germany and Chrysler in the United States. In addition, Chang (1994b: 305-307) provides a useful checklist of various conflict resolution policies used in East Asian and Scandinavian countries:

(i) the reduction of the possibility of conflict arising out of mass bankruptcy and redundancy during recessions;

(ii) the facilitation of mergers, take-overs and negotiated capacity scrapping to resolve adjustment problems;

(iii) the establishment of tripartite bargaining systems between organised labour, organised business and the state; and,

(iv) providing unemployment benefits, relocation assistance and retraining for displaced workers.

In order to examine whether or not a policy regime is geared towards the state acting as a conflict manager, we could look at evidence such as the unemployment of labour and industrial capacity, social unrest in the form of strikes, riots and lock-outs as well as retraining programmes put in place for displaced workers.

4.5.5 Establishing Normative Standards

North (1981: 45) has observed that in certain situations the individualistic cost-benefit calculus would tend to imply that people disobey the ruler. The outcome, of course, would be to make the system unworkable because of the large enforcement costs of ensuring compliance. However, as was observed earlier, there is stability in the social behaviour of individuals. This is because the cost to an individual of opposing state power is high which is also why the majority of individuals are apathetic about social change.

Normative standards, or what some writers call ideology (Gerschenkron 1962: 22; North 1981: 47; Chang 1994a: 52) is another means of ensuring stability. By promoting a national value system, the state can reduce the individualistic free-riding which can arise in social situations. In addition, normative standards help to reduce the cost of exchange due to informational asymmetry and bargaining. This is why communication and negotiation are usually easier between individuals who share a common language and approach. A familiar example of the difficulties and expense of negotiation between people who speak different languages is the requirement, often at great cost, of translators and interpreters at international meetings and conferences.

A less felicitous example of the use of ideology is the mass mobilisation of the fascist and communist regimes which dominated parts of Europe after the First and Second World Wars. Korea, however, provides an example of a less destructive use of ideology to promote national values and normative standards. The *Jarip Gyongje* (independent economy) in which workers were mobilised under the objective of fighting a patriotic war against poverty and exporters were given medals for reaching set targets, illustrates the value of the state promoting normative standards (Chang 1993: 152; Chang 1994a: 126). Hirschman (1968: 9) also notes that the process of industrialisation in Brazil was driven by a *desenvovimentista* (developmentalist) ideology.

It could be argued therefore that, in multi-ethnic developing countries, the state has a crucial role to play in promoting a national value system. In assessing the completeness of any development paradigm, therefore, it is important to analyse its direct or indirect effect on the formation of normative values. This may be through the use of mass mobilisation campaigns, exhortation or sheer example of the leadership.

The functions outlined above can be linked to the roles of coordination, conflict resolution and the creation of institutions of exchange although not necessarily in a one to one manner. For instance, providing macroeconomic stability, entrepreneurship and specifying property rights all have coordination purposes. Yet property rights specification by clearly defining rights can also reduce conflict as can the understanding brought about by common normative standards. Macroeconomic

stability is a major institution of exchange simply because of the importance of a stable financial system just as the provision of infrastructure which also facilitates exchange could also come about through the state acting as an entrepreneur.

4.6 CONCLUSION

In this chapter, the view was advanced that neoclassical economics theory and its neo-liberal offspring upon which structural adjustment policy is based is flawed on institutionalist grounds. As such, an institutionalist political economy approach was proffered in which history, politics and state intervention are explicitly acknowledged as influencing the performance of economies.

Specifically, the importance of a particular institutional form - that of state intervention - was explored in the context of coordination of economic activity, reduction of conflict and providing institutions to support the process of exchange. It was argued further that the state could promote economic transformation, reduce transactions and monitoring costs and information asymmetry by providing macroeconomic stability, showing entrepreneurial leadership, stimulating productive activity, moderating conflict and introducing normative values.

Bearing in mind the importance of these factors, the next chapter will attempt to untangle some institutional implications of policy reforms in developing countries with the intention of identifying useful elements for an empirical critique.

CHAPTER FIVE

INSTITUTIONAL CONSIDERATIONS IN STRUCTURAL ADJUSTMENT

It was contended in the preceding chapter that institutional arrangements play an important role in determining economic performance and that the state through its political power as an actor is central to determining the institutional make-up of any economy. This chapter outlines the institutional inadequacies of structural adjustment policy in developing countries, especially those in Africa, as well as some repercussions which may arise in the process of implementation.

The first section notes some positive elements in the structural adjustment package that are often overlooked in the criticism of such reforms. The second section looks at the relationship between policy reform and the flexibility of economies while the third part of the chapter highlights two problems associated with policy reforms; that of false identification as well as reproducibility. Section four examines the limited view of politics which underpins structural adjustment programmes while the following section attempts to show some potential consequences of economic policy reforms. The sixth section concludes the chapter.

5.1 SOME POSITIVE ELEMENTS

There is a tendency while criticising economic policy reforms to discount or disregard the economic crisis in Africa prior to reform. This tendency also takes little or no account of the insights provided by the New Political Economy about the information and agency problems of state-led economic development. It remains useful, therefore, to identify some positive aspects of economic policy reform.

First, is the intention of stabilisation. In other words, whatever the drawbacks of conventional stabilisation policies, it must be accepted that rampant inflation and consistently large fiscal and balance of payments deficits do not provide an enabling environment for structural transformation. As such, by insisting on stabilisation, proponents of economic policy reform are making a useful contribution. Of course, it does not necessarily follow that the recommended policies by themselves always lead to macroeconomic stability as sometimes the use of a devaluation may result in inflationary pressures through higher import prices. Also, if exports do not respond to a devaluation, the result may be a rise in the price of traded goods, resulting in a cut in purchasing power and aggregate demand and in addition, the impact may be severe contraction as a result of sharp cuts in imports (Taylor 1997: 148)[18].

A second positive element of economic policy reforms is that it forces policy makers in developing countries to understand the realities of globalization and the difficulty of insulated domestic policy formulation. This is particularly important given the volatility of the international economic environment and the need for foreign financial resources in the transformation process. The rapidity with which information about local political and economic conditions travels, impacts on the economies of developing countries especially exchange rates and inward financial flows. As such, these countries ought to be awake to the realities of globalization.

Third is the re-vitalisation of economic activity in the private sector through price liberalisation and market deregulation. Price liberalisation may allow for increased economic activity in previously depressed areas and the deregulatory aspects of economic policy reforms including abandonment of licensing regimes often allows for the entry of new actors into areas previously reserved for the state (Van Akardie 1995: 200). For instance, in some countries, private commodity brokers were able to establish legitimate operations with the scrapping of commodity marketing boards. Similarly, with the deregulation of air transport in Nigeria, for instance, private airlines were

[18]Dell (1982) argues forcefully that stabilisation often involves economic retrenchment that was more than was necessary to meet stated objectives.

established and competed effectively against inefficient state carriers and amongst themselves. However, Aron (1996: 95) sounds a note of warning by pointing out that price liberalisations can easily be reversed as was the case in Nigeria with interest rates and exchange rates in 1994.

Fourth, by adopting economic policy reforms, developing countries were able in an era of generalised debt crisis to avoid financial strangulation. By implementing structural adjustment policies, developing countries were able to reschedule their foreign debts and in some case obtain debt cancellation. In addition, access to concessional financial flows and other forms of technical assistance was usually contingent on the adoption of policy reforms.

Finally, there is the position canvassed by Van Akardie (1995: 200) that because structural adjustment policies tend to favour inhabitants of rural areas, they do not have a regressive impact on income distribution. It is true that farmers, for instance, may benefit from higher producer prices resulting from the removal of price controls and the scrapping of marketing boards. However, Van Akardie's conclusion may not necessarily be valid for the simple reason that massive rural - urban migration has left many African countries with a large pool of urban poverty. Moreover, poor rural dwellers may be adversely affected by the general budget cuts which reduce the subsidies available on schooling for their children as well as agricultural extension services and subsidised farm inputs. As Stein (1992: 89) notes 'ability to pay' rules may undermine agricultural production due to curtailed supply of vital inputs.

In spite of these potential or actual advantages, many reforming countries in Africa have not performed well. While a broad range of possibilities have been explored earlier (see Chapter Two), it is intended in the following sections to look at the problem from another perspective, that is, the implications of liberalisation on institutional arrangements in developing countries.

5.2 POLICY REFORMS AND ECONOMIC FLEXIBILITY

By insisting on "getting prices right" and reducing the role of the state, the proponents of economic policy reforms, while not explicitly acknowledging it, are assuming the instant flexibility and adaptability of prices within an institutional framework which is also assumed to be responsive to prices and efficient in all economies. There are two problems with this approach. First is that within a given institutional framework the demand and supply responses to price liberalisation are not always flexible. For instance, the supply side responses expected from structural adjustment would require perfect mobility and substitutability of factors of production. There are, however, rigidities in the production chain that arise, for instance, from asset specificity and barriers to factor mobility such as transportation costs which bring about the likelihood of production losses when one set of industries is priced out of the market.

Moreover, there is inter-dependence of sectors in any economy. Austerity, therefore, will not only curtail demand but will also affect output. In other words, if one sector purchases less from within the economy, this will impact negatively on sales of other domestic sectors (Lo 1995: 82). This means that the outcome of a process of getting prices right may be stagnation instead of expected growth.

It could be pointed out, of course, that such rigidities can be removed or improved by easing information constraints, reducing transactions costs and proper specification of property rights. These are, indeed, desirable and necessary objectives. The problem, and this is the second one, is that such changes imply a change in the institutional framework. However, institutions themselves are not fully flexible and are also path dependent as pointed out in section 4.3.2 above. To put it differently, the required improvements in institutional arrangements may not be readily brought about by price reform. As Jones (1995: 80) sees it: " ... in the medium term, more behaviours are undoubtedly resistant to price incentives than the assumptions of economics allow, others are more malleable than historians imply."

This factor points to the weaknesses of studies carried out in the endogenous growth tradition such as Easterly and Levine (1994). This particular study provides econometric evidence which shows that low educational standards, political instability, underdeveloped financial markets, large black market premiums, large budget deficits, inadequate infrastructure and ethnicity are all correlated to slow economic growth. This finding, however, leaves a number of questions unresolved.

In the first place, it appears as if African countries did not grow because they are underdeveloped. This is in the sense that the causative factors identified could easily be said to be features or even effects of slow growth and underdevelopment. Otherwise, how else could the existence of underdeveloped financial markets or inadequate infrastructure be understood. Additionally, such studies take no account of the difficulties of time, politics and history that emerge if such problems are to be addressed. For instance, the problem of ethnicity only arises in the specific historical context of colonialism in Africa whereby different ethnic groups were merged into new and fragile state structures. It is therefore not surprising that political instability is pervasive in African countries. Finally, there is the assumption that these problems can be solved by economic policy reforms when it is stated that "this paper's results are consistent with the view that improving policies alone boosts growth substantially" (Easterly and Levine 1994: 4). There is, therefore, a sense that educational standards can be easily improved, black market premiums readily erased and large fiscal deficits closed once the state retreats and prices are right.

However, as Jones et al. (1991: 8) note, for instance, curb markets may continue to exist after liberalisation. This may be due to the fact that imperfect information prevails and banks may keep interest rates low and ration credit in order to keep low risk clients who would otherwise be driven out of the market by high interest rates. In such instances, curb markets may remain to serve smaller or more risky creditors whose profile is better known to moneylenders and local traders.

The difficulties arising out of production and institutional flexibility contribute to uncertain outcomes with the implementation of economic policy reforms. Some of these are considered in section 5.5.

5.3 FALSE IDENTIFICATION AND REPRODUCIBILITY PROBLEMS

Economic policy reforms suffer from the problems of false identification and reproducibility in the sense that the factors identified or assumed in the success of other economies were either misleading or not readily replicable in African economies.

5.3.1 The Problem of False Identification

Proponents of economic policy reform ascribe the problems of developing countries to restraints on the market due to active state intervention and empirical backing was given to such claims by suggesting that successful economies avoided such market restraining policies. For instance, the World Bank (1981b: 25) saw Korea as a good example of success with minimum state intervention. Similarly, Friedman and Friedman (1980: 80) described East and South East Asian countries as thriving due to their extensive reliance on private markets.

These views were therefore the basis for two key elements of structural adjustment programmes which were:

(i) the drawing of a non-existent dichotomy between import substitution and export orientation; and,

(ii) the myth of the minimalist state.

These were problems of identification in the sense that if countries that had succeeded in attaining economic transformation did or did not do certain things, then the less successful ones should learn from them by emulating them. That is, in the two examples given, developing countries were required to abandon attempts at import substitution in favour of outward orientation and active state intervention in favour of the minimalist state. Of course, such views were seen as theoretically sound because they meant accepting the theory of comparative advantage as well as giving free reign to markets.

The difficulty is that the identification was a false one in the sense that it misrepresented the institutional arrangement in the successful economies, as will be elaborated below.

5.3.1.1 Import Substitution versus Outward Orientation

The debate on outward orientation has already been outlined in Chapter Three above. The intention here is to underscore the important role which protection of industry played in newly industrialised countries and the fact that the relationship between protection and exporting is not mutually exclusive.

Stein (1994: 287) notes that in Korea the export boom after 1963 was linked to an earlier period of import substitution. Similarly, the drastic expansion in clothing exports from Thailand in the 1980s was linked to an earlier period of industrial protection. The relationship between import substitution and export orientation is in fact not necessarily sequential. It is quite possible for some sectors of the domestic economy to remain protected at a time when manufacturing exports are growing fast. In other words, since different industries are at different levels of proficiency, there is no reason for a uniform tariff structure across industry.

The relationship between protection and exports could also extend to support. For instance, some industries in East Asian had a two-tier system of pricing through which higher domestic prices supported competitive export pricing (Stein 1994: 294). Such support was also extended to the macro-level as described by Chang (1995: 392):

> ***"After establishing themselves, the new industries of East Asia were expected to provide foreign exchange for importing technology ... that is necessary for the development of a new generation of technologically more demanding infant industries".***

All these arrangements must be linked to a consideration of the dynamic effects of protection of industry, in particular the emphasis placed on learning in the process of late industrialisation. Such

learning involves the creation of capability to utilise, adapt or improve on technological processes of more advanced industrial countries. The exposure of infant industry to competition reduces the scope for such learning by domestic actors.

Some neo-liberal writers acknowledge the historical use of infant industry protection and quarrel mainly with the fact that protected industries never grow up. This is an allusion to the political difficulties involved in withdrawing protection which has become a form of rent-seeking. Indeed, such difficulties are linked to a general dislike for state intervention.

5.3.1.2 The Myth of State Neutrality

The idea that the state was non-interventionist and neutral across sectors in the NICs is another pillar of the false identification problem. If it could be shown that in these successful countries the state did not play an active economic role, then developing countries facing economic crisis would find it worthwhile to learn from such experiences. As such, the relatively small size of government expenditure to GDP in countries such as Japan and Korea compared to countries with similar levels of development was advanced as evidence that the state in these countries was non-interventionist.[19]

The problem with this position is that it was mythical and ignores other means by which governments may play an active role such as industrial policy or conflict resolution. Stein (1994: 295) has clearly demonstrated that even in Singapore and Hong Kong (cases paradoxically excluded even by those arguing for state intervention) there was active state intervention to keep labour costs down through the use of political repression, immigration and subsidisation of food, housing and education.

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[19]The World Bank (1991: 139) (Table 7.4) records that in 1985the ratio of government expenditure to GDP in Japan was 33% as compared to the United States - 37%; Germany - 47%; United Kingdom - 48%; Sweden - 65%. In Korea in 1989, the same ratio was 16.9% as compared to Mexico - 21.2%; Brazil - 30.6%; South Africa - 33% (World Bank 1991: 224-225).

The problem of identification, however, was not only the misleading use of empirical examples to back preconceived positions. This was problematic enough, however, the use of such examples had severe short and long term consequences for developing countries that attempted to follow this path as will be demonstrated in section 5.5 below.

5.3.2 The Problem of Reproducibility

The assumption that the institutional basis of capitalism is the same in all countries at all times contributed to the belief of policy reformers that the conditions underlying the success of a certain group of countries can readily by reproduced elsewhere. This is not necessarily the case as shown by the following two assumptions:

(i) The assumption of a conducive international environment.

(ii) The assumption of state capacity.

5.3.2.1 Assumption on an Enabling International Environment

Structural adjustment downplayed the importance of global economic conditions in assuming that domestic policies were sufficient to bring about economic growth. The fact is that the conditions under which newly industrialised countries became exporting giants may not be readily replicable at all times and certainly not in the 1980s when economic policy reforms were being urged on developing countries.

The importance of the international environment in structural change is distinct from the argument that the economic crisis of developing countries was brought about by deteriorating international conditions. Rather, the point is that the international conditions which favour rapid structural change may not exist even if domestic policies are appropriate or adequate. This would be in contrast to the process of structural change in the golden age of capitalism (1945-1973) which favoured today's newly industrialising countries (Panic 1995: 57). This does not mean that economic development is no longer possible in developing countries but that the process will be

affected by the international economic environment which may or may not be more favourable than in the past but is certainly changing.

Three factors may be identified which are related to the international economic environment in which developing countries have had to operate in the era of structural adjustment, namely, gaining market access, coping with volatility and securing financial flows.

Access to more developed and wider markets is important for countries seeking structural change because successful production of manufactured goods is dependent on economies of scale and competitive pressures from rival producers in terms of product prices and quality. This would require that the markets of the developed economies and, indeed, of the NICs should be open to exports from the rest of the developing world. Such market access is indispensable if the export success of the NICs is to be reproduced in other developing countries.

Improving market access would require the maintenance of tariff preferences from which the NICs benefited such the Generalised System of Preferences (GSP), the Lome Convention between the European Union and the African, Caribbean and Pacific (ACP) countries and the United States Caribbean Basin Initiative. Many of these preferences have been eroded by successive rounds of tariff cutting, including most recently the Uruguay Round of the General Agreement on Tariffs and Trade. Safidi et al. (1996: 1227) argue that developing countries participating in such schemes face further negative effects from the tariff cutting of the Uruguay Round.

Similarly, the quantitative barriers often placed in the way of developing country exports would need to be dismantled quickly. However, in 1986, at the peak of structural adjustment efforts, 31% of manufactured goods imported into the United States and Europe from developing countries were restricted by quantitative barriers, as opposed to only 18% of manufactured imports from other developed countries. And, this was in spite of the fact that imports from developing countries were only 1.5% of the consumption of manufactured goods in the industrialised countries (Wade 1990: 347). It was also during the 1980s that voluntary export restraints (VERS) became the protectionist

instrument of choice for developed economies with half of such quantitative measures affecting developing country imports (Safidi et al. 1996:1228).

Developing countries desirous of structural change also need to find ways of coping with the increasing volatility of the world economy. Of particular concern are the globalization of financial flows, manufacturing production and technological changes. Wade (1990: 347) notes that "financial capital is ricocheting around the world thirty to forty times bigger than trade flows ... (and) the relationship between exchange rates and trade, interest rates and investment, and fiscal and monetary policies have become unhinged". Similarly, Panic (1995:65) records that the value of deposits in the Eurocurrency markets which was $19 billion in 1964 amounted to $4509 billion in 1987; and that by the end of the 1980s daily turnover in world foreign exchange markets was about $1 trillion as compared to the total foreign exchange reserves of central banks of $800 billion.

The situation makes it very difficult for developing country governments to set and maintain stable macroeconomic policies. Such volatility brings about uncertainty and high transactions costs of negotiating, monitoring and enforcing foreign exchange contracts. Similarly, manufacturing has also become a complex web of production at several sites in different countries. A finished product may consist of components in which value has been added in several countries and may have been exported and re-imported into the country of final production. The World Bank (1992:33) states, for instance, that intra-firm trade of the world's 350 biggest firms is about 40% of total world trade. The process of technological change also tends to reduce the advantages of developing countries as low wage sites for manufacturing. As such, production is now shifting from developing economies back to industrial countries (Ohiorhenuan 1989:40; Wade 1990: 348)[20].

Attracting inward financial flows is also critical in the transformation process of developing economies, particularly as external resources are an important means of supplementing domestic

[20]It must be noted, however, that these changes are not entirely negative and may provide developing countries with an opportunity to leap frog into still evolving industrial sectors. Malaysia's move into semi-conductor manufacturing on a major scale is a good example of such strategic behaviour.

investment. Such resources could be in the form of aid, foreign direct investment or loans. Foreign assistance from the United States was of critical importance in the transformation efforts of Korea and Taiwan which were in the defence perimeter against communist expansion. By comparison, the phrase 'aid fatigue' has come into current usage to refer to the disappointment with the poor outcome of the development effort in Africa.

In contrast to huge international lending to developing countries in the 1970s, the 1980s was marked by wariness of lending brought about by the debt crisis. Portfolio holdings and foreign aid also dried up. Thus between 1980 and 1989 net resource flows to developing countries fell from $60 billion to $21 billion and net transfers from an inflow of $30 billion to an outflow of $30 billion (World Bank 1991: 126).

To conclude, the international economic environment which developing countries faced in the 1980s was difficult yet structural adjustment policy was partly premised on the East Asian exporting miracle. The article by Cline (1982) which outlined the obstacles to this path of action was an early example of the difficulty of reproducibility.

