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The Neo-Liberal Doctrine and the African Crisis

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Structural Adjustment Programmes and the Policy Conditionality

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

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

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

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

economy seized by the general incapacity to generate a sustained improvement in the standard of living.

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

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

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

Simply appending the `poverty reduction policy' to SAPs without due attention to this complex growth-poverty nexus is really problematic, giving rise to internal inconsistency of the policy package. Furthermore, PRGS country papers suggest that poverty reduction is supposed to be achieved almost exclusively through an increase in social expenditure. While these policy measures are undoubtedly important elements of any poverty reduction strategy, an unfounded expectation that poverty could be reduced by applying these measures only should not be encouraged. This is because poverty is

outcome of economic, social and political processes and their interactions, which are mediated through a range of institutions. The multidimensional nature of poverty implies that any poverty reduction strategy should include a set of long-term strategic measures of changing institutional structures and environments.

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

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

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

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

Furthermore, their critical review of the third generation models based on new growth theory, which include the Burnside-Dollar study, shows that the results by Burnside and Dollar are an odd-one out from the other three studies. While all other three studies suggest a significant impact of aid on growth as long as the aid to GDP ratio does not exceed 25 % or more, only the former study concludes that the effectiveness of aid depends on economic policy. Overall, in

each generation of studies, those arguing the negative effect of aid on growth are in a minority. Hence, they caution us strongly against basing aid allocation rules on the single-cause explanations.

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

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

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

Methodological Foundations of Structural Adjustment- a Critique

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

A. Methodological Components: Micro-foundations of Adjustment

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

The model relies entirely on methodological individualism. It begins with choices at the individual level and the end point is maximisation of the welfare of the individual. Markets are perceived as exchanges where goods and services are transferred from producers to consumers. Exchange in the neo-classical model arises spontaneously from the atomistic interaction of self-seeking individuals. Equilibrium arises in the sense that the market clears and optimal choices are made. Moreover, in this ideal world unfettered markets normally will lead to indicators that reflect scarcity and choice. Decisions based on markets under these conditions will lead to efficient choices on what and how to produce that are indicative of the endowment of societal resources. Thus the outcome is consistent with the natural underlying conditions. Equilibrium is a natural state.

The thinking behind the model is also rational deductive and axiomatic. It is rational-deductive in the sense that the behaviour of agents is predetermined by a set of rules, which are deductively posited. Neo-classical economic reliance on an axiomatic approach is particularly problematic. Economists working in this framework begin with a series of axioms and generate policy initiatives, which are then applied to concrete historical conditions. When policies have not worked it is generally because non-economic variables have subverted the process. Policy variations are possible within a narrow realm, but since the basic body of theory arises from a set of axioms there is no alteration of the basic theory level. In essence, the theoretical level is cut off from concrete historical experiences.

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

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

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

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

B. Macroeconomic Models Underlying Adjustment

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

In order to counterbalance these short-run contractionary effects, the supply - side policies are supposed to initiate structural reforms through liberalisation and privatisation. Liberalisation policies are derived from the neo-classical microeconomic models where consumers' utility maximisation and producers' profit maximisation would evoke a strong response to changes in relative prices. As these models assume that removing price distortions would assure Pareto efficiency in resource allocation, liberalisation and de-regulation policies are by definition treated as "growth-enhancing and social welfare-maximising". De-regulation of goods and factor markets and trade liberalisation are supposed

to result in a removal of the `structural' causes of macroeconomic imbalances. As prices signals are assumed to embody all necessary information, changes in relative prices are viewed as a critical prerequisite to a predictable shift to a new equilibrium state. If efficiency is not observed, it is argued that this is due to price distortions exogenously imposed on markets.

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

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

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

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

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

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

To start with, conditions affecting the balance of payments are very precarious. On the export side, most African economies are still uncomfortably dependent on a very limited number of primary commodities - unprocessed agricultural and mineral products-, vulnerable to the vicissitudes of externally determined prices and quantities demanded. On the import side, whilst their import capacity has dwindled, the import dependence of African economies remains high. First, agricultural production in Africa has not benefited from any major

technological break-throughs (like the "green revolution"). With rapid population growth, dependence on food imports has increased, rising to one-third of domestic food production in recent decades. Secondly, largely as a result of the tied nature of foreign aid, the pattern of industrialisation has created an industrial and manufacturing sector with a high import dependence for both inputs and technology.

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

A series of external shocks from the international economic system in the 1970s and 1980s exposed the weak foundation of these economies and contributed to the crisis conditions of the 1980s. Many countries turned to the only available source to finance growing balance of payments deficits --- official foreign assistance and loans, which were increasingly tied to the implementation of SAPs. Access to desperately requested debt-rescheduling facilities has also become conditional upon accepting these policies.