5.3.2.2 Assumption of State Capacity

In order to be able to successfully implement policy, it is no doubt important for a state to have a degree of effectiveness. As such, the main implementing agency of the state which is the bureaucracy would need to function well. In order to do so, however, state officials need to be highly trained and equally important, individual rational-instrumental behaviour would need to be transcended and a core of competent officials with commitment to common goals established (Rueschemeyer and Evans 1985: 51).

The neo-liberal thinking behind economic policy reforms favoured individualistic behaviour and was motivated by a distrust of the bureaucracy in developing countries. In this context, it is useful to recall the earlier stated view of the World Bank (1994b: 99) that the public sector lies at the core

of the stagnation and decline in growth in Africa. This may well have been the case. However, as was earlier noted, in order to implement even the minimum uncontested areas of intervention, the state needs some degree of capacity which is not guaranteed in some developing countries. It would seem, therefore, that the promoters of economic policy reform were assuming the reproducibility of even these minimum levels of state capacity given that it was state officials who were expected to implement policy reforms. This is the orthodox paradox that was mentioned earlier.

Some of the consequences of this assumption will be discussed later. However, even the World Bank has come to realise the problem of assuming state capacity. In its World Development Report for 1997 (World Bank 1997a: 2) it states that:

> ***"The clamour for greater government effectiveness has reached crisis proportions in many developing countries where the state has failed to deliver even such fundamental public goods as property rights, roads, basic health and education".***

This is an acknowledgement that the ability of developing countries to implement even the minimalist policies advocated cannot be assumed. Yet, this is precisely what economic policy reforms were partly predicated on. The imperative of a conducive international environment and state capacity to successfully implement policy objectives show clearly that the conditions favouring development in one economy are not readily reproducible in other economies at all times.

5.4 LIMITED VIEW OF POLITICS

Structural adjustment programmes have been criticised for not taking account of political factors such as resistance to reform, sustainability and commitment to implementation (see for instance Nelson 1984: 986-991). These approaches have their own appeal but may be limited by the fact that they are premised on the inevitability of structural adjustment. Further scrutiny of economic policy reforms, however, also reveals a limited view of politics.

The point was made earlier that politics matters, not only because the state and market are political constructs, but because where there is information asymmetry and transactions costs, power also matters. As a result of its theoretical antecedents economic policy reform appears to ignore the literature on developmental states (Johnson 1982; White et al. 1988; Amsden 1989; Wade 1990; Chang 1994a; Evans 1995) which has convincingly demonstrated the importance of institutional factors such as state capacity, state autonomy and embeddedness in the transformation process.

The lack of state capacity in many developing countries which was overlooked in the insistence on structural adjustment was mentioned in the previous section. It is important, however, to understand that the state has a key function to play in the creation or strengthening of bureaucratic capacity. As such, where governments find that they are constrained by inadequacy of capacity, maybe as a result of a historically bloated and inefficient bureaucracy, they may strive to create pockets of efficiency. Evans (1995: 61) provides in this context, the example of the regime of President Kubitschek of Brazil which used the National Economic Development Bank (BNDE) to promote its developmentalist agenda in the 1950s.

It is also important for the state to be autonomous in the sense that it needs to be insulated from capture by vested interests. Of course, such independence of action can be negative as discussed in Chapter Three. Nevertheless, for policies to have effect, there is a compelling need for some degree of autonomy or what has been referred to as a 'strong state'.

Where a state is soft, there is a tendency for policies to be used to buy off different sectors of society such as rival power elite or powerful workers organisations. This is not to say that a strong state is necessarily a dictatorship or vice versa. As Streeten (1993: 1281) puts it "a soft state could be associated with a high degree of coercion, violence and cruelty" with the softness arising from an "unwillingness to coerce people in order to implement declared policy goals".

Such autonomy which allows a state to pursue independent policy goals may, of course, coincide with the interests of certain economic actors but the state is not necessarily bound to them. It is also

important for the state to be autonomous because it has to be able to set stringent performance criteria for 'beneficiaries' of its policies including export targets, allowing competition or letting unsuccessful firms go under. Equally important, it also has to be able to exact performance such as increased output, exports, savings and investment from domestic economic agents as emphasised by several writers explaining successful state intervention in East Asia (Amsden 1989: 145; Chang 1994a: 121; Mosley 1995: 697; Stiglitz 1996: 162).

Since autonomy can be abused, there is an inherent tension between it and accountability. A variety of structures would have to be developed to restrain such possibilities. These include limiting the size of the bureaucracy which makes bureaucrats feel like an elite and thus allows for some degree of commitment and appropriate remuneration while avoiding the lack of control inherent in a massive bureaucracy.

In the particular context of structural change, Wade (1990: 371) recommends the establishment of an 'economic general staff' such as could be said to exist in Japan: MITI, Korea: Economic Planning Board, Taiwan: Council for Economic Development and Planning. The intention would be to achieve a balanced role between giving bureaucrats too much power and too little. Another possibility would be to divide the labour of government between politicians and bureaucrats. For example, Chalmers Johnson has described the arrangement in Japan as one in which politicians reign and bureaucrats rule (quoted in Ranis 1989: 1446). The effect is to allow the insulation of bureaucrats from social pressures thus allowing them to focus on the task of development. Of course, civil society also has an important role in ensuring the accountability of state organs. Amsden (1989: vi) has argued that the student movement played this watchdog role in an otherwise authoritarian Korea.

Accountability is only one part of the problem. Condensed economic transformation also requires a two-way information flow and commitment to common goals by the economic bureaucracy and the business community. Evans (1995: 12) introduces the notion of embeddedness to capture the

need for ***"concrete set of social ties that binds the state to society and provides institutionalsized channels for the continued negotiation and re-negotiation of goals and policies".***

Ties of embeddedness may need to be innovatively fashioned as is the case with capacity and autonomy. However, structural adjustment policy in recognising the dangers of unaccountable state structures but insisting on reducing the role of the state throws out the baby with the bath water.

Politics is also important where information is incomplete and there are costs of monitoring. The need then arises for the negotiation of contracts for employment and supply of inputs. Once this is the case, power becomes important because the outcome of bargaining is crucially dependent on power. Lo (1995: 89) points out usefully, that power also enters the process of exchange because someone invariably has to combine the price-setting role of the Walrasian auctioneer with that of producer or distributor.

The limitations of structural adjustment in this context arises from the possibility of countervailing action and the use of power to maintain a particular political arrangement. Simply put, if a leader like Mobutu used the power of his office to plunder Zaire's resources, nothing in the structural adjustment package (forced on him by donors) prevented him from inventing new means of appropriating state funds for himself and his clique.

On the basis of the foregoing, there is a need for the state to be aware of its role as a "creator, defender and reformer of institutions" (Chang 1994b: 298).

5.5 POTENTIAL CONSEQUENCES OF STRUCTURAL ADJUSTMENT

The earlier sections of this chapter outlined some of the limited institutional basis of structural adjustment. Specifically, if the economy is not flexible and the conditions in other countries are improperly identified or cannot be reproduced, then the outcome may be different from what was intended. Such deviations are particularly likely where already weak state structures are further

undermined by an attempt to conform with the minimalist ideals of neo-liberalism. This section proposes to outline some of the potential consequences of structural adjustment where the institutional setting is inappropriate. These consequences include weakened public sector capability, de-industrialisation and financial chaos, evasion of policy measures and adoption of misleading solutions.

5.5.1 Erosion of Public Sector Capability

The fact that economic policy reforms contributed to an erosion of public sector capability is clearly captured by the World Bank (1997: 24) which states that:

> ***"As often happens with such radical shifts in perspective, countries sometimes tended to overshoot the mark. Efforts to rebalance government spending and borrowing were uncoordinated, and the good was as often cut as the bad. ...The result seen most starkly in Africa, the former Soviet Union, and even parts of Latin America was neglect of the state's vital functions threatening social welfare and eroding the foundations for market development".***

A direct consequence of such overshooting was the loss of morale in the public service. In Africa, a public sector job was a natural aspiration for the first and second generation of educated citizens because the most visible presence of the former colonial power were the perks and authority of colonial administrators. The elevated status of public servants only began to fall under assault from neo-liberal advisers and quite naturally, the former have tended to resist and resent the social relegation brought about by bureaucrat-bashing.

In addition, economic policy reforms have had a very negative impact on state capacity by bringing about a very sharp reduction in the income of public servants in developing countries. Devaluation of local currencies led to a sharp drop in real incomes while salaries have not kept pace with inflation. As Sandbrook (1991: 108) notes:

> ***"Since it is suicidal for rulers to dismiss many civil servants in a context of massive unemployment and poverty, governments retain most of their employees while allowing their real incomes to fall. This is a way of reconciling political realities with the need to reduce budget deficits".***

The result was a situation in which middle level officers in the public service could not feed, house, clothe or educate their families on their salaries in countries such as Somalia, Nigeria, Sierra Leone, Tanzania, Ghana, Uganda, Guinea (Sandbrook 1991: 108). Writing in the same vein, Van Akardie (1995: 207) recalls a common joke in several African countries that shows the response of public servants to such a sharp drop in their earnings, viz.: 'the government pretends to pay us, and we pretend to work'.

The loss of morale and poor salaries led to weakened capacity to implement policy as public servants resorted to exit and survival strategies. For instance, the success of policy reforms is dependent on improved state capability in information gathering, processing and management as well as in the coordination and reconciliation of conflicts. To quote from Sandbrook (1991: 96) again:

> ***"Structural adjustment assumes an institutional capacity to design and implement complex policies concerning prices, trade, banking, finance and foreign investment, to reform parastatals, and to manage complicated negotiations with donors and subsequent assistance programmes".***

A demoralised public service may not be able to carry out these functions effectively and certainly the better public servants will seek greener pastures elsewhere. A related consequence is that in order to survive, public servants may resort to informal sector activities and neglect their duties. Of course, while moonlighting may be productive if it takes the form of farming or urban transport provision, it can also lead to loss of administrative efficiency and public disenchantment with absent civil servants (Sandbrook 1991: 109).

The reduction of public sector capability also affected the provision of infrastructure. While one of the objectives of limiting the role of the state in the economic policy reform process was to enable it to be leaner and more efficient in the provision of social services and infrastructure, "a by-product of fiscal austerity has been diminished social services and infrastructural provision as well as a further decline in the institutional capability of the state" (Aron 1996: 101).

Reduced state provision of infrastructure may be due to the fact that the capital budget or maintenance provisions are easier to cut. One particular problem which reduced provision of infrastructure poses for economic policy reforms is that it may not be possible to expand exports if there is no adequate network of roads, rail and ports through which to evacuate such goods (Stein 1992: 88) In Africa, for instance, one-third of capital investment on roads has been eroded through poor maintenance thus adding about 17% to freight costs (Aron 1996: 103). Other obvious examples are the additional costs of doing business arising from inadequate power supply, poor water provision and barely existent telecommunications links.

Similar problems may arise with health and education provision. The concern raised about the human dimension in the implementation of structural adjustment programmes has already been mentioned in Chapter Three. What makes the situation more problematic is that given the negative growth of output in most African countries and the increase in population growth the poor averages for social service delivery are in fact likely to be an underestimate, and real spending per capita on social services is likely to have declined (Aron 1996: 103).

Harriss-White and White (1996: 4) have pointed out that "domestic and international liberalisation - by undermining political credibility and regulatory capacities of many states - has contributed to a more generalised process of political decay".

5.5.2 Reduction of Long-Term and National Flexibility

Another of the potential consequences of economic policy reform is that it places short-term considerations over long-term ones and individual interests over national ones. The short- term price responsiveness desired from reforms may, if they occur, also undermine the ability of the national economy to gain long-term adaptability. Where there is asset specificity or large sunk costs, allowing firms to enter or exit from sectors on the basis of current price signals alone may be costly in terms of the long term availability of investible resources and the learning of technology.

Another example of how short-term responsiveness may affect long-term productive capacity is in the use of scarce foreign exchange resources. Foreign exchange and trade liberalisation have often led to situations in which manufacturing concerns cannot obtain the foreign exchange to import their capital and intermediate goods requirements while the more privileged sectors of society have been able to support their consumption habits (Stein 1992: 89).

In spite of trends towards economic and political integration, the nation is still the main unit of economic policy making and national economic interests may differ very sharply from individual economic interests. This would imply that while individuals may be showing a flexible response to policies aimed at 'getting prices right', the national economy may not be showing enough flexibility. This, indeed, was Killick's (1995b: 156) finding when he investigated economic flexibility in Africa.

A more complicating factor, however, is that individual flexibility may reduce national flexibility (Chang 1995b: 206). This may occur, for instance, through the increasing mobility of international capital which enables individuals to respond to a national economic problem by resorting to capital flight. This, in turn, may lead the national economy into a foreign exchange crisis and contribute to a collapse in the value of the national currency and a sharp drop in available investible resources.

Indeed, even where the crisis has not come to a head, individual responses, given an uncertain property rights regime, may tend to favour short-term speculative uses of such resources over projects of long-term benefit to the national economy. Wade (1990: 351) argues that, in such instances, the state has a responsibility to a poor, immobile and relatively unskilled workforce and should not just fold its hands. Another way in which individual flexibility could reduce national flexibility is through the brain drain or loss of skilled and educated manpower from developing economies to better paying jobs in industrial economies. The negative implications of the loss of most of Africa's first and second generation of engineers, doctors, scientists, managers and policy makers to its development prospects is compounded by the damage being done, through loss of teachers, to the ability of future generations of Africans to acquire knowledge and skills that are indispensable for development.

5.5.3 De-industrialisation and Financial Chaos

In the absence of a suitable institutional setting, the policies introduced under economic policy reforms may lead to de-industrialisation and financial chaos in implementing countries. Industrialisation, especially manufacturing production, is crucial to the process of structural change. This is because in nearly all economies manufacturing had been central to the process of transformation from a primitive, low productivity base to a dynamic, diversified and sustained one (Lall 1992: 105). Yet, the impact of foreign exchange, trade and financial liberalisation had contributed to de-industrialisation in Africa.

Domestic industry in Africa has been negatively affected on the cost side by devaluation which increases the costs of imported inputs, increased interest rates which increase the cost of borrowing and the higher prices of domestic inputs arising from the decontrol of agricultural prices. On the revenue side, African industry has had to contend with increased competition from imported goods as a result of the liberalised foreign exchange regime and loss of protection (Stein 1992:89).

The combination of these factors has certainly had a contractionary effect on the performance of industry in Africa. Lall (1995: 2022) records, for instance, that "many African countries suffered sustained 'de-industrialisation' over the past decade and a half" with manufacturing value-added falling from 3.3% in 1989-90 to 0.4% in 1991-92 and recovering modestly to 1.5% in 1992-93. In the specific case of Ghana which is often held out as an example for reforming African states, manufacturing value-added fell from 12.9% in 1984 to 1.1% in 1992 due to greater competition from imports and the use up of previously existing excess capacity[21]. In the same country, manufacturing employment fell from a height of 78,700 workers in 1987 to 28000 in 1993 (Lall 1995: 2025).

In addition to the social conflict likely to be engendered by de-industrialisation on such a scale, is the effect on 'capability development' where shortage of skills is already a problem. As Pack (1993: 1) puts it: "without an increase in proficiency, the responsiveness of output to even the best designed structural adjustment programmes is likely to be limited". Yet the emphasis placed on trade liberalisation in economic policy reform may reduce the ability of developing countries to provide protection for infant industry and thereby constrain their ability to learn new technologies or create long-term productive capability.

The situation is further compounded by the fact that very often there may be no export response or improvement in foreign direct investment in areas of comparative advantage as expected after the adoption of economic policy reforms. The data on the response of manufactured exports to import liberalisation in Africa is rather sketchy and does not allow for appropriate analysis of the effects. However, in a study of Ghana summarised by Lall (1995: 2024-2026) the data shows that while there was an increase in manufacturing exports the values remain rather small and do not indicate a broad based response as would have been expected. The writer ascribes the problem with expanding exports partly to the fact that conventional wisdom did not take into account the fact that the ability

[21]Pack (1993: 4) makes a similar observation about adjustment cum liberalisation programs having had little success except for the greater utilisation of capacity allowed for by newly available foreign exchange.

to compete effectively in international markets requires a minimum level of "productivity and managerial and technical skills presently lacking in Ghana" (Lall 1995: 2026).

The inflows of foreign direct investment into Africa[22] was similarly disappointing. The total value increased from an annual average of US$1.7 billion in 1980-85 to US$3 billion during 1986-90. This was, however, quite modest if compared to the total flow to all developing countries which grew from US$19.4 billion in the prior period to US$62.2 billion in the latter period. In other words, Africa's share of foreign direct investment into developing countries fell from 8.6% to 5% in the period under consideration (UNCTAD 1995: 24).

In a similar vein, financial liberalisation could actually lead to crisis in the financial system especially where there was rapid expansion in the financial services sector and the regulatory agencies are unable to cope through inadequate capability or the effect of being weakened by the desire to reduce the role of the state.

Stiglitz and Uy (1996: 260-261) provide evidence of financial crisis even in the economies of East Asian when there was rapid expansion in the financial sector. Very often commercial banks resorted to establishing non-bank financial intermediaries as a means of avoiding regulatory scrutiny, while others engaged in speculative lending as a result of high interest rates. The effect of such practices, in addition to engendering uncertainty and the probability of a collapse in the financial sector, may be that financial liberalisation may not actually lead to increased savings and, worse still, may cause scarce resources to be diverted from the real sectors of the economy.

The potential interaction between de-industrialisation and financial chaos is very aptly captured by Rodrik (1990: 942) when he asserts that:

> ***"Financial liberalization can also endanger structural reforms in the real economy. Increased interest rates aggravate the costs already incurred by firms***

[22]Includes all of Africa except South Africa.

as they try to adjust to a sharply altered pattern of relative prices. Firms adjusting to trade liberalization or devaluation in an environment of depressed domestic demand need credit at easy terms, not at high rates. With high real interest rates, the complications in the real and financial sectors can then start to interact. Firms in difficulty refinance their loans at ever-increasing interest rates; nonperforming loans mushroom on the balance sheets of banks; and much of the domestic banking sector ends up insolvent".

This is certainly not what those calling for the removal of financial repression may have had in mind.

5.5.4 Evasion of Policy Measures

It was observed earlier that because institutions themselves were path dependent they may not necessarily change as a result of economic deregulation. Specifically, where power and uncertainty are taken into account economic actors may respond to deregulation with countervailing action or retention of past behavioural patterns.

5.5.4.1 Countervailing Action

A major objective of economic policy reforms is to reduce the ability to use access to state resources to promote personal or group interests. However, introducing structural adjustment policy may not necessarily bring about the desired result. Where economic policy reforms are introduced by the existing political class,[23] they may use innovative ways and means to protect their 'privileges'. Wade (1990: 370) aptly describes the possibility of such an outcome when he writes that:

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[23]Buijtenhuis and Rijnierse (1993: 8) define the political class in African countries as on that "generally did not exert control over the means of production but utilised its position in the state apparatus to provide itself with an economic basis".

> ***"The argument for economic liberalisation ... also needs to address the question of what kinds of private sector groups will gain from the change. It cannot be assumed that they will ... be entrepreneurial investors rather than luxury consumers ... Liberalization may lead to the capture of economic power by less accountable cliques around the power-holder, Marcos style".***

One of the ways in which this could be done is through countervailing action which Mosley et al. (1991: 138) describe in the following way:

> ***"Economic policy is not divisible. Consequently, the effect of loan conditions which are devised to regulate the use of one group of policy instruments can be undermined by the use or invention of other policy instruments which also impinge on the same dependent variables".***

One common example of countervailing action is the resort to extrabudgetary expenditure to overcome the constraints of fiscal retrenchment. Another is the use of pre-shipment inspection, port levies and related charges to overcome the objectives of tariff liberalisation. The emphasis which the policy reform package places on the deregulation of exchange controls may bring about a situation whereby economic rents are transferred from industrialists and central banks and passed on to speculators and foreign exchange traders. Given the small size of the financial sector in developing countries such strategic behaviour is possible through the restricted and, therefore, privileged access to foreign exchange auctions or to bank licences.

In a similar context, privatisation of public monopolies without a corresponding change in the rules to allow for competition can clearly lead to the creation of a private monopoly. The efficiency considerations remain the same and the method of sale chosen may favour certain groups, including persons fronting for state agents. Countervailing action may also possibly undermine the objective of 'getting prices right'. To get prices right, they have to function as expected. If transactions have not been taking place on the basis of the market mechanism, the reaction of economic actors to price liberalisation may be conditioned by the institutional environment. For instance, Van Akardie

(1995: 205) has observed from the experience of Eastern Europe that attempts to harden the 'soft budget constraint' of state-owned enterprises by the withdrawal of budgetary support was countered by resort to bank credit or credit from other state owned enterprises.

The point is that even when formal rules have changed, if the underlying normative code or power structure allows for countervailing action it may be unrealistic to expect a programme designed to reduce the role of the state to work, as new and imaginative methods will evolve to circumvent such formal requirements.

5.5.4.2 Retention of Behavioural Patterns

The uncertainty generated by the sharp change in the policy environment may also cause the retention of behaviour that encourages evasion of policy intentions. This may manifest in a number of ways including individual short-termism as well as the continued existence of corruption and informal rules which may have originated from the desire to evade state control. Rodrik (1990: 936) has described *cortoplazismo* (short-termism) in Latin America as "that pervasive mix of chronic anxiety and scepticism that leads to an inability to plan beyond next week". Such informational deficiencies dominate individual preferences in a period of economic crisis and exacerbates exit options such as capital flight and economic migration.

Economic deregulation rests on two key assumptions; namely that government action is effective and that markets would function ideally in the absence of controls. However, the existence of institutions like parallel and fragmented markets are proof that government controls are not fully effective and that markets are not ideal constructs (Jones et al. 1991: 3). There is nothing, therefore, to guarantee that economic policy reforms will remove the behavioural underpinnings of such institutional arrangements.

Structural adjustment may actually compound the effect of the behavioural patterns which had emerged in response to economic crisis. The continued existence of parallel markets is a good

example of such informal arrangements. Such activities have their own rules as aptly captured by Van Akardie's (1995: 204) statement that "survival in a supply constrained economy depends as much on technical 'know-who' as technical know-how".

While it may be true that parallel markets usually first emerge in the era of the 'crisis of state control' and may actual become formal after economic policy reforms have been implemented, the behavioural rules developed then may still remain in effect. Such behavioural rules may bring about negative business ethics which remain after reform. Examples of such possibilities include:

(i) institutionalising disrespect for the law through activities such as street trading, erection of illegal structures, illegal connections to power grids;

(ii) disregard for legal requirements for doing business such as non-registration of businesses, ignoring of intellectual property rights, non-compliance with health and environmental standards;

(iii) disrespect for normal fiscal obligations such as tax evasion, non-registration for value-added and sales taxes, non-payment of municipal dues; and,

(iv) in general avoidance of most forms of government control (see also Van Akardie 1995: 204).

In the case of corruption, empirical evidence has been adduced to show that economic liberalisation may displace corruption instead of reducing it by transferring the initiation and control of corruption from state agents to actors in civil society (see Harriss-White and White 1996: 2).

5.5.5 Adoption of Misleading Complementary Solutions

Evans (1995: 28) notes that ***"'talk about governance and institution building' emerged as the World Bank began to focus on the possibility that its clients problems arose not just from bad policies but from institutional deficiencies correctable only in the long term".*** This was not mere coincidence but a realisation that the old defence that international financial institutions could not

be held responsible for the internal arrangements of implementing countries was no longer tenable. Such views ignored the reality of the power bestowed on the World Bank and the International Monetary Fund by their ability to award 'certificates of good behaviour'. Without the positive sanction of these bodies that its policies were sound, it was virtually impossible for a debtor country to obtain debt relief or concessional aid.

As a consequence of the realisation that insisting on economic policy reforms was inadequate without taking account of the institutional framework, the notion of governance was introduced as the political counterpart to economic policy reforms. The term 'governance' which does not find favour with Van Akardie (1995: 195) was used to encapsulate the requirement for pluralism, respect for the rule of law and protection of human rights. In such a case, it can be argued that the insistence on good 'governance' or government is no more than a substitute term for demanding democratic arrangements in developing countries. Indeed, donor countries and bodies such as the United States, France and the European Union, which were not constrained by the delicate situation of the international financial institutions, have clearly linked these requirements to the institution of democracy (Young 1991: 14). The idea is that pluralistic politics makes for more accountability and transparency in government because of electoral considerations and the fact that civil society would have a voice.

There is nothing wrong with a desire to promote good government, transparency and accountability within the ambit of democracy. Indeed, democratisation may break entrenched interests and create a political impetus in favour of structural change. Moreover, given the acknowledged tension between state autonomy and accountability a pluralistic political structure could allow opposition parties, the press and wider civil organisations to play a watch-dog role. There are, however, a number of issues that need to be addressed.

Insisting on democracy which takes the form of elections every few years may, however, amount to putting the cart before the horse. The mere existence of a constitution and electoral rules does not imply the existence of a functioning democracy within which certain normative behaviour is

associated. Moreover, even if Marx's contention that democracy flows from certain minimum socio-economic, cultural and political conditions (see Emmerson 1991: 9) is put aside, it is not entirely evident that democracy is a requirement for successful structural change, nor that it can bring about a reduction in corruption or that the elimination of corruption is a prima facie requirement for structural change.

A pertinent question to ask in this context is whether the state can reform itself? In certain instances, the answer to this question is seen to lie in changes of governments. But, the state is much more than the government. As such, the coming to office of a reform minded government does not imply changes in the nature of the state. The bureaucracy, the judiciary, the military and law enforcement agencies are all part and parcel of the state. Given the erosion in their income and morale occasioned by economic policy reforms, it is not at all certain that these state agents will act in a reformist manner.

Another factor to take into consideration is the fact that the breakdown in political authority that sometimes accompanies economic crisis may make pluralistic democracy more difficult to attain. Conversely, political liberalisation may make administrative and economic reform harder to introduce since the losers in the process of structural change may hold the electoral trump cards through the large number of their votes.

The empirical evidence of authoritarianism in East Asia and Latin America shows clearly that democracy is not a necessary requirement for successful structural transformation. As such, the issue in Africa may not be the prevalence of one-party states, military rulers, corruption or other negative features but instead, why such institutions are incapable of generating the good economic performance obtained in other authoritarian developing countries (Van Akardie 1995: 196). In a widely publicised polemic, Lal (1983: 33) who advocates wholesale economic policy reforms also asserts that an illiberal regime is required to over-ride the influence of vested interests which goes to show that even a staunch advocate of economic liberalisation believes that democracy is not a necessary accompaniment to economic development. Conversely, of course, an authoritarian

regime is no guarantee of good economic performance if the track record of dictatorships such as that of the Philippines under Marcos or Zaire under Mobutu are anything to go by (Rapley (1994: 504) makes a similar observation).

The important point here, however, is that the introduction of democracy as the political accompaniment of structural adjustment was misleading because it promised what it could not deliver and further stretched weak capacity of states which had to grapple simultaneously with political and economic reform. In certain instances, as was the case with Nigeria, the transition to democracy provided an 'acceptable' excuse for evading fiscal restraint and transferring state resources to the political class (see section 6.5.2 below).

5.6 CONCLUSION

An attempt has been made in this chapter to outline some institutional considerations in the implementation of economic policy reforms. It was shown that the economic policy reform paradigm has several important components, especially macroeconomic stability and economic deregulation. However, difficulties of an institutional nature such as the inflexibility of economies and institutions; false identification and reproducibility; and a limited view of politics could result in a number of problematic outcomes. In particular instances, structural adjustment programmes could be said to contribute to an erosion of public sector capability; loss of long term and national flexibility; de-industrialisation and financial chaos; innovative means of evading policy measures; and adoption of misguided complementary solutions.

By promising much once prices were right and the role of the state was reduced, economic policy reform may have contributed to a lack of vision in the form of the expected end product; abdication of state responsibility for institution building; and disregard for the broader consequences of

liberalisation. It is proposed in the next chapter to investigate these issues from the perspective of Nigeria which adopted economic policy reforms from 1986 to 1993.

CHAPTER SIX

ECONOMIC POLICY REFORMS IN NIGERIA: AN INSTITUTIONAL PERSPECTIVE

It was contended in previous chapters that the state has an institutional role to play in the process of economic transformation and that economic policy reforms may not work as desired if the institutional setting is not appropriate. The intention in this chapter, therefore, is to examine whether structural adjustment as implemented in Nigeria encouraged the state to play a positive institutional role and also to establish if some of its potential negative consequences outlined in Chapter Five were manifest in the Nigerian experience.

The first section briefly summarises Nigeria's economic antecedents from independence in 1960 to the height of the oil boom it experienced from 1973 to 1980. The second section then examines the extent of economic crisis in Nigeria prior to reform, the cause of the crisis, and the factors leading to the adoption of the structural adjustment programme in 1986. The third section proceeds to outline the objectives of the structural adjustment programme and shows that the policy instruments introduced were no different from those identified in Chapter Two as forming part of the conventional package. In the fourth section, the performance of the Nigerian economy under the structural adjustment programme is examined within the framework of the institutional role outlined for the state in Chapter Four, while the fifth section analyses the Nigerian experience against the framework of potential consequences developed in Chapter Five. The last section concludes the chapter.

6.1 NIGERIA: ECONOMIC ANTECEDENTS

Lewis (1994: 442) identifies four distinct periods in the evolution of Nigeria's political economy. These are the late colonial period to the onset of the Nigerian civil war, the end of the civil war to the very early 1980s, the crisis of the early 1980s and the period of structural adjustment.

On the attainment of independence in October 1960, the Nigerian economy was predominantly agricultural. The share of agriculture in Gross Domestic Product was, on average, about 63% between 1952 and 1960 before falling to 25% between 1981 and 1985 (Ogun: 1996: 38). The economic policy of the time emphasised promotion of primary commodity exports and modest encouragement for local entrepreneurs. State revenues were mainly derived from indirect taxation of agricultural exports principally through the mechanism of marketing boards. These revenues were in sharp decline by the late 1960s due to the end of the commodity boom in the early part of the decade and the draw down of the surpluses of the marketing boards.

The onset of the civil war 1967-70, led to the introduction of war time economic management including the regulation of trade, production and foreign exchange markets. The apparent success of these measures and the high petroleum revenues which accrued in the early 1970s, led to an "assertive state strategy" (Lewis 1994: 443) at the end of the civil war. The policy regime was a a state led programme of import substituting industrialisation typified by sustained and high rates of protection and economic regulation such as administrative controls in the area of prices, supply, trade and distribution, regulation of domestic and foreign capital flows, indigenisation of the ownership of certain sectors of the domestic economy, a change in the profile of public expenditure exemplified by the increase in expenditure of 3 billion Naira projected on the Second National Development Plan to 42 billion Naira under the Third National Development Plan, and an expansion in the state enterprise sector from 250 entities in 1970 to 800 by the end of that decade (Lewis 1994: 443).

The Nigerian economy in the post-civil war period was dominated by massive fiscal and export revenues deriving from the huge increases in oil prices which occurred in 1973 and 1979. As Babawale et. al (1996: 122) note, revenues accruing to the state from oil exports rose dramatically from a "few hundred million at the end of the 1960s ... to about five billion dollars in 1975. This era, however, shared certain characteristics with the pre-civil war period although there were differences in scale and magnitude. In particular, there was the continuation of clientelist and neo-patrimonial use of state policy. In the pre-civil war period, the appointment of Licensed Buying Agents for the marketing boards gave room for preferential access to rents derived from the commodity boom while the preferential allocation of development finance to political allies also provided opportunities for patronage.

In the oil boom period in Nigeria, clientelist and prebendal practices continued with the use of policy to introduce indigenisation which favoured only a particular class of people, import licensing which provided huge rents and the appearance of the "emergency contractor" a peculiarly Nigerian phenomenon centred around government procurement which provided large rents for private contractors and huge spoils for their public service mentors As Lewis (1994: 443) notes some of these "deals were never implemented beyond the exchange of kickbacks and mobilization fees...".

The next two periods identified above are the subject of the next two sections of this chapter.

6.2 PRE-ADJUSTMENT CRISIS IN NIGERIA 1981-1985

Nigeria is a major producer of crude oil and, as such, benefited from the sharp rises in petroleum prices which occurred in 1973 and 1979 (usually referred to as Oil Shock I and Oil Shock II). In spite of these huge resource inflows, a serious economic crisis erupted in Nigeria by 1981. As Table 6.1 shows, Gross National Product per capita fell from $1010 in 1980 to $730 in 1984. The inflation rate rose from 16% in 1980 to as high as 38.7% in 1983 while external sector activity contracted quite severely. The total exports of goods and services fell from about $26 billion in

1980 to $10.4 billion in 1983 while total import spending fell from $14.7 billion to $8.9 billion by 1984. The trade balance fell from a surplus of approximately $11.2 billion in 1980 to a deficit of $1.1 billion in 1983, an overall swing of $12.3 billion in the space of four years (International Monetary Fund 1992).

Public and publicly guaranteed external debt increased sharply from $4.1 billion in 1980 to $18.9 billion in 1985. This over fourfold increase in a five-year period was compounded by the nature of the debt which was dominated by short-term trade arrears and borrowings from commercial banks as compared to other African countries whose debt was mainly owed to official creditors.

TABLE 6.1 Selected economic indicators

	1980	1981	1982	1983	1984	1985
Real GDP growth rates (1984 market prices)%	2.9	-2.9	-0.6	-4.9	-4.8	9.7
GNP per capita $*	1010	870	860	770	730	800
Consumer prices (end of period) %	16	17.3	7.1	38.7	22.6	1.1
Exports (fob) $bn	26	17.7	12.2	10.4	11.9	12.6
Imports (fob) $bn	14.7	18.4	14.9	11.5	8.9	8.3
External debt $bn	4.1	6.1	12.4	17.8	17.3	18.9
Current account balance $bn	4.3	-6	-72	-5	-1.1	-0.2
Avg. official exchange rate N/$	0.55	0.62	0.67	0.72	0.77	0.89
Saving deposit rate (end of period) %	6	6	8.5	7.5	9.5	9.5
Foreign exchange reserves	10.3	4.45	1.96	1.22	1.5	1.68

Source: Moser, G. et al. 1997: 9, except *World Bank 1996

The magnitude of the crisis is further demonstrated by the fact that Nigeria's foreign exchange reserves fell from $10.3 billion in 1980 to $1.68 billion in 1985. This reflected the falling oil revenues and the delayed response of successive Nigerian governments to the crisis, in the sense that there was a tendency to draw down on foreign exchange reserves instead of adjusting to the crisis.

The extent of the crisis has been commented upon by several writers such as Olukoshi (1991: 12) who describes it as the severest in Nigeria's history while Mosley (1992: 228) states that: "so sharp and quick a fall in living standards under peacetime conditions is probably unprecedented, either in a developing country or anywhere else".

The immediate cause of the economic crisis can be traced to an external shock, in this case, from supply and demand factors in the global oil market. On the demand side, there was a recession in the industrial economies, partly as a result of the 1979 increase in oil prices. Also contributory, were the energy conservation policies adopted by oil importing countries in response to the sharp increases in petroleum prices and the mild winter of 1980-81 which reduced demand for oil and put a brake on rising oil prices (Dipeolu 1990: 15).

On the supply side, there was increased oil production from non-OPEC countries due to the higher oil prices which had allowed for the development of previously uneconomic oil-fields. Moreover, members of the International Energy Agency (IEA) were depleting oil stocks which had been steadily built up since 1973, an act which coincided with the resumption of production which had been disrupted by the Iran-Iraq War (Dipeolu 1990: 15).

The combined result of these demand and supply factors was an oil glut and consequently, a fall in oil prices. The spot market price for Nigeria's premier crude, Bonny Light, fell from $42 per barrel in November 1980 to $30 per barrel in February 1983 and as low as $15 per barrel in 1986. At about the same time, the Organisation of Petroleum Exporting Countries (OPEC) introduced production arrangements amongst its members for the first time. In 1983, Nigeria was allocated a

quota of 1.23 million barrels a day compared to a production level of 2.2 million barrels a day in 1979[24].

The impact on Nigeria's export earnings and government revenue was severe as can be seen from Table 6.1A, 6.1B and Table 6.2. As can be gleaned from Table 6.1A, the revenue profile of the Nigerian government in the period 1979 to 1985 shows that total Federally Retained Revenue fell from a high of 12 billion Naira in 1980 to as low as 7.3 billion Naira in 1984. In contrast, total expenditure while in deficit throughout the period did not decline as fast. As such, the financing gap as a percentage of total revenue increased from 0.11% in 1980 to 39.7% in 1984. In the same period, interest payments soared to 2.8 billion Naira in 1985 from 0.69 billion Naira in 1980. Capital expenditure also fell from as high as 8.4 billion Naira in 1982 to 3.9 billion Naira in 1984, that is by more than half in just two years.

Table 6.1B reveals that the relative share of recurrent and capital expenditure in the federal government expenditure profile changed dramatically from a relationship of 38.12% and 61.88% respectively in 1979 to 61.98% and 38.02% by 1984, a complete reversal of positions. As the figures on interest payments show, the change was substantially due to interest payments which increased almost sevenfold from 4.65% to 27.69% between 1979 and 1985. As Table 6.2 shows revenue from oil exports fell from $25 billion in 1980 to $9.6 billion in 1983. Given the fact that oil exports accounted for an average of about 95% of total earnings and 80% of government revenue, the fall in oil prices meant that Nigeria was confronted with a severe crisis in fiscal and payments balances.

[24]International Petroleum Encyclopaedia annual issues from 1980 to 1986.

TABLE 6.1A Nigeria: Federal Government Revenue and Expenditure Profile (1979-1985) Naira millions							
	1979	1980	1981	1982	1983	1984	1985
Federally Retained Revenue	8891	12059	8057	8254	7483	7345	9007
Total Expenditure	9648	12202	13240	12617	14078	10264	10422
A. Recurrent	3678	5229	4997	4164	6627	6362	5854
1. Interest Payments	449	693	748	1360	2045	2607	2886
a. External	144	225	289	346	616	761	826
b. Domestic	305	468	459	1014	1429	1846	2060
2. Other	3229	4536	4249	2804	4528	3755	2968
B. Capital	5970	6973	8243	8453	7451	3902	4568

Source: World Bank 1994a: 104

TABLE 6.1B Nigeria: Breakdown of Expenditure Items (1979-1985)%							
	1979	1980	1981	1982	1983	1984	1985
Recurrent Revenue as % of Total	38.12	42.85	37.74	33	47.07	61.98	56.17
Capital Expenditure as % of Total	61.88	57.15	62.26	67	52.93	38.02	43.83
Interest Payments as % of Total[a]	4.65	5.67	5.64	10.77	14.52	18.51	27.69

Derived from Table 6.1A

a) Interest Payments are part of Recurrent Revenue

TABLE 6.2 Nigeria: oil-related statistics 1979-1983					
	1979	1980	1981	1982	1983
Crude oil production (bpd) (000)	2302	2058	1439	1287	1235
% change from preceding period		-10.5	-30	-10.5	-4.0
Crude oil export (bpd) (000)	2210	1960	1228	981	935
% change from preceding period		-11.3	-37.3	-20.1	-4.6
Crude oil revenue $ (000)	16103	25037	16770	11940	9619
Merchandise exports $ (000)	16811	25929	18115	12163	10344
Share of crude oil in total export %	95.7	96.5	92.5	98.1	92.9

Source: International Petroleum Encyclopaedia 1980-1986

The socio-economic crisis was equally severe. Capacity utilisation in manufacturing fell to as low as 20% of installed capacity, several industries closed down along with the lay-off of thousands of workers. There was also an acute shortage of basic consumer items such as bread, milk, rice and sugar, coupled with irregular payment of public sector workers and decay of infrastructure and social services (Babawale et. al. 1996: 127).

The response by the government of President Shagari was to pass the Economic Stabilisation (Temporary Provisions) Act of April 1982, later amended in November of the same year. Two aspects of the government's response stand out. The first, as the title of the legislation indicates, was a perception that the crisis was a temporary one. The other is that the policy approach chosen in response to the crisis was to slash budgetary expenditure while maintaining and further tightening existing administrative controls in the economy.

The measures taken included a reduction of capital expenditure and the enlargement of excise duties and customs tariffs. Excise duties were increased to between 5% to 45% while tariffs were raised

on 49 items. Other measures taken were a reduction in personal and business travel allowances, further centralisation of foreign exchange allocation in the Central Bank, outright prohibition of the importation of certain goods and the addition of 156 commodities to the list of those requiring specific import licences.

The civilian government of President Shagari was overthrown in a military coup which took place in December 1983 and several commentators have ascribed the coup to economic factors. For instance, the military officers who took over charged the civilians with lack of accountability and mismanagement and expressed the desire to work towards the restoration of Nigeria's creditworthiness in the international financial community (Forrest 1993 :93; Lubeck 1992: 10; Olukoshi 1991: 40).

The new government was headed by Major-General Muhammadu Buhari and it set out to tackle the economic problems facing Nigeria by further tightening of expenditure and administrative controls. This reflected a belief that mismanagement rather than policy was behind the inability of the previous government to turn the economy around. For instance, the new Head of State is reported to have said:

> ***"The monetary and fiscal policies introduced under the Economic Stabilisation Act 1982 to boost local production of goods, improve foreign exchange reserves and make the economy more self-reliant <u>were not implemented in a manner that could have the desired effect</u>"*** (emphasis added)(quoted from Olukoshi 1991: 40).

As such, existing foreign exchange and import controls were further firmed up while an attempt was made to reduce government spending by resorting to retrenchments in the public service (Olukoshi 1991: 42; Forrest 1993: 98). As a consequence, by mid-1985, all imports were subject to licensing while the importation of 16 commodities was completely prohibited. In addition, travel allowances

were further reduced and the life span for foreign exchange approval was reduced from one year to six months (Oyejide 1991: 488).

The outcome of these efforts was undoubtedly positive in some respects. As can be seen from Table 6.1, real GDP growth had resumed by 1985. Also, the budget deficit was reduced from 12% of GDP in 1982 to 3% of GDP in 1985 (Oyejide 1991: 488). Furthermore, the current account had reduced from a deficit of about $6 billion in 1981 to a deficit of $200 million in 1985, a net reduction of over $5 billion in four years (Moser et al. 1997: 80). In addition the inflation rate declined from about 38% in 1983 to just 1.1% in 1985 (Moser et al. 1997: 80)

The cost of achieving these results was, however, very high. The debt service ratio grew from 16.2% in 1980 to 33% in 1985 (World Bank 1993: 298) while external trade activity (merchandise exports plus imports) was almost halved from $40.7 billion in 1980 to just under $21 billion in 1985 (see Table 6.1).

In addition, the country was unable to restore normal trade arrangements or obtain debt relief. Normal trade credit arrangements remained suspended and the export credit guarantee agencies of the major trading nations refused to provide cover for Nigeria (Forrest 1993: 101). At the same time, despite sharply increased debt repayments, external creditors refused to discuss rescheduling without a conclusion of a stand-by agreement with the International Monetary Fund (Olukoshi 1991: 66). This was due, no doubt, to the fact that the government had continued to ignore the fundamental concerns of its international creditors, including the international financial institutions, who as was shown in Chapter Three, had lost faith in dirigiste development policies and insisted on the adoption of economic policy reforms before reaching loan agreements with developing countries.

Indeed, by 1986, time had shown that the external shock emanating from the global oil market was not temporary[25]. Moreover, the example of a country like Indonesia showed that the impact of oil price drops did not need to lead to as severe an outcome as the Nigerian experience (World Bank 1994b: 32-33; Dipeolu 1990).

The Buhari administration, however, felt that mismanagement and corruption were at the root of the Nigerian economic crisis and its priorities were to improve the record of government in these areas. In addition, patriotism and vigorous public opposition did not make capitulation to the international financial institutions an attractive option. Advocates of economic policy reform would not dispute the fact that mismanagement and corruption were at the root of the Nigerian economic crisis. However, the very core of their case was against administrative controls and state-led industrialisation which were seen as the inherent source of the crisis facing developing countries by encouraging corruption, distortions and rent-seeking.

The Buhari government was itself overthrown in a palace coup in August 1985. The new government led by Major-General Babangida promised, among other things, to end the deadlock with the IMF and reduce the debt service ratio. Indeed, some ascribed the take-over to the failure of the previous government to reach an agreement with the IMF (Forrest 1993: 209 mentions the Financial Times of London as taking this view).

The new regime organised a national debate on whether or not it should reach accommodation with the IMF and quickly discovered the depth of domestic opposition to any such agreement. A stand-by agreement with the IMF was viewed as a loss of sovereignty and national capitulation. Since General Babangida's government determined to reach an agreement with the IMF, it found itself in a quandary and resorted to the imaginative device to overcome the deadlock. First, it summarised the terms of the debate as an acceptance by Nigerians of the need to make the necessary sacrifice

[25]Global petroleum prices fell to record lows since the sharp increases of 1973. This was reflected in the fall in petroleum export revenue from $12.2 billion in 1985 to $6.3 billion in 1986.

in so far as it was not externally imposed. Second, instead of concluding a deal with the IMF, the World Bank was used to obtain a stamp of approval for the policies being adopted (Forrest 1993: 212; Mosley 1991: 230). As it turned out, the Structural Adjustment Programme adopted by the Nigerian government in June 1986 was hardly different from the conventional reform package that other developing countries adopted under the aegis of the IMF.

6.3 THE STRUCTURAL ADJUSTMENT PROGRAMME

The Nigerian government launched a Structural Adjustment Programme (SAP) in June 1986 on the premise that "more austerity without structural adjustment constitutes an inadequate response to the fundamental economic and financial problems confronting the country" (Federal Government of Nigeria 1986: 1).

The objectives of the SAP were to:

(i) restructure and diversify the productive base of the economy in order to reduce dependence on the oil sector and on imports;

(ii) achieve fiscal and balance of payments viability over the period;

(iii) lay the basis for a sustainable non-inflationary or minimal inflationary growth; and,

(iv) lessen the dominance of unproductive investments in the public sector, improve the sectors efficiency and intensify the growth potential of the private sector (Federal Government of Nigeria 1986: 8).

The policy measures chosen to achieve these objectives were:

(i) strengthening of the hitherto strong demand management policies;

(ii) adoption of measures to stimulate domestic production and broaden the supply base of the economy;

(iii) adoption of a realistic exchange rate policy;

(iv) further rationalisation and restructuring of tariffs in order to aid the promotion of industrial diversification;

(v) a move towards improved trade and payments liberalisation;

(vi) reduction of complex administrative controls simultaneously with a greater reliance on market forces;

(vii) adoption of appropriate pricing policies especially for petroleum products and public enterprises; and,

(viii) encouragement for the rationalisation and privatisation of public sector enterprises (Federal Government of Nigeria 1986: 9).

It is easily demonstrated that these policies conformed to the core elements of the conventional package outlined in Chapter Three. The strengthening of demand management policies and adoption of a realistic exchange rate policy refer to cutting the budget deficit, tightening monetary policies and devaluation of the national currency, the Naira. The movement to improved trade and payments liberalisation and the rationalisation and restructuring of tariffs clearly fall within the ambit of trade policy reform. Similarly, the reference to appropriate pricing policies not only refers to price liberalisation but also the removal of subsidies. Finally, policy items (vi) and (viii) clearly show an acceptance of deregulation and privatisation.

In short, Nigeria was abandoning the erstwhile policy regime of administrative controls in favour of the new paradigm - economic policy reforms. A more detailed look at the elements of the Structural Adjustment Programme (henceforth SAP) may prove useful prior to an assessment of the performance of the Nigerian economy in the period of reforms.

6.3.1 Demand Management Policies

At the core of the SAP were the familiar demand management policies consisting of fiscal and monetary policies. On the fiscal side, the objective was to control the budget deficit by keeping it within 3% of GDP (Oyejide 1991: 490). In addition, expenditure was to be controlled by freezing civil service employment and keeping wage increases lower than the rate of inflation. Also public

spending programmes were to be rationalised with expenditure for maintenance prioritised over new capital investment. It was also expected that there would be reduced support for parastatals as an outcome of the privatisation or commercialisation of public enterprises (World Bank 1994: 35).

Monetary policy was to be kept tight in order to avoid inflation and to contain demand in the foreign exchange market. As such, monetary growth was to be tightly controlled through a reduction in net credit to the central government (World Bank 1994: 35). In addition, interest rates and spreads were deregulated with the removal of floors and ceilings for deposit and lending rates (World Bank 1994: 38). The previously favoured approach for controlling the growth of bank credit was through credit guidelines issued by the Central Bank of Nigeria (CBN). The aim under SAP was to eliminate this process. At the onset, however, credit guidelines were retained but simplified. Apart from an overall growth target, multisectoral allocation guidelines were discarded in favour of a two-tier system with one priority sector (agriculture or manufacturing) to receive at least 50% of new credit while other sectors shared the balance.

6.3.2 Exchange Rate Policy

Simply put, the exchange rate policy which was at the core of SAP was to devalue the naira which was perceived as unrealistically over-valued. The instrument through which this was achieved was the introduction of a Second-Tier Foreign Exchange Market (SFEM). All external receipts and payments were to be processed through this second window "except for those relating to debt service and direct government imports which would still be conducted at the existing administratively determined official exchange rate" (Oyejide 1991: 491).

When the SFEM took off in September 1986, it led to a 60% devaluation of the naira. The rate was unified in July 1987 although two separate exchange rates continued to exist. One was determined by auction and open to banks, government offices and official foreign exchange dealers and the other was the interbank rate (Faruqee 1994: 255).

6.3.3 Trade Policy Reforms

In keeping with the emphasis on liberalisation, one of the first acts of the Nigerian government under SAP was the abolition of import and export licensing. This was accompanied by a shortening of the list of prohibited imports as well as a reduction in the height and dispersion of tariffs (World Bank 1994: 12; Oyejide 1991: 491). Specifically, in 1986 the number of prohibited items was reduced from 74 to 16 items while the trade weighted average nominal tariff was reduced from 33% to 23%. Moreover, most tariffs fell by up to between 10% to 30% (World Bank 1994: 12).

There was also the intention to reverse the bias against exports and as such the SAP allowed for unrestricted disposal of export earnings and 100% right of retention of foreign exchange. Similarly, all export bans were lifted while supply side measures, such as a duty drawback scheme and export credit guarantee arrangements, were introduced (Oyejide 1991: 492).

In a related context, six existing commodity marketing boards were scrapped, thus effectively removing price controls on agricultural commodities and allowing private sector participation in the export of cash crops (Oyejide 1991: 492; World Bank 1994: 15). In addition, price and distribution controls had existed on many manufactured goods and enforced at factory level, thus enabling distributors to reap huge rents between the market price and the control price. These restrictions were done away with by 1987 (Faruqee 1994: 259).

6.3.4 Financial Sector Reforms

An integral part of the structural adjustment programme was financial sector reform. In addition to monetary policy, such as the liberalisation of interest rates, the financial sector was deregulated. This mostly involved the relaxation of barriers to entry which allowed for more banks and greater private sector participation in the banking industry. A larger role was also envisaged for non-bank

financial institutions such as insurance companies, bureaux de change, finance houses, mortgage banks and stockbroking firms.

6.3.5 Privatisation and Commercialisation

The privatisation objectives of the structural adjustment programme were formalised in Decree No. 25 of July 1988 which clearly stated the intention of the Federal Government to privatise or commercialise 145 parastatals. Specifically, the decree required the implementing agency, the Technical Committee on Privatisation and Commercialisation (TCPC) to:

(i) restructure and rationalise the public enterprise sector;

(ii) ensure positive returns on investment in enterprises to be retained in the public domain;

(iii) reduce commercially viable parastatals' dependence on the federal budget and encourage their entry into the Nigerian capital market; and

(iv) reduce the size of the public sector through the sale of public enterprises that can be operated better by the private sector.

6.4 POLICY REFORMS AND ECONOMIC TRANSFORMATION

It was stated in earlier chapters that the process of economic development should entail growth and structural transformation. Following from this the impact of SAP on the Nigerian economy will be assessed first by examining the macroeconomic performance of the economy in the period of structural adjustment and then by its contribution to structural transformation within the parameters set out in Chapter Four.

6.4.1 Macroeconomic Performance

The performance of the Nigerian economy in the period of structural adjustment was not encouraging as can be seen from Table 6.3. Gross Domestic Product grew at an annual rate of 9.6% in 1988 but fell steadily to 1.5% by 1993. This progressive decline in economic performance requires explanation, if only because the best growth year under SAP was in 1988, the year in which due to social pressure, the Nigerian government relaxed some of its tight demand management and other policies. Per capita Gross National Product, having fallen sharply between 1980 and 1985 continued to fall from $710 at the beginning of SAP to $280 by 1993 (see Figure 6.1).

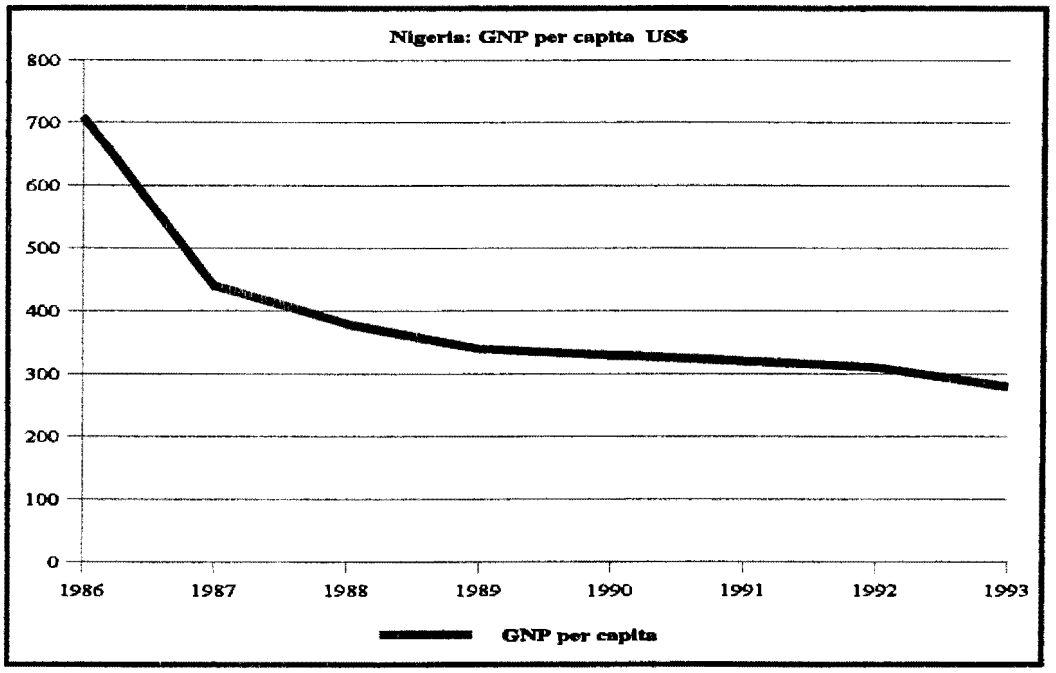
Merchandise exports rose from $6.8 billion in 1986 to a peak of $13.6 billion in 1990 before falling to a value of $11.2 billion in 1993. These changes could not, however, be ascribed to policies undertaken under structural adjustment as crude oil still accounted for over 90% of total Nigerian exports and oil prices are determined in the international petroleum market. The peak in 1990-1991 was, therefore, clearly due to the sharp rise in world petroleum prices as a result of the Iraqi invasion of Kuwait in late 1990 and the Gulf War in early 1991. The relatively good price of petroleum in the following years owed its provenance to the embargo imposed on Iraq's oil exports as well as the fact that Kuwait had not fully resumed oil exports due to the damage done to its production capacity.

TABLE 6.3 Nigeria: macroeconomic indicators 1986-1993								
	1986	**1987**	**1988**	**1989**	**1990**	**1991**	**1992**	**1993**
Real GDP growth rates %	-0.6	-2.8	9.6	7.5	7.8	5.4	2.6	1.5
GNP per capita (US$)	710	440	380	340	330	320	310	280
Exchange rate N/$								
Official	1.8	4.0	4.5	7.4	8.0	9.9	17.3	22.1
Parallel	4.1	6.7	6.7	10.7	9.3	6.7	21.9	56.8
Interest rate: Commercial lending %	10	14	16.6	20.4	25.3	20	24.8	31.7
Consumer prices*(end of period) %	13.6	9.7	39	44.7	3.5	23	48.8	61.3
GDI/GDP%	15	12.5	13.6	13.5	13.6	16.6	16.6	15.1
GDS/GDP%	11.6	16.4	14.6	21	28.3	22.3	21.2	18.5
GNS/GDP%	4.3	6.1	5.5	12.2	18.1	13.3	12.5	na
Exports* (fob) $bn	6.8	7.5	7.1	9.8	13.9	12.1	12.3	11.3
Imports* (fob) $bn	6.7	5.8	5.8	5.9	7.1	7.9	8.7	8.1
Current account* $bn	-3.8	-1.2	-1.9	-0.4	-2.5	0	0.6	0.9
External debt* $bn	24.6	28.3	30.1	31.4	33.7	33.7	28.8	29.8

Source: World Bank 1996: African Development Indicators, except *Moser et al. 1997: 80-81

FIGURE 6.1

Nigeria: GDP per capita 1986-93



Gross Domestic Investment as a percentage of Gross Domestic Product was the same at 15% in 1993 as it was at the introduction of SAP in 1986. This was not only far lower than the investment rate of high performing economies such as Chile - 26%, Indonesia - 28%, Korea -34%, Malaysia-33%, (World Bank 1995: 178) but also represents a 50% fall from the levels achieved in 1980. The implication of such a low level of investment is brought into sharp relief by an analysis of the South African economy given by Malherbe (1997: 80) who underscores the fact that GDI often includes figures for replacement of depreciating and obsolete capital equipment. Using an arbitrary figure of 13% of GDP for such expenses, he shows that in 1995, new investment in South Africa would have been only 6% of GDP as compared to 21% of GDP in East Asia in the same period. By the same token, new investment in Nigeria between 1986 and 1993 would have been just 2% of GDP annually. A survey carried out by the Manufacturers Association of Nigeria (1990b: 11) shows that the share of asset replacement and plant modification in total capital spending was 37% and 35%,

respectively. This means that new projects and plant execution only accounted for 28% of total capital spending or about 4.2% of GDP.

Gross Domestic Savings as a percentage of GDP rose from 11.6% in 1986 to 18.5% in 1993. This is not only far lower than the level of 33.2% of GDP reached in 1980, an era of controls, it was hardly of benefit to the domestic economy. As can be seen in Table 6.3, Gross National Savings were only 12.5% of GDP in 1993, indicating that there was a net outflow of domestic savings from the Nigerian economy. This was despite the fact that nominal interest rates charged by commercial banks rose from 10% in 1986 to 31.7% in 1993 and was probably due to debt repayment and capital flight.

Total external debt which stood at $18.6 billion just prior to the adoption of SAP grew to about $30 billion in 1993, in spite of the fact that an annual average of 5% of GDP was spent on debt repayment in the period (Faruqee 1994: 271) and the fact that the latter figure was only a result of debt reduction by the Paris Club in 1992 (World Bank 1994: 91-92).

The performance of the Nigerian economy in the period of structural adjustment can also be viewed through the lenses of the government's revenue and expenditure profile in that period which is summarised in Tables 6.3A, 6.3B and 6.3C.

TABLE 6.3A Nigeria: Federal Government Revenue and Expenditure Profile (1986-1992) Billions of Naira							
	1986	1987	1988	1989	1990	1991	1992
Federally Retained Revenue	11.3	16.6	16.4	35.1	54	68.8	90.2
Total Expenditure[a]	13.7	22.4	30.2	44.8	61.6	90.9	138
A. Recurrent	7.9	15.5	20.9	31.6	44.6	54.8	79.7
1. Interest Payments	3.6	12.3	15.4	23.9	33.7	38.1	55.8
a. External	1	8.4	10.4	16.7	21.3	23.1	35.9
b. Domestic	2.6	3.9	5.1	7.1	12.3	15	19.9
B. Capital	5.7	5.4	8.3	11.3	15.5	34.4	55.1

Source: World Bank 1994a: 18

a) Total recurrent expenditure and capital expenditure do not add up due to expenditure on exchange rate guarantee introduced by the government to meet obligations assumed before the establishment of the foreign exchange market (World Bank 1994a: 23).

TABLE 6.3B Nigeria: Breakdown of Expenditure Items (1986-1992)%							
	1986	1987	1988	1989	1990	1991	1992
Recurrent Expenditure as % of Total	57.6	69.2	69.2	70.5	72.4	60.2	57.7
Capital Expenditure as % of Total[a]	41.6	24.1	27.4	25.2	25.16	37.8	39.9
Interest Payments as % of Total[b]	26.27	54.9	50.99	53.34	54.7	41.9	40.4

Derived from Table 6.3

a) Total recurrent expenditure and capital expenditure do not add up due to expenditure on exchange rate guarantee introduced by the government to meet obligations assumed before the establishment of the foreign exchange market (World Bank 1994a: 23).

b) Interest payments are part of recurrent payments

TABLE 6.3C Nigeria: Federal Government Expenditure by Function (1986-1992)%							
	1986	1987	1988	1989	1990	1991	1992
1. Economic Services	15	9	10	11	10	13	12
Agriculture	4	1	2	4	4	4	3
Transport & Communication	4	2	2	2	1	2	2
Other Economic Services	8	5	5	5	5	7	7
2. Social Services	14	3	11	12	11	12	13
Education	8	1	5	7	6	4	6
Health	3	1	2	2	2	2	3
Other	3	1	4	4	4	5	4
3. Other Primary Expenditure	44	26	25	20	22	32	32
Defence and Security	12	9	8	6	8	13	12
General Administration	16	12	14	11	11	16	17
Pensions and Gratuities	6	0	3	1	2	2	2
Other[a]	11	4	0	1	1	1	1
4. Interest due	26	55	51	53	55	42	40
Total (1+2+3+4)	100	100	100	100	100	100	100

Source: World Bank (1994a: 24)

a) Includes grants, subventions, and lending to public enterprises and States

The huge increase in Federally Retained Revenues[26] as from 1989 shown in Table 6.3A is partly due to the devaluation of the Naira which increased receipts to government from its sales in the foreign exchange market. It is also partly due to the increase in revenues as a result of the sharp increase

[26] The revenue retained by the Federal Government of Nigeria after the allocation of revenue between it and the states and local governments from the Federation Account on the basis of a revenue allocation formula

in the price of petroleum which took place after the Gulf War (World Bank 1994a: 17). As the table clearly indicates, however, the expenditure behaviour of the government was odd. The budget deficit as a percentage of Federally Retained Revenue grew very sharply from 21.2% in 1986 to around 52.9% in 1992. This was partly due to increased interest payments which rose from 26.27% in 1986 to as high as 54.7% in 1990 before falling to 40.4% in 1992. However, as will be demonstrated later in Table 6.7 it was mainly due to extrabudgetary spending.

A look at Table 6.3C shows clearly the sectoral spending patterns of the Federal Government of Nigeria between 1986 and 1992. Expenditure on economic services declined sharply from 15% of total expenditure in 1986 to 10% in 1990 before rising again to 12% by 1992. By contrast, expenditure on social services fluctuated sharply falling from 14% of total expenditures in 1986 to 3% the following year 1987. By 1992, however, it had risen to 13% of total expenditures. Other primary expenditures fell from 44% in 1986 to 32% in 1992. However, a closer look at subsectors indicates that the brunt of the reduction was in the area of grants, subventions and lending to public enterprises and component States of the Federation which fell from 11% of total expenditure to only 1% from 1989 to 1992. Defence spending which fell from 12% of total expenditure to only 6% in 1989 rose to its previous level of 12% in 1992. Similarly, General Administration which fell from 16% of total expenditure in 1986 to 11% in 1989-1990, rose to 17% by 1992. The changing expenditure pattern reflected the political priorities of the government as it approached the terminal period of its self imposed date for transfer of power to a democratically elected government as well as the changing interest payments. Equally pertinent, therefore, was the reduction in the share of expenditure devoted to interest payments due to successive debt rescheduling arrangements reached with Paris Club creditors in 1989 and 1991, the London Club in 1989 as well as a debt reduction agreement reached with the London Club in March 1992 (World Bank 1994a: 91-92).

The preceding analysis indicates clearly that the macro-economic performance of the Nigerian economy in the period of the structural adjustment programme was patchy, at best. However, the figures do not tell the full story of the socio-economic consequences of structural adjustment. Amale (1991: 128-129) for instance provides a bleak, if brief, picture of the consequences of structural adjustment for Nigerian workers in terms of pay cuts, retrenchment and falling standards

of living. Nevertheless, there were undoubtedly positive aspects of the liberalisation that accompanied economic policy reforms.

In particular, the deregulatory aspects of the Structural Adjustment Programme allowed for greater private sector participation in the economy. This was especially true of import and export trade as well as other sectors previously regulated, monopolised or dominated by the state such as trading, banking, airlines and shipping. Also, the country benefited from debt rescheduling and debt reduction which lowered the annual debt service burden, though not the total debt. Producers of agricultural commodities also benefited in the initial stages although it soon became apparent that the sharp price gains were unsustainable being mostly due to speculation (see Lewis 1994: 445 and section 6.5.2 below).

These positive features do not however mask the continued poor performance of the Nigerian economy under SAP. As Lewis (1994: 437) puts it:

> ***"price reforms were not accompanied by improved fiscal management or effective administrative support, and the reform program failed to elicit a significant supply response from the private sector. Within six years, the program was near collapse and the palpable achievements of structural adjustment remained sparse".***

6.4.2 Structural Adjustment and Economic Transformation

It was argued earlier that the process of structural transformation might require an active state role in matters related to coordination and reduction of asymmetrical information. Specifically, experience from other regions shows that the state ought to play an entrepreneurial role; ensure macroeconomic stability; provide a property rights regime that reduces uncertainty and favours production; act to resolve societal conflicts arising from the process of structural change; and assist the development of normative standards to reduce the transactions costs of exchange.

6.4.2.1 Macroeconomic Stability

In the Nigerian experience, the economy did not achieve macroeconomic stability in the period of structural adjustment. Table 6.4 compares Nigeria's macroeconomic performance to a group of countries chosen from Rodrik (1991: 935). The measurement used, also derived from the same source, is the absolute difference between the highest and lowest annual values of indicators such as GDP growth, gross domestic investment as a ratio of GDP, the budget deficit, inflation and real exchange rates. The first group (designated 'A') consisting of Korea, Thailand, Turkey and Colombia is chosen from a group assessed to have been relatively stable by Rodrik in the period of 1982 to 1987. The second group (designated 'B') consisting of Brazil, Ghana, Côte d'Ivoire and Kenya was relatively unstable in the similar period. The data for Nigeria is from 1986-1992 corresponding roughly to the period of structural adjustment.

TABLE 6.4 Macroeconomic Stability: Absolute difference between highest and lowest annual values, Nigeria and Eight Developing Countries

		GDP	GDI/GDP	Fiscal deficit/ GDP	WPI (Inflation)	Real exchange rate
A	Korea	6.2	3.4	3	5.4	27.0
	Thailand	2.6	2.9	3.78	15.8	29.0
	Turkey	3.1	5.2	3.6	22.0	22.0
	Columbia	4.2	3.0	-	5.7	54.0
B	Brazil	10.8	4.8	5.3	99.5	34
	Ghana	15.2	6.2	5.7	88.9	255.0
	Côte d'Ivoire	12.1	12.3	18.1	5.5*	20.0
	Kenya	5.5	4.7	6.0	16.4*	23.0
C	Nigeria	12.4	4.1	12.9***	29.8**	68.3***

Source: Rodrik (1990: 935), Table 6.3 except ** World Bank (1996: 46),* Moser et al (1997: 80)**
A - Rodrik's relatively macroeconomically stable group (1982-1987)
B - Rodrik's relatively macroeconomically unstable group (1982-1987)
C - Nigeria (1986-1992)

As can be gleaned from table 6.4, the growth rate of GDP in Nigeria during the period of structural adjustment was unstable as compared to other countries. The absolute difference between the highest and lowest values was 12.4% which was surpassed by only one other country in either Group A or Group B, i.e. Ghana. The fluctuation in Gross Domestic Investment as a percentage of GDP was 4.1% which was lower than all the countries in Group B but higher than the countries in Group A except Turkey. The swing from the highest and lowest levels of the fiscal deficit as a percentage of GDP was 12.9%, which is higher than all countries in Group A but below Côte d'Ivoire in Group B. The figures for changes in the rate of inflation also show that Nigeria would not have been included in Group A of Rodrik's study since its fluctuation of 29.8% was higher than Turkey which had the highest fluctuation rate of 22%. Moreover, the variation in inflation in Nigeria was also higher than what was obtained in Côte d'Ivoire and Kenya which were included in Group B, the unstable group. The fluctuations in Nigeria's real exchange rate was a difference of 68.3% which surpassed all countries in Group A and only Ghana had a higher rate of instability in Group B. In summary, therefore, it can be argued that compared to other countries, the macroeconomic environment in Nigeria during structural adjustment was not persuasively stable.

6.4.2.2 Entrepreneurship

The very nature of structural adjustment did not envisage an entrepreneurial role for the Nigerian state. This lack of vision is evident from the abandonment of five year national plans in favour of a two year structural adjustment programme. While it is true that the five year plans were overly ambitious and gave too much prominence to central planning (at least in principle), they at least represented an opportunity for policy makers to show the sectors and projects accorded priority in the economy. That is, they served a signalling role. By contrast, SAP covered only two years and promised no more than macroeconomic improvements after the implementation of certain policies.

In the case of Nigeria, the introduction of three year rolling plans were not intended to provide a vision but were aimed at improving budgetary and expenditure procedures (World Bank 1994: ix; Faruqee 1994: 249). Apart from providing a vision, a key feature of the entrepreneurial role

expected of a developmental state is the mobilisation of resources, especially finance and human resources. Structural adjustment left financial mobilisation mainly to the market place with the result that while Gross Domestic Savings improved as mentioned earlier, the average over the entire period was less than in the pre-liberalisation era (Lewis and Stein 1997: 16).

In Nigeria, where monetary policy retained simplified credit allocation arrangements, these were largely ignored. The World Bank ascribes this to the fact that banks found it less costly to incur the penalties than to observe the rules (World Bank 1994: 41). This was certainly the case but leaves unanswered the question of why such rules were easy to ignore. It could either have been that the sanctions were deliberately kept weak or that the government could not enforce the rules it introduced. In the latter case, this could have been due to a laissez-faire attitude that came with the implementation of SAP or that the regulatory capacity to supervise the banks was weak or non-existent.

State participation in public enterprises as a means of financial mobilisation was clearly precluded by the intention of policy reformers. Instead, the state was expected to limit public investment to the provision of social services and maintenance of infrastructure (Faruqee: 1994: 247). This was, however, not achieved in Nigeria. Allocations continued to be made for new projects while the provision of infrastructure was neglected. For instance, the World Bank (1994: 25-28) notes that:

> ***"In the power and petroleum sectors, neglect of O&M (operations and maintenance) had disastrous effects on performance. Owing to inadequate resources for maintenance and spare parts, three of the four refineries run by the NNPC need major rehabilitation expenditures. Gross underperformance in power generation is also largely attributable to similar neglect, while in the transport sector inadequate attention to road maintenance threatens the whole road network. The share of federal roads classified as in poor condition increased from 23% in 1985 to 30% in 1990. These poor roads, moreover, cost vehicle operators some $200 million annually in terms of higher maintenance cost and delays".***

The questions that need to be answered are why there was such a lack of commitment and what the capital budget was used for. The answer, if the World Bank (1994: 25) is to be believed, is that there remained a trend of spending on new projects. This alone does not explain preferences; a further clue for which is also provided in the same World Bank study (pg25) which states that: ***"A large number of projects are also far from least cost either because of inappropriate choices of technology or location or <u>because of padding by foreign suppliers introduced to cover commissions and the costs of doing business in Nigeria</u>"*** (emphasis added). This is diplomatic language for saying political considerations and corruption.

The available evidence does not support the view that structural adjustment favoured social spending to develop human resources in Nigeria. The simplest means of showing policy commitment is the preferential allocation of funds to the favoured sector. In Nigeria, government spending on education fell sharply from N974.6 million in 1986 before the introduction of structural adjustment to N448.6 million in 1987, the first full budget year under SAP.[27] This amounted to a fall from N11.4 per capita to N5.1 per capita (World Bank 1994a:26). Total spending on education rose to N1.16 billion in 1988 (under the expansionary budget of that year) and was maintained at a corresponding level until 1991 when the responsibility for primary education was transferred to states and local governments (*ibid*). These figures mask the sharpness of the fall in allocation to education because they do not reflect the reduced purchasing power of the naira (as a result of devaluation) in respect of imported items such as books and educational materials.

School enrolment is another means of assessing human resource mobilisation in Nigeria under structural adjustment. Primary and secondary school enrolment in Nigeria, despite being below the norm for developing countries, fell sharply at the onset of crisis in 1983 and did not show any appreciable improvement after the adoption of structural adjustment polices. The primary school

[27]Nigeria's annual budget projections are released in January, while the structural adjustment programme was adopted in June 1986.

gross enrolment ratio[28] fell from 119 in 1980 to 93 in 1991-1993 (World Bank 1996: 343). This reduction may appear as a normalisation of the school age of those attending primary school. However, a clearer picture emerges when account is taken of the fact that the percentage of pupils who actually finished primary school in 1990 was no higher than 58% (World Bank 1996: 344)[29].

In a similar vein, expenditure on health was more or less stagnant falling from N419.6 million in 1986 to N385.6 million in 1991; in other words, a fall in per capita provision from N4.9 to N3.9 over the period (World Bank 1994a: 26). The extent of this decline is also masked by the fall in the value of the naira. Using the official exchange rates shown in Table 6.3 shows that federal expenditure on health services in 1986 was $233.1 million as compared to $38.9 million in 1991. In other words, there was more spent on health in the worst year of foreign exchange earnings under structural adjustment than in the best year for such earnings under the same programme.

6.4.2.3 Property Rights

The property rights regime promoted by economic policy reforms tends to treat a change of ownership from the public sector to the private sector as the main source of productivity gains. The point was made in Chapter Three that change in ownership alone was an insufficient theoretical basis for privatisation. More critically, however, a property rights regime in a developmental state should favour those who would use scarce resources most productively. It is important, therefore, to determine which sectors are favoured by a property rights regime. Also, while private ownership has been shown historically to be more innovative and responsive than public enterprise, there has to be an acknowledgement that there are differences in private sector performance over time and space, and across and within sectors. Even in the best performing economies, just as there are

[28]Number of pupils regardless of age enrolled in primary school as a percentage of population corresponding to official school age.

[29]It is worth noting that the figures provided by the World Bank (1994: 1) are less favourable, showing a drop in primary school enrollment from 104% in 1980 to 76% by 1990.

successful farmers, there are unsuccessful ones, and while there are prosperous manufacturing firms there are those which go bankrupt.

The evidence from Nigeria would seem to indicate that it was the financial sector that appeared to be the most direct beneficiary of structural adjustment rather than the real sector. As shown clearly in Table 6.5A, the contribution of the financial sector to Gross Domestic Product grew sharply and almost threefold from 3.1% in 1986 to 8.7% in 1993. By contrast, manufacturing declined from 9.4% to 8.5% in the same period. This indicates that the finance sector surpassed the manufacturing sector in relative contribution to GDP by the end of the period under review. Agriculture, which remained the biggest contributor to GDP fell from a share of 38.6% in 1986 to 36.5% in 1992 (World Bank 1994a: 97).

TABLE 6.5A Contribution of Finance and Manufacturing Sectors to GDP 1986-1993

	1986	1987	1988	1989	1990	1991	1992	1993
Finance*/GDP %	3.1	3.3	3.5	6.2	8.7	8.7	8.7	8.7
Manufacturing/ GDP %	9.4	9.7	9.8	8.1	8.2	8.5	8.4	8.5

Source: Lewis and Stein (1997: 16)

*Finance and Insurance

TABLE 6.5B Nigeria: Capacity Utilisation in Manufacturing (half yearly figures 1986-1993)

Capacity utilisation	1986		1987		1988		1989		1990		1991		1992		1993	
	JJ	JD	JJ	JD	JJ	JD	JJ	JD	JJ	JD	JJ	JD	JJ	JD	JJ	JD
	na	na	25	37	35	40	31	29	37	37	30	38	35	36	36	29

na - not available, JJ - January to June, JD - July to December

Source: Manufacturers Association of Nigeria: Half-yearly Economic Review 1987-1993 Issues

The reason for the increased importance of the financial sector could be traced partly to the fact that exchange rate policy was at the centre of structural adjustment. Currency trading, especially speculation against the naira, was a profitable activity. The currency fell in the parallel market from N4.1 to US$1 in 1986 to N56.8 for U$1 in 1993. This was compounded by the arrangements put in place after exchange rate liberalisation. Not only did the existence of two tiers allow for round-tripping, the auction arrangements in the Second Tier Foreign Exchange Market allowed banks to chase big economic rents. As such, the number of banks (the only organisations allowed to bid for foreign exchange) mushroomed and was later complemented by a large number of bureaux de change. By 1992, the total number of deposit-taking banks[30] had increased to 523 from a mere total of 41 in 1986. Similarly, the number of bureaux de change grew from 52 in 1989 when they were legalised to 132 by 1992 (World Bank 1994a: 43).

The huge proliferation in financial institutions continued with the legitimisation of finance houses which numbered 558 in 1991, the first year of registration. These establishments were poorly funded and offered loans at such high interest rates that the emphasis on borrowing was for the short term, especially speculative trading.

By contrast, the manufacturing sector was beset by all manner of difficulties. The devaluation of the naira resulted in sharply increased costs of imported intermediate and capital goods whilst trade liberalisation meant that competing imports were more readily available to a sharply reduced demand base. The contraction in demand was a result of the reduced purchasing power of most wage earners, especially in the large public sector. Empirical evidence is provided by the Central Bank of Nigeria which publishes the results of an annual survey of manufacturing firms in its Annual Reports. The following quotations from its 1987 and 1992 reports are instructive:

> ***"The progressive slowdown in manufacturing output during the year was induced by rising inventory accumulation following low consumer demand. Thus, manufacturing activity was undertaken in the face of rising costs resulting from***

[30]This group consisted of commercial banks, merchant banks and community banks.

depreciation in the value of the Naira and consequent escalation in the prices of finished goods... An important development in the manufacturing sub-sector was the decline by 4.4% in total investment expenditure due to what respondents referred to as 'high cost of credit' from the banking system" (Central Bank of Nigeria 1987: 24-25).

Five years later, the Central Bank would still remark that:

> ***"The performance of the manufacturing sub-sector was constrained by the high cost of production which was attributable mainly to substantial depreciation of the naira exchange rate. The resultant sharp rise in cost of importation of raw materials, machinery and spare parts resulted in corresponding sharp rise in the overall cost of production. Other factors that contributed to the high cost of production during the year were escalation in interest rates, sharp increases in tariffs on public utilities ... These translated into higher product prices which tended to dampen demand for local manufactures resulting in high inventory accumulation"*** (Central Bank of Nigeria 1992: 85-87).

Capacity utilisation figures[31] for the manufacturing sector obtained from the regular half-yearly economic review of the Manufacturers Association of Nigeria (MAN) are shown on a half-yearly basis in Table 6.5B. The highest level of capacity utilisation reached in the period under review was 40% in the latter half of 1988 (the expansionary year) while the lowest was in the first half of 1987 the beginning of structural adjustment. Although these figures mask sectoral performance and are highly aggregated and unweighted, they clearly show an unstable and low level of capacity utilisation in the period of structural adjustment.

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[31]This concept is always problematic to define. Our source for the figures, the Manufacturers Association of Nigeria recognises this and provides the definition for capacity utilisation data it is providing as follows: ratio of actual output to potential output as represented by the maximum output possible with a given firm's short run stock of capital.

This is a pointer to the uncertain macroeconomic and institutional environment which deters long term investment. This feature was remarked upon by the CBN in its Annual Reports for the period of structural adjustment and well captured by the Manufacturers Association of Nigeria (1988: 3) when it states on a basis of a survey of its members that:

> ***"Among industrialists, there was also prevailing uncertainties (sic) about the direction and prospects of industrial business in the country. Consequently, in the face of SAP-induced operational problems, their main pre-occupation was survival. Inevitably, therefore, they tended to shorten their planning horizons with the result that any real investments that were undertaken were geared only to adaptation and modification for survival".***

There is general agreement that there were initial gains in the agricultural sector after the adoption of structural adjustment. The World Bank (1994: 66), Faruqee (1994: 278), Adejumobi (1995: 177), Oyejide (1991: 496) all attest to this improvement. However, there were some drawbacks. Faruqee (1994: 278) concedes for instance that there was a decline in food crop production, while Oyejide (1991: 496) and Adejumobi (1995: 177) ascribe the improved performance in agriculture more to favourable weather conditions. The last writer also draws attention to the fact that the annual growth rate of the agricultural sector declined steadily from a high of 9.8% in 1988 to 1.9% 1992.

Although increased agricultural productivity is essential for successful transformation, our stylised facts in Chapter One would indicate a shrinkage in the relative size of this sector compared to manufacturing. In Nigeria, during the period of structural adjustment, although the share of agriculture as a percentage of GDP did decline marginally as stated earlier, this did not reflect a substantial change in the pre-eminent role of agriculture in the Nigerian economy.

6.4.2.4 Conflict Resolution

A central plank of the framework developed in earlier chapters was the important role of the state in acting as a conflict manager between factors in losing sectors and those in gaining sectors during the transformation process.

The most likely source of social conflict is unemployment of factors of production as a result of structural adjustment. Quite interestingly, and contrary to popular perceptions, the World Bank (1994a: 81) reports that unemployment actually reduced in the period of structural adjustment stating that: ***"Unemployment rates began to come down during SAP starting in 1988. Rural unemployment fell from 5% in 1986 to 4.3% in 1998 while urban unemployment declined from 10% in 1986-87 to 8% in 1988-89".***

This contrasts sharply to other informed opinion which is well captured in the following passage attributed to Sam Aluko, one of Nigeria's most eminent economists, viz.:

> ***"while the UAC[32] has been announcing increased annual naira profits since 1987, the number of its Nigerian employees had been falling. In 1980, UAC employed about 20,000 Nigerians, 22,500 in 1982 and 23850 in 1985. But the number fell to 19,000 in 1986 shortly after the introduction of SAP. 14,000 in 1987, 9000 in 1988 and is now about 7500. It is planning to further reduce the number to about 6000 in 1990"*** (obtained from Fadahunsi 1993: 46).

The picture is further complicated by the finding of Fashoyin et al. (1993: 30) who found broadly on the basis of a nation-wide survey that while employment in the private sector had risen, there was a fall in public sector employment. This apparent paradox would require explanation. One possibility is that the inconsistency may be due to the fact that data is notoriously unreliable in Nigeria and the lack of hard facts forms part of the institutional environment. This is confirmed by Fashoyin et al. (1993: 8)

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[32]United Africa Company, then the largest conglomerate in Nigeria.

Perhaps more critical is that neither the World Bank (1994a) nor Fashoyin et al. (1993) appear to have been checking the data for increases in total employment in the economy. Employment may be increasing in certain establishments but if it is doing so at a rate slower than the increase in new entrants into the work force, this would represent a net increase in unemployment. In a country like Nigeria in which population growth was at an average of 3% in the period of policy reform (World Bank 1996: 7), this is an important consideration. Indeed, Faruqee (1994: 262), despite repeating the same claims of reduced unemployment as the World Bank, hints at this point when he states that ***"employment grew by slightly more than 3% annually after the inception of the program - a growth rate almost sufficient to absorb the growing number of workers in the labour force".*** Almost, but clearly not sufficient.

In addition, the period which the World Bank reports that there was a reduction in unemployment may misrepresent the achievements of structural adjustment for a number of other reasons. The first is that 1988-89 was the early period of structural adjustment and there was the likelihood that such initial productive responses may be due to easier access to foreign exchange as well as to price liberalisation. Secondly, such survey results do not include figures of companies that were closed down or under receivership (MAN 1988: 2). Thirdly, strictly speaking, the period chosen could not be said to reflect a positive outcome of SAP, if only because 1988 was the year in which SAP policies were relaxed by the Nigerian government. Indeed, the reduction in unemployment observed by the World Bank may have been due to the high growth rate of that year brought about by the very same expansionary policies it criticises. Even the Vice-President of Nigeria in the period of structural adjustment was not sanguine about the effect of SAP on employment as can be gleaned from the following paragraph:

> ***"However, it must be admitted that SAP as implemented rather than as conceived has brought in its trail some negative effects...One of the most vicious effects has been rising unemployment as a result of retrenchment, reorganisation and rationalisation ..."*** (Aikhomu 1994: 50).

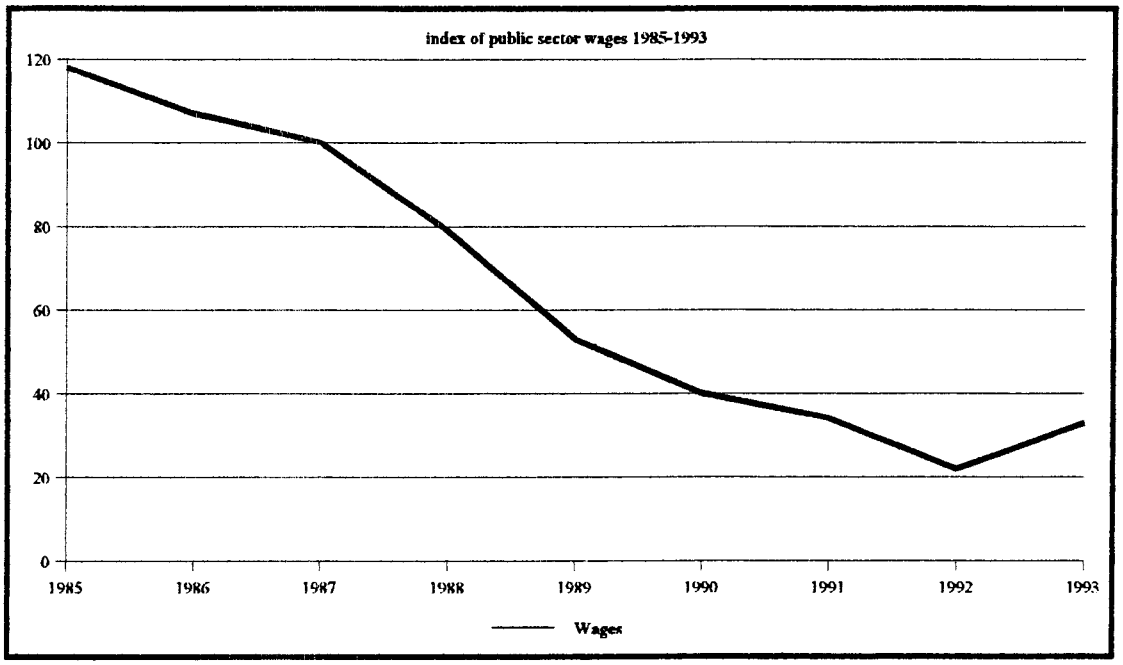
In any case, even if there was increased employment as a result of structural adjustment, this cannot mask the problems of retrenchment entailing the loss of experience and learning due to asset specificity. In the specific case of Nigeria's admittedly inefficient car assembly plants, there was no attempt to prevent the loss of the use of installed equipment or acquired skills to society.

Given Nigeria's huge investments in tertiary education in the late 1970s and early 1980s, such employment figures obscure sectoral differences. As the World Bank (1994a: ix) admits, the urban middle classes were hardest hit by structural adjustment. Therefore, whatever the merits of the reduction in unemployment observed by the World Bank, it was not conflict resolving for the simple reason that it excluded the most articulate and restless section of the populace.

In the public sector which was the largest employer of labour, there was a steep decline in wages as shown by the graph in Figure 6.2. (Data sourced from World Bank (1994a: 83) in respect of highest salary grade in the civil service Grade Level 17). In a similar context, Lubeck (1992: 19) argues that in real terms the minimum wage in Nigeria fell from about $201 per month to $16. The consequences were wide-spread moonlighting and a brain drain, especially of academics, medical doctors, engineers and other professional cadres. These responses in turn had a negative effect on public sector capabilities and domestic productivity.

FIGURE 6.2

Nigeria: Index of Public Service Wages 1985-1993



There is, in fact, extensive evidence that structural adjustment was a source of conflict in the Nigerian body politic as evidenced by resistance to the policies from some sectors of society. Students, workers and professional associations, in particular, engaged in campaigns, strikes and threats to register their opposition to SAP. These acts culminated in riots in 1988 and 1989. Lubeck (1992: 19) provides details of these two economic riots. Such outcomes reinforce the evidence provided by Green (1991: 258) about how structural adjustment led to civil disorder in countries such as Zambia -1986; Sudan - 1985 and 1989; and Tanzania - 1984.

6.4.2.5 Normative Values

The implicit message of economic policy reforms is the promotion of individual initiative as an alternative to collective solutions. However, as was shown in earlier chapters, there are situations in which collective solutions may be socially efficient. In particular, successful economic organisation may depend on the reduction of transaction costs and the state may have a major role to play in reducing such costs to society. In a multi-ethnic and multi-religious state like Nigeria, it may be necessary to promote a national value system as the high transactions costs of the changing nature of exchange is further compounded by cultural and linguistic pluralism.

While it is debatable to blame SAP for the absence of policies to promote a national value system in Nigeria, it is instructive to note two acts by the government which introduced the economic reform programme. The first was the scaling down of the War Against Indiscipline (WAI), a major social plank of the previous regime. WAI was a patriotic if crude attempt by the Buhari regime to instil cooperative social behaviour in Nigerians. It combined a mixture of exhortation and repressive methods as a means of moving Nigerians towards adopting socially cooperative behaviour such as a queuing culture, increased productivity at work and improved environmental consciousness (Forrest 1993: 94).

Imaginative advertisements were placed in the media to promote such behaviour and a memorable example was a series of television advertisements depicting a fictitious character called Andrew being dissuaded from emigrating in search of greener pastures. By sharp contrast, the Babangida administration set up a Committee to examine the consequences of the brain-drain and concluded upon receipt of the report that there was nothing wrong with the brain drain. This is evidence that in consonance with the tenor of its economic policies, the government encouraged individual flexibility over national flexibility, by abandoning even the symbolic attempts to persuade its highly educated people to stay within the country.

The second act was a noticeable absence of any references in public speeches, interviews and statements during the tenure of the regime to the need to fight corruption. Instead, the government set about releasing politicians and public servants who had been jailed for embezzlement of public funds by the preceding regime. A radical Nigerian historian has described the behaviour of the regime in the following way:

"The main distinguishing feature of the Babangida regime was the pervasive culture of impunity: any of his acolytes, however high or low in status, could loot the treasury to their heart's content with impunity, provided they remained absolutely loyal and committed to the leader" (Osoba 1996: 382).

6.4.3 Explaining Poor Economic Performance in Nigeria

Potential explanations for the poor record of structural adjustment in Nigeria range from inadequate time to external factors to poor implementation. After an examination of such arguments, which are not very persuasive, the consequences of structural adjustment in Nigeria are looked at prior to advancing alternative explanations for its poor record.

It is sometimes argued that economic policy reforms need time to work themselves through. The evidence from Nigeria, however, is not very persuasive. In the first place the initial time period allocated for the programme was just two years, implying that the effects were expected to have begun to show in the economy. For instance, the second objective of SAP clearly states the intention to seek fiscal and balance of payments viability over the period. However, the statistics summarised earlier from Table 6.3 tell a different story eight years after the programme was adopted. Specifically the trend of GDP growth was seen to be falling in the period under review instead of rising or remaining at high annual rates.

Blaming external factors for the continued poor performance of the Nigerian economy after the adoption of SAP is not the full story. The very proponents of economic policy reform would reject any such argument since they have always insisted on the paramount importance of domestic

policies in assessing national economic performance. Moreover, in the case of Nigeria, there was an improvement in oil revenues after 1986 and, indeed, a major windfall as a result of the sharp rise in prices due to the Gulf War. Additionally, domestic petroleum production increased from 1.46 million barrels per day in 1986 to 1.9 million barrels per day by 1993.[33]

While it was not a major recipient of foreign aid, Nigeria benefited from a near doubling of disbursements from multilateral agencies from $288 million in 1985 to an annual average of $485 million between 1986 and 1992. However, total inflows of credit and technical assistance dried up from $3.7 billion in 1982 at the onset of the global debt crisis to $702 million in 1992, out of which $170 million was in the form of rescheduled loans (World Bank 1994: 102). Foreign direct investment was also unencouraging. UNCTAD (1996: 305) reports that despite the best efforts of the Nigerian government, foreign direct investment outside the non-oil sector was disappointing. This was hardly the expected international response to the adoption of economic policy reforms which were expected to restore developing economies to creditworthiness. In sum, however, the external environment whilst not entirely favourable could hardly be considered to be the major cause of poor economic performance under SAP.

Uneven implementation is the explanation favoured by the international financial institutions for the poor performance of the Nigerian economy in the period of structural adjustment (See World Bank 1994: vi; Faruqee 1994: 245). There is, indeed, evidence to show that implementation was uneven and inconsistent under SAP. For instance, after the deflationary effects of SAP began to be felt, the Federal Government released in 1988 a budget that was deliberately expansionary only to change course the following year when the inflationary consequences became apparent (World Bank 1994: vii - viii; Faruqee 1994: 248).

Furthermore, after adopting a more liberal tariff regime at the onset of SAP, the Nigerian Government released a new tariff structure under the "Customs and Excise Tariff Consolidation

[33]International Petroleum Encyclopaedia 1990 and 1995 editions.

Decree of 1988" which had an unweighted average nominal tariff level of 28%. This was higher than the level of the 1986 interim tariff schedule and was coupled with tighter customs procedures including assessment of import duties in the course of pre-shipment inspection which was aimed at improved revenue collection (World Bank 1994: 12).

As a final example, there was the build up of large fiscal deficits in 1990-92. This was as a result of higher spending encouraged by increased oil revenues due to the Gulf War as well as the political transition programme of the government (Faruqee 1994: 246)

There is, therefore, some merit in the claim that implementation of SAP in Nigeria was unsatisfactory. This by itself, however, is an inadequate explanation. As was pointed out in Chapter One, implementability must be taken into account in any realistic programme. To ascribe such failures to a lack of political will attracts criticism from Streeten (1994: 1293) who states that ***"it is futile or tautological to say that ... political will is lacking...If the will to action is lacking, there is no point asking for the will to have the will to action".***

In any case, the main problem encountered with administrative controls or central planning was not of conception of plans but also one of difficulties in implementation. Moreover, the examples of uneven implementation in Nigeria are more of policy reversals, in which case it is clearly more helpful to enquire into the reasons for such policy reversals.

The point being advanced here is that the state has an important role to play in the development process and its character remains critical either for dirigiste policies or liberal policies. This is due to the fact that the institutional make-up is crucial in the development process and the state, through its exercise of power is, inevitably, a key shaper of such arrangements. In the next section, the inadequacy of SAP in Nigeria is explored within our framework for state intervention after which an explanation is proffered based on the institutional underpinnings of the Nigerian economy.

An assessment of structural adjustment in the Nigerian economy within the bounds of our framework shows that it lacked an appropriate institutional content. Of course, the point may be made that it is wrong to examine economic policy reforms against standards to which no claims were made. However, the very point being emphasised is that since economic policy reforms were presented as a consensus panacea for the economic woes of developing countries and as a sure path to structural transformation, then the policy measures can be criticised on the grounds of inadequacy as a development paradigm. We had argued earlier, moreover, that economic policy reforms also tended to ignore the existing institutional milieu and attempt to show below that this was also the case in the Nigerian experience.

6.5 INSTITUTIONALIST CONSIDERATIONS AND ECONOMIC REFORM IN NIGERIA

The point was made earlier that poor implementation alone could not explain the poor record of structural adjustment in Nigeria. If implementation remains a problem irrespective of the policy regime, then there is a need to look further to the institutional setting.

There are many facets to the institutional underpinnings of the Nigerian economy. For instance, Ohiorhenuan (1989: 24) correctly points to a preference for private enterprise and an ambiguity about foreign investment as institutional features of the Nigerian economy. It is also clear from the work of Stolper (1966) *Planning without Facts* and Mosley (1992) *Policy Making without Facts* that a particular form of information asymmetry, that is a lack of facts, permeates decision-making in Nigeria, be it under a planning regime or under structural adjustment. In the broad context of the Nigerian economy, however, the intention here is to identify such factors within the framework of potential consequences outlined in Chapter Five. It will be recalled that because of problems of economic flexibility, false identification and reproducibility and a limited view of politics, there were certain potential consequences of economic policy reforms in developing countries which were anticipated. These include the erosion of public sector capability, reduction of long-term and national flexibility, de-industrialisation and financial chaos, evasion of policy measures and misleading complementary solutions. These are now examined within the context of Nigeria.

6.5.1 Compounding Weak State Structures in Nigeria

Structural adjustment may have compounded weak state structures in Nigeria.. Prior to reform, the civil service as a corporate entity was administratively weak for several reasons. In particular there was informational asymmetry arising from a lack of clear cut procedures, the drawbacks of the political requirements of Nigerian federalism and a loss of morale and autonomy.

Chang (1994a: 34) has made the point that procedural rationality is key to the effective functioning of large organisations including a bureaucracy. In Nigeria, however, procedural rationality in the civil service was hindered by the fact that civil service handbooks were outdated. The main handbooks, the Civil Service Rules and Financial Regulations were last revised in 1974 and a substantial portion of their contents have been overtaken by numerous circulars and amendments. Such changes, moreover, are not readily available in a single volume.

These informational deficiencies were further compounded by civil service reforms introduced as a complement to structural adjustment in 1988 under Decree No. 43 (1988) known as "The Civil Service (Reorganisation) Decree". These reforms not only introduced new and unfamiliar rules but in the search for specialisation went as far as abolishing the Office of the Head of the Civil Service and delegating establishment matters to individual Ministries (Oshionebo 1995: 246). In other words, the reforms abolished one of the major means of coordination in the Nigerian civil service without providing an alternative (Gboyega 1995: 268).

Another set of factors impeding administrative effectiveness were the political requirements of Nigerian federalism. The economic implications include the determination of revenue allocation formulas, coordination of multi-tier budgets and the intricacies of varying degrees of fiscal management. These factors, while significant were not a cause of weak administrative capacities

and are more likely to be effects. Of particular importance in the Nigerian political economy, are the principle of federal character and the continuous creation of States[34].

As an attempt to reduce the rivalries arising from Nigeria's ethnic and religious diversity, the principle of federal character was introduced to give all sectors a sense of belonging. This was practised in varying forms right from independence in 1960 but only found specific content in the 1979 Constitution, the pertinent portion of which reads as follows:

> ***"The composition of the Government of the federation or any of its agencies and the conduct of its affairs shall be carried out in such a manner as to reflect the federal character of Nigeria and the need to promote national unity and also to command national loyalty thereby ensuring that there shall be no predominance of persons from a few States or from a few ethnic or sectional groups in that government or any of its agencies"*** (Federal Government of Nigeria 1979: Chapter II. Article 15(3)).

However, given the prebendal nature of Nigerian politics, the federal character principle was applied more to distribution of government revenues and largesse. As such, it came to be associated with location of industry, appointments to government offices, admission to state-owned educational institutions, allocation of land in the federal capital and, indeed, to elective offices.

In the particular case of the public service, the idea of a merit based bureaucracy gave way to the need for representativeness. This, as Adamolekun et al. (1991: 78) point out, was largely due to the educational imbalance within the country. Moreover, such considerations led to an enlargement of the public sector (Osayimwese and Iyare 1991: 91). Both of these features were in stark contrast to the small merit based bureaucracies found in East Asia.

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[34]The capitalised form, States, is used to distinguish Nigeria's administrative regions or provinces from our usage in the rest of the text.

In addition, however, and as a means of accommodating the demands of various ethnic groups, the number of component states in Nigeria has increased often by fiat (once by referendum in 1963) from three in 1960 to 36 by 1996. After every exercise, civil servants in affected States had to move to their new states of origin. The effect of such State creation exercises was, therefore, to dilute existing civil service capacities at State level and the rapid accession of inexperienced officials to senior bureaucratic positions.

Administrative capacity in Nigeria was further weakened in the era of structural adjustment by a loss of morale and autonomy. This was due partly to the sharp fall in public sector salaries illustrated in Figure 6.2. The low wages reduced the living standards of civil servants so drastically that the lucky ones tended to exercise exit options by going to work in the private sector or by leaving the country. Those left behind resorted to moonlighting as highlighted by Sandbrook (1991: 109).

The autonomy of the civil service was further reduced by the civil service reforms which transferred the powers of the Permanent Secretary to Ministers and changed their designations to Directors-General (see also Oshionebo 1995: 247). The pertinence of this change which put Ministers in charge of finances and personnel matters was that it enthroned short-term over long-term considerations. For instance, Directors-General were no longer required to be career civil servants and as such had no need to be versed in procedures, an important means of reducing information asymmetry in large organisations. Moreover, they were appointed at the pleasure of the Head of State and terminated when the government that appointed them left office.

These changes, intended to ensure civil service commitment to government goals, only served to reduce the ability of the civil service to behave impartially. The Directors-General were under pressure to please their political masters and the Ministers by virtue of their position had short-term outlooks, since they owed their jobs to the political fortunes or whims of unelected leaders (see Gboyega (1995: 276-277) for an elaboration of some of these concerns). The situations was not helped by the fact that the Babangida administration had a penchant for changing Ministers and State Governors with bewildering rapidity (see Amuwo 1995: 9).

In addition to the fall in income and loss of morale and autonomy there was evidence of reduced provision of infrastructure and social services. Table 6.3A shows clearly that the share of Federal Government expenditure on capital projects fell from 41.6% in 1986 to 25.16% by 1990 before rising again to 39.9% by 1992. Of greater interest, however, is the view supported by the World Bank (1994a: 25) that a "substantial portion of the capital expenditure program has been uneconomic" This is evidenced by the demonstrable neglect of operations and maintenance of existing projects and huge expenditure on unviable projects mentioned earlier in this chapter. Similarly, as was demonstrated in section 6.4.2.2 above, the actual and per capita commitments of the Federal Government on the education and health sectors declined relatively in the period of structural adjustment in Nigeria.

In conclusion, therefore, the weak state structures in Nigeria were compounded by structural adjustment as well as the civil service reforms introduced in 1988 as a complement to SAP. Economic policy reforms certainly contributed to compound the weak administrative capacity which bedevilled the Nigerian civil service by reducing bureaucratic autonomy and morale as well as the states commitment to the provision of infrastructure and social services.

6.5.2 Complicating Inflexible Production Structures in Nigeria

The Nigerian economy is heavily dependent on oil. For instance, in the period 1981 to 1985 the share of petroleum in the Gross Domestic Product averaged 16.4%, higher for example, than the share of manufacturing which was 13.8%. Yet, this figure reflected a decline in the relative importance of the petroleum sector from a share of 25.1% of GDP in 1980 and was due to the downswing in global petroleum prices that precipitated the Nigerian economic crisis. However, since control of the global oil market is clearly beyond the individual capacity of Nigeria, unlike maybe Saudi Arabia, structural change would require lessening dependence on crude oil by obtaining a productive response from non-oil sectors. In fact, this was a clearly stated objective of the structural adjustment programme (see first item of SAP listed above).

The non-oil sector of the Nigerian economy was inflexible in the sense that it exhibited a sluggish production response to stimuli. In the 'oil boom' period, the economy was said to be inert in the sense that domestic production failed to respond to the stimulus provided for by sharply increased domestic demand (Schatz 1984). By comparing growth in current to constant price GDP, Schatz (1984: 47) was able to demonstrate that most of the increase in aggregate demand was due to inflation (78%) as opposed to production increases which accounted for just under a quarter (22%).

It can also be shown in several other ways that during the period of structural adjustment, the Nigerian economy remained inflexible in response to price stimulus arising for example from devaluation and increased interest rates.

As Table 6.6 shows, oil continued to dominate the Nigerian economy contrary to clearly stated objectives. The contribution of the petroleum sector to government revenues increased from 73.8% in 1986 to 81.2% in 1992, averaging 80.2% over the period. Similarly, oil exports continued to account for an average of 94.8% of total export revenue between 1986 and 1992 which was no different from the average in the period of crisis. The same picture emerges from examining the share of petroleum in the Gross Domestic Product which rose from 13.6% in 1986 to 29.5% in 1992, greater than its contribution in 1980 which was the height of the oil boom. Clearly, crude oil retained its primary importance in the Nigerian economy in the period of structural adjustment.

TABLE 6.6 Oil and the Nigerian Economy 1986-1992								
	1986	1987	1988	1989	1990	1991	1992	AVG
Oil export as % total export	94.1	92.8	91.3	95.9	97	96.1	96.4	94.8
Contribution of oil to government revenue %	73.8	77.2	78.4	84.8	83	83.3	81.2	80.2
Contribution of oil to GDP %	13.6	23.7	20.9	25.4	29.5	28.9	29.5	24.5

Source: International Petroleum Encyclopaedia 1990, 1995

Given the pride of place given to devaluation in the policy package, the response of non-oil exports to such a price stimulus is another means of showing the inflexible response of the non-oil sector. The most important agricultural exports for Nigeria at the time were cocoa, palm kernel and rubber. After the structural adjustment programme was introduced in 1986, the value of cocoa exports increased from $258 million in 1985 to $265 million in 1986 and peaked at $375 million in 1987 before falling to $176 million in 1991. This latter figure was far less than was realised from cocoa exports in 1983 and was equal to the lowest level of cocoa exports in the ten years prior to the adoption of structural adjustment (derived from World Bank 1994:100). The export performance of palm kernel was no better, although the value of rubber exports seem to have increased as a result of a four-fold increase in prices between 1987 and 1989 (World Bank 1994: 100).

The sharp increases in agricultural exports (especially cocoa) in the immediate aftermath of the adoption of economic policy reforms may have been in fact due to factors other than a response to price liberalisation. It was due partly to a sharp reduction in smuggling and partly to the marketing of lower grade produce (Lewis 1994: 445) Moreover, increased cocoa production depends on the planting of new cocoa trees and a proper supply response would only have begun to show after three years, yet the volume indices show a clear decline over a three-year period from 1986 (World Bank 1994: 100).

It was shown above that the performance of the manufacturing sector was not particularly encouraging in the period under study. While figures for manufactured exports are not readily available, Faruqee (1994: 276) writing a relatively favourable assessment of structural adjustment in Nigeria for the World Bank study entitled *Adjustment in Africa* notes that: ***"Exports of manufactured goods have not increased as would be expected with the simplification of export procedures and the devaluation of the naira".***

Killick (1995b: 173) reminds that it is not only to price that output can respond. This is clearly the case in Nigeria where another reason for inflexibility is the poor provision of infrastructure. The study by Lee and Anas (1989) has shown the extent of infrastructural deficiencies in Nigeria. The important point however is that such poor provision of infrastructure is costly in transactional terms and worse has contributed to the flowering of expensive individualistic solutions instead of socially cooperative ones. The outcome is such that individual households and businesses have become mini-local governments as they provide their own water through boreholes, electricity through private generating sets, security through high walls and security guards, waste disposal through local dump heaps, and transportation through purchase of own vehicles.

The inflexibility of the non-oil sector in Nigeria is also partly a reflection of the extent of the oil windfalls accruing to the economy in the aftermath of the sharp price increases of 1973 and 1979. This contributed in no small way to making government coffers the main source of economic rents in the country. Schatz (1984: 55) refers to this period as bringing about a transition to 'pirate capitalism'. He states that: ***"For the most vigorous, capable, resourceful, well-connected and 'lucky' entrepreneur (including politicians, civil servants and army officers) productive economic activity, namely the creation of real income and wealth, has faded in appeal".***

However, not only did production structures remain inflexible in Nigeria, long term and national flexibility may have been further eroded by structural adjustment. This was particularly so in the possible loss of industrial skills and equipment as well as in the use of scarce foreign exchange earnings. For instance, while some industrial sectors like synthetics showed gains in the index of

manufacturing production from a base of 100 in 1985 to 1891.6 in 1992 others such as car assembly and electronics showed sharp declines from 100 to 18.3 and 100 to 11.6 respectively in the same period. However, while the increase in the fortunes of the synthetics manufacturing sector can easily be ascribed to the coming on-stream of Nigeria's petrochemical plants, the same cannot be said for the other sectors. Indeed, the point here is that certain specific assets underpin production in such losing sectors. As such, allowing firms in these sectors to go bankrupt means that these skills are lost to the economy and can only be resuscitated at great cost.

The use of foreign exchange in the economy is not easy to capture because of invisible transactions and the fact that capital flight is not easy to record. However, a look at the composition of imports shows that the value index for the importation of consumer goods rose by 41% between 1987 and 1991 while the same index for capital goods only rose by 23% in the same period. The importation of raw materials also rose by 50% in 1987 to 1991 indicating that one of the main objectives of structural adjustment which was to source raw materials locally was not readily achieved. However, it was miscellaneous import items which dominated the import profile rising by over 173% from 1987 to 1991. These figures demonstrate that the concerns expressed by Stein (1992: 89) that the use of scarce foreign exchange under structural adjustment may favour consumption over productive activity.

It would seem therefore that economic policy reforms in Nigeria did not lead to increased economic flexibility. For instance, Nigeria recorded a serious brain drain during the period of structural adjustment. While precise figures are difficult to obtain, the extent of the problem is readily demonstrated by the fact that the Nigerian government set up a panel to investigate the extent and consequences of the brain drain to the domestic economy.

6.5.3 De-industrialisation and Financial Chaos

The framework developed in section 5.4 showed that a potential consequence of structural adjustment as seen in the experience of other countries was that of de-industrialisation and distress in the financial sector.

6.5.3.1 De-industrialisation

The evidence of de-industrialisation in Nigeria as a result of SAP is mixed. On one hand as the previous analysis in section 6.4.3.2 indicates, the share of manufacturing in GDP fell from 9.4% in 1986 to 8.5% in 1993 and that capacity utilisation in manufacturing remained below 40% on average in the same period. This is further buttressed by data from UNIDO (1997: 203) showing that the industrial production index declined by 3% between 1985 and 1995.

On the other hand, the World Bank (1994a: 58) claims that manufacturing value-added grew by 5% between 1986 and 1992 and that its share of GDP remained fairly constant. The balance of probabilities, however, would seem to favour the view of the Central Bank of Nigeria and the Manufacturers Association of Nigeria mentioned earlier in Section 6.4.3.2 that manufacturing was beset by all manner of difficulties in the era of economic reform. The discussion of manufacturing employment in Section 6.4.3.3 also shows that there are ambiguities in the data but that there appeared to be increased unemployment in the era of structural adjustment.

Certainly, structural adjustment sought to reduce the height of tariffs as manifested by the reduction in 1986 of the average nominal tariff rated to 23% from 33% . However, by 1988 the average nominal tariff rate increased to 28% and as the World Bank (1994a: 12) reports this was acknowledgement of the fact that the "interim tariff had gone too far, too fast, seriously undermining the financial viability of much of the manufacturing sector". This point is also underscored by Mosley (1992: 232). The relevance of this issue is that it provides evidence of an

attempt without any sense of priorities to abandon protection of industry and the opportunities provided to learn new technologies. As if to prove the point, Mosley (1992: 231) and the World Bank (1994a: 12) ascribe the afore-mentioned policy reversal manifested by the increase in the average height of tariffs to the political need to placate a particular constituency rather than the desire to protect domestic industry for its perceived benefits.

While the deleterious effect of structural adjustment on the manufacturing sector in Nigeria was not clear cut, there was no such ambiguity about the financial chaos which emerged as a result of reforms.

6.5.3.2 Financial Distress in Nigeria

The Central Bank of Nigeria eased restrictions on bank licensing in 1986 which led to a rapid expansion in the number of new entrants from two per year in the preceding decade to nine in 1987; sixteen in 1988; fifteen in 1989; and twenty-five in 1990. Thus the total number of banks and non-bank financial institutions rose from eighty-four in 1986 to 801 by 1993 (Lewis and Stein 1997: 9). This rapid expansion to a large extent reflected the loss of rents in the other parts of the economy and the potential rents accruable from trading in foreign exchange that was available to banks and bureaux de change. The immediate consequence of such a rapid expansion in the financial system was that it further stretched the weak regulatory capacity of the Central Bank of Nigeria. The creation of the Nigerian Deposit Insurance Company in 1988 did not improve the situation especially as banks used the non-bank financial institutions to evade regulatory scrutiny.

The emergence of crisis in the financial system was primarily due to such poor regulation and increased malpractices in the financial sector such as Ponzi schemes, obtaining of foreign exchange through shadow bidding for shell companies and the use of round tripping by lending money to finance houses for onward lending at higher rates since they were not subject to regulatory scrutiny. The crisis was manifested by a fall in financial sector share prices by up to one third in 1992; a sharp

rise in the ratio of bad debts to shareholder funds to an average of 300% which was three times the minimum prescribed by regulators (Nigerian Deposit Insurance Company 1993: 16-17).

The crisis was brought to a head in 1993 when the apparent victory of Chief M.K.O. Abiola of the Social Democratic Party (SDP) at the Presidential election held in June was annulled by President Babangida's government. The uncertainty caused by this event led to a run on some banks and extensive defaults by non-bank financial institutions. By the end of that year, the Nigerian Deposit Insurance Company was reported to have acknowledged that 24 banks were insolvent and another 26 were in trouble thus endangering nearly two thirds of total assets and almost three quarters of deposits in the financial system (Lewis and Stein 1997: 14).

The evidence from Nigeria, therefore, is that there was indeed financial distress as a result of rapid expansion in the financial sector as a result of financial liberalisation. This was due mainly to weak regulatory capacity as well as the use of new financial opportunities for rent seeking and the evasion of policy measures, a behavioural response to structural adjustment further examined below.

6.5.4 Continued Evasion of Policy Measures

The point was made in Chapter Five that economic policy reforms took a limited view of politics in the sense that power and its use are important in the economy. Earlier reference has been made to the fact that government coffers were a source of economic rents and corruption in Nigeria and that Schatz (1984: 55) had ascribed the onset of such behaviour to the massive revenue gained from the huge oil price increases of 1973 and 1979. However, his observation may be faulted for ascribing the onset of pirate capitalism to the period of the oil boom. This is a point he concedes when he states that:

> ***"The use of the state for enrichment is certainly not new. Before independence, the colonial regime was involved in the economy in ways which accorded primacy to British interests. Thus the Nigerian political class perceived "government" as a means of serving the interests of those who controlled it. When they got power,***

they cheerfully and enthusiastically used the state to further their own private interests"(ibid).

The role of the colonial state in forging the post-independence state in Africa has been clearly articulated by a pre-eminent observer of African political economy, the late Claude Ake. He observed that the colonial state exercised an arbitrary claim on the rights and resources of the colonised people and that at independence the nature of the state did not change, thus allowing the domestic political elite to assume the same arbitrary control over resources (Ake 1992; 1996: Chapter One).

In the specific instance of Nigeria, Joseph (1987: 55) argues that the disproportionate importance of access to the state in a multi-ethnic society lay the ground for the emergence of what he termed "clientelist and prebendal politics". The following passage quoted at length from Joseph (1987: 56) provides a clear illustration of the phenomenon:

> ***"... clientelism and prebendalism are two of the fundamental principles of political organisation and behaviour in Nigeria. An individual seeks the support and protection of an Oga or a "godfather", while trying to acquire the basic social and material goods - loans, scholarships, licences, plots of urban land, employment, promotion - and the main resource of the patron is quite literally a piece of the state. Such an argument can easily be made in the case of ministerial appointments, or positions on government boards. It also applies, however, to individuals within the nominally private sector, since the business world is hemmed in by bureaucratic regulations which derive from the rationalistic and developmental concerns of post-independence government. To do business, one must be able to procure import and export licences, building and other permits; and then there is the welter of development grants and loans that can reduce the burden of initial capital investment. In the case of Nigeria and some other African countries, there are the special phenomena of marketing boards (or other renamed agricultural agencies) which became the depositories of large sums taxed from***

peasant agricultural production. The access of individuals to the use of these funds was secured via the capture of regional governments by political parties during the terminal colonial period. More recently, the expansion of petroleum production in Nigeria, which amounts in years of high output to 85-90 per cent of state revenues, heightens the centrality of the state as the locus of the struggle for resources for personal advancement and group security. One way of seeing the extensive corruption in Nigeria is as constituting part of the 'economic assurance of office'".

Joseph was describing the behaviour of political actors in Nigeria prior to the adoption of structural adjustment. However, the contention in this thesis has been that contrary to the aims and expectations of economic policy reformers, structural adjustment did not lead to a reduction of such behaviour in Nigeria. Instead, what emerged were new and innovative responses to the change in policy regime. In other words, the institutional setting may have undermined structural adjustment or was further worsened because the locus of power and basis for seeking it had not changed.

There is clear evidence that the Nigerian penchant for evading policy measures continued under the structural adjustment programme. The government itself took countervailing action to offset some of the effects of its own policies while the citizenry retained some patterns of behaviour prevalent before structural adjustment such as rent seeking and corruption.

In the face of the fiscal retrenchment required under SAP and under domestic pressure from its 'clients', the Nigerian government resorted to countervailing action in the form of extrabudgetary expenditure. This expenditure was partly used to fund an elaborate and ultimately unsuccessful political transition process (World Bank 1994a: 4) and the establishment of a plethora of new government bodies, a process which was described by Osoba (1996: 382) as follows: ***"Babangida established innumerable commissions, directorates, centres, bureaux, task forces, committees, etc. with open ended budgets, woolly and indeterminate agendas and arbitrary powers to accommodate his multitudinous army of cronies, lackeys and opportunists".*** In both instances,

budgetary procedures were circumvented to allow for business as usual, while appearing to meet the fiscal restraint demanded by the international financial institutions and other creditors.

As such, extrabudgetary spending grew from 22.1% of total expenditures or 4.1% of GDP in 1986 to 65.2% of total expenditure which was equivalent to 17% of GDP by 1992, as the following extract from the World Bank (1994a: 23) indicates:

TABLE 6.7 Extrabudgetary expenditure in Nigeria

	1986	1987	1988	1989	1990	1991	1992
As % of total expenditure	22.1	26.2	21.2	35.5	38.3	61.2	65.2
As % of GDP	4.1	5.4	4.4	6.9	8.3	16.4	17

Source: World Bank 1994a: 23

Inconsistency in policy which was mentioned earlier in this chapter was clearly due to pressure from domestic interests compounded by the information asymmetry arising from inadequacy of data. Mosley (1992: 231) ascribes the heavy slippage in two policy areas agreed with the World Bank (tariff structure and fertiliser subsidy) to pressures from farmers and industrialists. He further explains that at the time the available data appeared to support the views of these groups although the data later turned out to be misleading. Incorrect data may have aided the lobbying process. However, the retention of discretionary clauses in the implementation process of SAP in Nigeria was clearly due to the prebendal requirements of the polity. As Lewis (1994: 445) put it: ***"...the discretionary management of privatisation policies and trade liberalisation allowed for diversion of benefits towards specific allies and clients".*** Similarly, the World Bank (1994: 12-13) notes that 1000 out of the harmonised system of 5000 six digit import items remained subject to conditional import prohibitions and that there was a high variability in effective rates of protection reflecting *"different industries ability to lobby ... rather than any particular comparative advantage".*

Another example of countervailing action introduced by the Nigerian government to undo the effects of some of its own policies was the use of excise duties to offset the effects of tariff cuts. The World Bank (1994a: 13) states, for instance, that the suspension of excise duties across the board in 1993 was intended to 'make domestic production of import substitutes more viable'.

Apart from countervailing action there was evidence of retention of behavioural patterns by state and non-state actors. Corruption, in particular, continued to exist within the polity. In addition to the reference made to Osoba (1996: 382) about the corruption in Nigeria in the period of structural adjustment, there is the reference made by Osinbajo (1997) to the report of the Okigbo Panel set up to investigate the activities of the Central Bank in 1994. The panel is reported to have discovered that over $12 billion most of which came from a windfall of higher oil prices during the Gulf War was disbursed and unaccounted for by the Babangida administration. In the same vein, Lewis (1994: 446) records that there were discrepancies in Nigeria's petroleum accounts of up to $5.2 billion in 1991 and 1992.

A further example of retained patterns of behaviour in the period of economic policy reform was the response of economic actors to the abolition of commodity boards. As was noted earlier, the agricultural sector's response to price liberalisation was more apparent than real. The abolition of commodity marketing boards led to massive speculative activity in the purchase of cocoa, since such export proceeds were a source of hard currency. The result as Lewis (1994: 445) observes was that domestic prices were bid to over N25,000 or over three times the world market price. Not surprisingly, domestic prices collapsed shortly thereafter with severe consequences for cocoa producing farmers. The implication here is that in certain instances liberalisation promotes short term behaviour to the detriment of economic operators in the real sector.

The way the privatization exercise was run provides another example of the use of policy to feather private nests. For instance, as Lewis (1994: 446) reports, 'dispersal of government assets, especially in a tight economy, created numerous opportunities for windfall gains". As such practices such as

insider trading and favourable sale of companies to friends and business associates thrived in the atmosphere which operated with little or no transparency.

A final example derives from the discussion of the financial distress that occurred as a result of the retention of behavioural norms in the era of economic policy reform. The liberalisation of interest rates and foreign exchange allocation was accompanied by a rapid expansion in bank licensing. However, most of the new banks were used solely for access to lucrative trading in foreign exchange. The extent of this practice is aptly captured by a comment in the Financial Times of London (March 16 1992) that: ***"Ten years ago, a Nigerian import permit was a licence to print money. In the early 1990s ... banking licenses have assumed the same role".***

In summary, the evidence from Nigeria is that structural adjustment policies may not lead to a real sector supply response if the institutional environment remains unchanged. Instead, what may result is a further deterioration in the productive capacity of the economy and an opportunistic response by individual actors to weaknesses exposed by such policies.

6.6 Faulty Transition to Democracy

A transition programme to democratic rule was introduced by the government to complement its economic reform programme especially to please its foreign creditors and stem domestic opposition to its programmes (Momoh 1996: 20). However, the process was tightly controlled and continuously subverted by the government. People perceived as 'old politicians' were initially forbidden from participating in the process, freely formed political association were denied registration and then two parties were created and sponsored by the government which shifted its handover date four times from October 1990 to October 1992 to January 1993 and finally to August 1993 (Momoh 1996: 32). Moreover, the government continued to resort to arbitrary arrest of its perceived opponents, the use of ouster clauses in decrees to reduce the power of the courts, the banning of newspapers and closure of newspaper houses as well as the banning of students and trade unions.

The behaviour of the Nigerian government was inconsistent with the process of '*abertura*' (opening) which took place elsewhere especially in Latin America. Certainly, it did not promote the accountability and transparency associated with a transition to democracy. Instead it provided additional opportunities for corruption and rent-seeking as evidenced by the spending on the transition programme such as the grants to the political parties, the construction of secretariats for them in all local governments, state capitals and federal capitals which of necessity involved giving out contracts (see Babawale et. al. 1996: 132). The World Bank (1994a: 4) also draws a very clear link between the massive extrabudgetary spending and 'Nigeria's very expensive electoral process'.

In the Nigerian example, the promise of democracy certainly did not enhance the structural adjustment process and the eventual nullification of the results of the Presidential election was to lead to a series of changes in the government which resulted in the abandonment of structural adjustment programmes in January 1994. This was manifested by a return to administrative controls on finance, trade, foreign exchange. Interest rates were pegged at 21% while the exchange rate for the naira to the dollar was fixed at 22 to 1 with all allocation made by the Central Bank of Nigeria (Lewis and Stein 1997: 15). Certainly, therefore, the democratisation process that accompanied structural adjustment in Nigeria did not contribute positively to an attainment of the programmes objectives.

6.7 CONCLUSION

This chapter has attempted to explain the poor economic performance of Nigeria under the structural adjustment programme introduced in 1986. It has been shown that the macroeconomic performance of the Nigerian economy in the period of structural adjustment remained poor and unstable. Furthermore, the ability of SAP to introduce structural change in Nigeria was questioned within the ambit of the framework developed from the experience of other regions. In particular, it emerged that the state did not play an entrepreneurial role to promote structural adjustment in Nigeria. Moreover, the property rights regime did not promote a productive use of resources, a key requirement in the process of structural transformation.

The usual reasons advanced for the failure of structural adjustment were not thought to be strong enough in the Nigerian case and an alternative explanation was sought in institutional factors. Inflexible production structures, continued evasion of policy measures including countervailing measures by the Federal Government itself, and weak administrative capacities were identified as key institutional constraints to structural transformation in Nigeria. The conclusion that can therefore be reached is that structural adjustment by itself is insufficient without the positive use of political power to change the institutional milieu.

CHAPTER SEVEN

SUMMARY, CONCLUSIONS AND IMPLICATIONS

7.1 SUMMARY

This thesis set out to study the factors behind continued poor economic performance in Nigeria after eight years of structural adjustment. It set out the competing explanations for economic stagnation; the debate on the role of the state; the ubiquity and controversy surrounding economic policy reforms; the importance of institutions in economic transformation; the institutional inadequacies of economic policy reforms; and examined the Nigerian experience of structural adjustment.

7.1.1 Competing Explanations of Economic Stagnation

Several arguments usually advanced for poor economic performance in the context of Africa were examined and found to be incomplete. For instance, historical factors such as colonialism and the small economic sizes of African states while pertinent did not explain much. After all, other successful economies like the United States and the newly industrialising states of East Asia and Latin America were once colonies. As was seen in the case of Nigeria in Chapter Six, the nature of the state inherited from the colonial rulers had a bearing on existing institutional forms. However, incorporating colonialism into the explanation for economic stagnation is inadequate in the sense that it does not explain the absence of post-colonial change.

Presenting the small size of African economies as a reason for poor economic performance does not stand up to close scrutiny. If the issue is merely one of economic size, then it can be pointed out that this is the outcome of the development process. As such, this may amount to no more than saying that a country is poor because it is poor. If the issue is one of geographic size the example of

successful island economies like Singapore, Hong Kong and Mauritius shows clearly the limitations of such a line of thought while the hitherto poor economic performance of countries like China and India prior to the late 1980s undermines any link to population size. In any case, given Nigeria's relatively large population and land area such arguments cannot applied to it in any meaningful way.

Political stability while a relevant factor was also an incomplete explanation in the sense that stability itself is no guarantee for economic progress. In fact, the performance of certain post war economies may allow for crude deductions of the need for war prior to good economic growth as exemplified by the experience of post war Japan, Germany and South Korea. Uganda, which was perhaps Africa's most traumatised economy in the 1970s and 1980s has had one of the best growth rates on the continent of about 5.6% per annum from 1990 to 1995 (World Bank 1996: 18). Perhaps more complicated, however, is determining the level or extent of political instability that impinges on economic performance. The notorious rapidity with which governments change in successful economies like Japan and Italy gives pause for thought in this context.

Placing the blame on external factors for the poor economic performance of African countries has its attractions. In addition to the perceived disadvantages arising out of the existing international trading patterns and a secular decline in terms of trade arising therefrom, there is the fact that the economic performance of African countries prior to the crisis which followed the collapse of the Bretton Woods system in 1972 and the oil crisis of 1973 was good compared to subsequent years. Such arguments, however, were ultimately weakened by the inability of developing countries to respond to the global economic crisis brought about by the oil price shocks of 1973 and 1979.

The notion that active state intervention in the economy was responsible for the economic crisis facing developing countries appeared to have prevailed and led to the introduction of structural adjustment programmes whose stated aims included a reduction in the role of the state in addition to getting prices right.

This thesis therefore set out to find out why the widespread adoption of structural adjustment in

Africa did not restore the sustained economic growth seen in the 1960s. It also sought to find out the consequences of attempting to reduce the role of the state when the conditions for market exchange may not yet have been firmly established. Moreover, there was the intention to investigate how the insights of institutional economics might help explain the inadequacy of economic policy reforms as a development paradigm.

7.1.2 Conventional Debate on the Role of the State

The conventional case for state intervention rests on market failure such as an under supply of public goods, lack of compensation for externalities, the existence of market power and information asymmetry. The inadequacy of markets also extends to the provision of merit goods or deterrence of demerit goods as well as an inability to bring about desired social outcomes in the form of acceptable income distribution. These difficulties with the market led many developing countries to introduce measures to correct for market failure.

Such measures included protection of industry across the board, price controls, foreign exchange controls and restrictions on export trade especially of commodities, state provision of cheap and directed finance for industry, and widespread state ownership of enterprises. These policies were heavily criticised, especially by neo-liberal scholars who felt that the economy functioned best with the invisible hand coordinating the actions of a large number of people acting in their own self interest. In particular, they argued that the state and its agents could not be expected to be well meaning, all knowing and all powerful. As such, allowing them an economic role would result in self-seeking and rent-seeking behaviour compounded by a lack of capacity. These drawbacks were used to explain poor economic performance in developing countries as a result of which economic policy reforms with the express intention of liberalising the economy by reducing the role of the state were introduced as a solution to the economic crisis confronting such countries.

There were, nevertheless, some fundamental flaws in the neo-liberal argument. In addition to the fact that there was ample evidence to show that the state had played an active economic role in the

industrialisation process of all late developers, such a view tended to stress a state-market dichotomy which took no account of the complementary and moderating relationship between state and market. Indeed, the conventional debate on the role of the state suffered on both sides from the shared assumption that exchange relations are ontologically superior to other kinds of social relationships.

7.1.3 Economic Policy Reforms

Economic policy reforms were introduced in a wide spectrum of developing countries in the early 1980s. This was partly due to the economic and debt crisis facing these countries at that time. However, the main reason for the widespread adoption of structural adjustment programmes was an ideological paradigm shift described as the neo-liberal counter-revolution. The economic policy reform package consisted of various policy measures which together were targeted at the broader objectives of its proponents.

Such measures included macroeconomic stabilisation, trade liberalisation, financial liberalisation, privatisation and the reform of the public sector. While there was no doubt that structural adjustment was ubiquitous, it was also true that it attracted a great deal of controversy. In particular, there were theoretical doubts about the workability of such policies in developing countries as well as an empirical questioning of claims of success. For example, in addition to concerns about the impact of economic policy reforms on social programmes, there was concern about the impact of such policies on long-term development. In addition, the claims made for outward orientation were seen to be weakened by definitional inadequacies and the historically proven importance of infant industry protection. While privatisation also had its attractions, including a diminution of the difficulties involved in monitoring the performance of public enterprises, there remained the fact that the structure of industry is more important for efficiency than ownership per se. Moreover, the entire structural adjustment policy package is agnostic about the important role of politics and institutions in determining economic performance.

7.1.4 Institutionalist Political Economy

The market is not the only economic institution, even in a market economy and as such it is important to understand other institutional forms in order to better study the development process. The arrangement of firms, banks, labour unions and government is different in every economy and their mutual interaction and impact varies accordingly. Neoclassical and welfare economics are therefore inadequate by not taking into account issues such as transactions and information costs which face economic actors. Also critical is the fact that the individual cost-benefit matrix is sometimes not in harmony with socially desirable outcomes. In such instances, institutional arrangements become important.

Attempts have been made to incorporate such concerns in the new institutional economics. These succeeded to the extent that they provided fresh insight into relations within the firm and the impact of risk, transactions and information costs on institutional arrangements. However, new institutional economics continued to rely on the 'logic of the bargained exchange' and retained a negative view of the use of political power.

It was proposed instead that approaches which take account of history, politics and the institutional diversity of capitalism hold promise for better understanding of developing economies. As such, especially since politics does not have to be negative, there was the perceived need to adopt a more nuanced view of the supply side of institutions, especially that of state intervention. Instead of the state-market dichotomy, this approach acknowledges the virtues of the market in addition to the important role the state has to play in coordinating economic activity, managing conflict and providing institutions of exchange.

Within this context, therefore, it was suggested that the state could assist the process of economic transformation by providing macroeconomic stability; acting as an entrepreneur to reduce risk and increase human and financial resources; specifying property rights in a manner that would promote productive activity; managing the conflicts that arise out of the process of structural change; and

encouraging the development of normative values to reduce the drawbacks of free-riding which undermine socially beneficial arrangements.

7.1.5 Institutional Considerations in Structural Adjustment

The importance of institutional arrangements in the search for condensed economic growth makes imperative the search for the institutional weaknesses of economic policy reforms especially inflexible production and institutional structures, false identification and reproducibility problems as well as limited politics.

Economic policy reforms which were crucially dependent on getting prices right may have been hampered by the absence of price and institutional flexibility in developing economies. Moreover, structural adjustment may have been over-reliant on the mistaken identification of certain features in other economies. In particular, the important learning effects of infant industry protection and the otherwise valid criticism of import substitution industrialisation were lost in the uncritical call for outward orientation while the idea that the state was neutral in outward oriented regimes was found to be misleading.

False identification of institutional arrangements to back up the call for economic policy reforms was not the only problem. There was also a problem of reproducibility in the sense that there was the implied belief that the conditions which favoured or contributed to economic development in some economies was available to all other economies at all times. This approach was considered problematic especially in view of the volatile international economic environment which emerged after the mid-1970s as well as the weak state structures in many developing countries, especially those in Africa.

Most African countries lack necessary capacity and autonomy for successful state intervention. However, they ended up eroding the little that they had in the process of implementing economic policy reforms. The loss of morale and earning power often contributed to a brain drain,

moonlighting and corruption which, in turn, further reduced already weak state capacity and autonomy. To further complicate matters, short-termist and individualistic reactions prompted by structural adjustment tended to hamper economic performance and result in de-industrialisation and financial chaos. For instance, in economies where financial capital was internationally mobile as a result of economic policy reforms, any national economic problem (no matter how temporary) tended to lead to capital flight, thus bringing about a currency crisis with increased import costs and a reduction in investible resources. Where this occurs with increased interest rates, firms began to re-finance their loans at even higher interest rates, banks become swamped with non-performing loans and given the weakened regulatory ability of state structures, the financial sector often ends up on the brink of collapse.

Contrary to expectations, behavioural patterns may also remain unchanged in the era of structural adjustment. Regime elites may use countervailing action as a means of retaining their privileges and thus subvert the purpose of policy. Moreover, norms which had developed in response to the era of state-led development may prove difficult to change and may also undermine the policy reform process. For example, tax evasion on direct taxes does not automatically disappear with the introduction of value added tax. It is the formal sector in both cases that continues to pay.

Also of particular concern was the danger that the preoccupation with economic policy reforms might lead to the insistence on misleading solutions. While democracy is desirable and should indeed be promoted, it is debatable whether it is directly linked to the process of structural adjustment. By insisting on governance as the political counterpart of economic policy reforms, donors may have been committing the error which Hirschman (1981: 20) has described as a belief that "all good things go together". This is not necessarily the case and such an approach can create difficulties for countries attempting simultaneous economic and political liberalisation.

7.1.6 Economic Policy Reforms in Nigeria

In the empirical study of Nigeria, it was seen that the structural adjustment programme which was

adopted was no different from the conventional economic policy reform package, despite claims that it was home grown in order to reduce public opposition to reforms.

Economic performance under structural adjustment was not encouraging as the annual growth rate of Gross Domestic Product fell from a peak of 9.6% in 1988 to 1.5% by 1993 while GNP per capita fell from $710 at the onset of structural adjustment to $280 by 1993. It was evident, moreover, that the economy was not stable in macroeconomic terms and that the property rights regime resulting from trade and financial liberalisation appeared to favour speculation over manufacturing, a key requirement of structural transformation. The institutional weaknesses of economic policy reforms were also clearly demonstrated by the fact that the entrepreneurial role of the state was weakened and there was no serious attempt at conflict resolution and the promotion of normative values. There was less spending on education and health and infrastructure continued to deteriorate, while total employment fell, thus contributing to social conflict and an erosion of normative values.

Furthermore, it was observed that price reform did not seem sufficient to alter the institutional basis of the Nigerian economy. The view that this was due to poor implementation was found wanting because a similar explanation was used to sound the death knell of previous dirigiste policies under the rubric of government failure. An explanation was sought instead in the continued existence of inflexible production structures, prebendal politics and weak state structures.

Production structures were inflexible in the sense that they did not or could not respond significantly to price reform. Crude oil production continued to dominate the economy and the contribution of non-oil exports remained relatively minor while the provision or maintenance of existing infrastructure continued to be inadequate. Politics in its prebendal form continued to play a central role in economic activity as was shown by the resort to extrabudgetary expenditure, resort to discretionary clauses, and evasion of policy intentions especially in the commodity trading and banking sectors.

The problem of weak state structures extended beyond the banking sector to the public sector in

general. The Nigerian public service suffered from agency and informational problems as well as the political requirements of federalism. The principle of a small, merit based bureaucracy gave way to the need for representativeness and resulted in an enlarged public service. These structural weaknesses were further compounded by a loss of morale and autonomy due to sharp falls in income levels as a result of economic policy reforms and its associated Civil Service Reforms.

7.2 IMPLICATIONS

A number of implications may be drawn from this thesis:

7.2.1 Importance of Appropriate Institutions

The adoption of economic policy reforms in developing countries was mainly a result of the paradigm shift in the discipline of development economics which had grown suspicious of active state intervention to correct for perceived market failures. Attention was, instead, shifted to reducing the role of the state in the economy along with vestiges of its influence, by among other things, getting prices right and promoting outward orientation.

After nearly a decade and a half of economic policy reforms, it has become clear that such reforms, their positive aspects notwithstanding, have not led to substantial economic transformation especially in African countries. It was, therefore, of interest to find out if the reason for this outcome could be explained by institutional factors using the example of Nigeria.

The fact that economic policy reforms in the form of a structural adjustment programme did not change the institutional underpinnings of the Nigerian economy, implies that such programmes may not work as desired in the absence of appropriate institutional arrangements. Indeed, economic policy reforms by recognising the agency and informational deficiencies of active state participation in economic activity implicitly concedes the need for institutional change by giving it less to do.

However, even the process of giving the state less to do and of liberalising the economy is an institutional change which still requires the positive use of political power. Otherwise, economic policy reforms just like dirigiste policies are vulnerable to claims of government failure.

7.2.2 Inflexibility of Institutions

Another implication that can be drawn from the study is that institutional arrangements are not fully flexible. This is in the sense that they do not necessarily change as a result of changes in relative prices. New institutional economics, in particular, promotes the idea that institutions which evolve are by definition efficient in the sense that, once there is a demand for new institutions as a result of exogenous change, such institutions will evolve.

However, as has been argued here, institutions have collective goods characteristics and there are problems with the assumption that beneficial institutions will emerge once individuals realise their uses. Apart from the fact that such a demand induced view of institutional change ignores the supply side of politically induced change, there is evidence from this thesis to show that changes in relative prices do not necessarily lead to economic growth. Equally important, is the fact that while politically induced institutional change may be negative, it is essential to develop and incorporate a positive view of the use of power in the search for condensed growth. Without this, economic policy reforms may not bring about desired outcomes and may even result in new and innovative forms of corruption and countervailing action.

7.2.3 Importance of State Capacity

While it is important to underscore the limitations of state intervention, it is also crucial to recognise that the state needs a minimum level of capacity to even carry out the tasks assigned to it. In the attempt to make up for market failure, state structures became over-extended and inefficient. Economic policy reforms were, therefore, partly based on the realisation that the state is not omnipotent, thus, the desire to roll back the frontiers of the state. However, the maintenance of law

and order, protection of property rights, provision of macroeconomic management, defence and public health, which the World Bank (1997: 27) lists as the minimal functions of the state, all require a minimum level of state capacity for effective implementation. It is not evident that such capacity exists effectively in developing economies.

At the same time, however, it is important to develop means of controlling corruption. This requires accountable and transparent government underpinned by moderating institutions such as a free press, democratically elected representatives, effective watch dog agencies and a concerted effort to bring about changes in the ethical mind set of public servants.

It would seem, however, that in seeking to reduce the role of the state, economic policy reformers ignored the importance of state capacity even in the implementation of reforms. Furthermore, it appears, as can be seen from the example of Nigeria, that economic policy reforms can lead to erosion of already fragile state capabilities due to loss of morale and autonomy as well as the exercise of exit options within the public service.

7.2.4 Need for Better Understanding of Institutional Forms

The importance of institutions in economic development and the institutional diversity of capitalism implies the need to better understand institutional arrangements in every economy. Institutions matter and, as presented here, history and politics play an important role in the emergence of institutions. While the bias of economic policy reforms in favour of prices is a useful check on over-reliance on administrative decision-making, it is clear that economic performance is subject to other institutions than the price system.

It becomes essential, therefore, to understand the institutional features of an economy that may act as a constraint or serve to enhance economic growth. In particular, given the search of developing countries for condensed growth and the importance of the use to which political power is put, there is need for a more nuanced view of state intervention and the important role it can play in the

development process. The World Development Report (World Bank 1997a) which is dedicated to this topic is an important contribution in this respect.

7.3 INSTITUTIONAL REFORM AS A BASIS FOR NIGERIA'S DEVELOPMENT

It has been argued that economic policy reforms were inadequate for bringing about economic transformation in Nigeria. This is because they took no account of the institutional environment. In order, therefore, to enhance its development prospects, there is a need to improve the institutional underpinnings of the Nigerian economy.

In particular, as a minimum, there is a need for the Nigerian state to use its political power to provide macroeconomic stability, be entrepreneurial, bring about a property rights regime that promotes production, reduce social conflict and encourage the adoption of normative values essential for economic transformation.

Macroeconomic stability would require achieving and sustaining low rates of inflation, low real interest rates, realistically valued exchange rates and the maintenance of low deficits in the government consumption budget. Such macroeconomic stability could be brought about by a stabilisation programme as was demonstrated by the government of General Sani Abacha who ruled Nigeria from the period of November 1993 to July 1998. In that period, the nominal parallel market exchange rate of the naira stabilised at approximately 80 naira to one United States dollar (World Bank 1997b: 50), while inflation fell from 72.8% in December 1995 to an estimated 8.5% by the end of 1997 (Federal Government of Nigeria 1998:2). Similarly, nominal interest rates as exemplified by the commercial bank lending rate had stabilised at an average of 20% between 1994 and 1996 down from 31.7% in 1993 (World Bank 1997b: 65) while the primary budget deficit was reduced from 29.5% in 1993 to 6.5% by 1996.

However, GDP grew on average by 1.8% between 1994 and 1996 (World Bank 1997b: 34) which demonstrates that stability, while important, is not sufficient for economic transformation. Therefore, the Nigerian state needs to actively support the production process in two ways. In the first place it has to play the role of an entrepreneur in the sense of providing a vision around which the Nigerian populace can rally in addition to mobilising resources for development. In this context, human resource development and the facilitation of access to finance for the productive sector are crucial. In the latter case Nigeria, due to the prebendal nature of its political economy, has not displayed the requisite capacity to successfully run public sector enterprises. As such, mobilisation of financial and technical resources for development may have to come from creating a conducive atmosphere for attracting foreign direct investment.

The importance of attracting foreign direct investment is closely linked to the second role of the state in supporting productive activity. That is, it has to encourage private sector initiatives by promoting a property rights regime that favours and encourages production. Macroeconomic stability and the availability of resources are insufficient if the property rights regime discourages investment and production. The state must make vigorous use of supply side measures in order to encourage production. In addition, however, business organisations require a stable legal, political and regulatory environment that offers protection against arbitrary confiscation, theft and destruction of property. These measures are important in order to reduce the risk of undertaking long term investment.

To complement these requirements, there has to be the realisation that conflict between gaining and losing sectors or between the suppliers and employers of labour can hinder economic transformation. While the repression of labour has been favoured elsewhere, it may backfire in a multi-ethnic and religiously polarised society such as Nigeria. It is also possible to attempt to reduce conflict through consultation using mechanisms like tripartite bargaining systems. What is important is a commitment to reducing unemployment of resources and the likely conflict arising out of a spate of bankruptcies and redundancies.

These measures need to be complimented by the promotion of normative values to stem free-riding and corruption and to promote a sense of fairness and equality of opportunity in Nigerian society. These factors are important not only to reduce the transactions costs of economic activity but also to allow for a sense of community in a multi-ethnic state which is necessary to reduce political instability and the prebendal instincts which undermine economic progress. In particular, direct measures have to be taken to improve state capacity by reducing corruption and apathy in the bureaucracy. This would require the payment of higher salaries, streamlining of government structures and more training in administration.

7.4 CONCLUSIONS

This thesis has attempted to identify the reasons for continued poor economic performance in Nigeria after the introduction of economic policy reforms and to assess therefrom whether economic policy reforms are adequate as a development paradigm. The following conclusions are therefore drawn from the study:

- conventional approaches requiring state action to compensate for market failure are weakened by the fact that they assume that the state or its agents are benevolent, benign, omniscient and omnipotent;
- by highlighting the agency and informational limitations in the state's capacity to correct for market failure, the negative view of state intervention is useful, however, it may go too far by ignoring empirical evidence of successful state intervention as well as the importance of moderating institutions on state power;
- the ubiquity of economic policy reforms owes more to new thinking on development than to the widespread economic and debt crisis of the early eighties which only provided a window of opportunity for its introduction;
- institutional economics may offer a wider perspective for analysing the economics of developing countries by going beyond the market mechanism to take account of

history, politics and the institutional diversity of capitalism. In particular, the use of political power for the positive supply of institutions may be essential for the success of development efforts;

- once the importance of these factors is acknowledged, it then becomes necessary to take a more nuanced view of state intervention;
- while there are several positive aspects to economic policy reforms, they do not seem, however, to take due account of issues such as flexibility, problems of identification and reproducibility as well as the importance of politics;
- where such factors are important, especially in developing countries, empirical evidence points to certain potential consequences such as weakening of state structures, de-industrialisation and financial chaos, evasion of policy measures and resort to diversionary tactics such as insincere political liberalisation;
- the empirical study of Nigeria showed that a structural adjustment programme was adopted in 1986 which despite claims of being home grown conformed with the essential elements of the new development paradigm;
- the structural adjustment programme in Nigeria did not lead to greatly improved macroeconomic performance nor to structural transformation of the Nigerian economy. However, the usual explanations of poor implementation, inadequate time and external factors were not convincing and greater emphasis was placed on the absence of an active institutional role for the state in the structural adjustment programme.
- the structural adjustment programme in Nigeria also exhibited some of the anticipated potential consequences such as weakened state capacity, continued inflexibility of production structures and retention of previous behavioural patterns such as countervailing action and continued disrespect for policy measures. The political transition programme that accompanied the structural adjustment programme in Nigeria also ended up in a crisis that led directly to the abandonment of the policies promoted under SAP.

The experience of Nigeria therefore provides tenable evidence that in the absence of appropriate institutional structures, economic policy reforms may be inadequate. This gives rise to the need for developing countries and international financial institutions to pay more attention to the important role of institutions in the development process. Doing so would require acknowledging the important role of states in the evolution of an enabling institutional environment and responding to the challenge of bringing about the positive use of political power in developing countries.

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