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

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

While public investment has experienced a substantial cut because of the needs for fiscal austerity with a resulting deterioration in physical and human infrastructure, private investment has not been picked up. Nissanke (2001) attributes a prime cause of the persistently low level of private investment to the extremely high degree of risk and uncertainty facing the private sector under SAPs. It has affected not only the asset composition of savings portfolio held by private agents but also the *composition* of investment in Africa in favour of reversible and safe investments that have a self-insurance character. Thus, safe and liquid assets are systematically chosen over less liquid, more productive assets. The latter could generate considerably higher social rates of return.

In the absence of the required investments, there has been little diversification of production and exports in SSA. After many years of `adjustment' there is very little `vertical' diversification, (i.e. a shift towards processed commodities and manufactures), while `horizontal' diversification (i.e. diversification within

the primary commodity sector) has not generally been successful. At the same time, attempts to increase the volume of traditional exports can lead to a self-defeating price depression through the `fallacy of composition' effect.

Africa has failed to diversify export structures under SAPs. Clearly, SAPs have limited the ability of African countries to move up the industrial ladder. Equally, SAPs have not been successful in attracting more foreign direct investment, except in mineral extracting activities. Consequently, a viable and sustainable position in balance of payments has not been attained. The conditions and prospects facing many countries have actually worsened due to their growing debt servicing burden combined with their reduced export earning capacity.

D. Adjustment and African Development: Failures and Incapacities

There are a number of fundamental failures arising from the use of neo-classical economics in its most restrictive version as a guide for the development of African economies. These are behavioural and interactive failures, problems of scope in undertaking and interpreting comparative studies, difficulties in dealing with the temporal and spatial dimensions of development and failures associated with aggregation problems.

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

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

In the narrower traditions of neo-classical economics there is little discussion of how economic and non-economic factors interact (an interactive failure). In rational choice theory non-economic variables are a product of the calculus of homo-economicus. Causality between economic and non-economic is therefore uni-directional and all non-economic variables are purposive and instrumental.

The interaction of economic and non-economic factors must include an autonomous definition of spheres , which have their own history and dynamic.

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

Definitional problems have also led to poor policy recommendations under adjustment. Public choice and rational choice theories have dominated the adjustment concept of the state. One of the great paradoxes of structural adjustment in the 1980s in Africa, observed by proponents and critics alike, was that the state was the primary focus of criticism by the Bank and Fund for Africa's ills as well as their major vehicle of policy delivery.

Many governments in SSA have experienced "a drastic erosion of their capacities to function as a `state' " Mkandawire (2001) due to policies that have perceived government as an agent which distorts and is opposed to the operations of markets. African states today are typically left in a fragile situation with a reduced institutional capability to function: the scope and quality of public social services and infrastructure have progressively deteriorated. Aron (1996) concludes that the state in Africa has come full circle to the *small* government of pre-colonial days, but with a seriously depleted and impaired institutional capacity to deliver social services and to build physical and social infrastructure.

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

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

The emphasis on methodological individualism raises additional spatial questions related to the connection between individual decision making and higher outcome levels. The problem of aggregation is a very thorny one in all the social sciences. The challenge to the scholar is to trace the ways that choices and actions taken at one level of social action are systematically combined with the actions of others so that they constitute a new aggregate or entity. Development requires the transformation of policies, institutions and organisations. The neo-liberal concepts underlying adjustment hardly connect these higher outcomes and choice at the individual level.

Conclusions: Toward a Theory of Development as a Process of Structural Transformation

In SSA, Structural Adjustment Programmes have failed to build institutional and technological capabilities that would transform the structure of production and trade. Relying on axiomatic reasoning and rational deductivity, theories and policies have been presented as universally applicable. `Adjustment', due to its foundations, has failed to take into account the structural features of the economies where policies have been applied.

The supply-side policies of SAPs have little relation to the real structural and institutional constraints that are impediments to these economies. The pre-occupation of neo-classical theories with attaining `static efficiency' through resource reallocation along the production possibility frontier (PPF), results in a misconception of the developmental challenges facing these economies. These economies are generally characterised by points inside the PPF with a substantial underemployment of resources relative to their real potential output. Their developmental aspirations lie not only in moving toward a full employment point on the PPF but in pushing the PPF outward over time. The attainment of this goal calls for policies aimed at enhancing dynamic efficiency, not at meeting the Pareto optimality criteria of static efficiency. It requires structural transformation. Policies must be designed after a careful identification of the potential strengths and opportunities of the economies concerned.

The structural transformation of Africa's economies is a prerequisite for reversing Africa's economic malaise. Without structural transformation, macroeconomic stability cannot be achieved on a sustainable basis. Indeed, `Adjustment' may have exacerbated the underlying structural weaknesses of Africa's economies. Perhaps the most significant legacy of adjustment is the huge mostly multilateral and bilateral debt accrued since 1980s.

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

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

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

Advancing the theory of imperfect information, Stiglitz (1989) also defines markets as an important set of institutions. More specifically, markets are viewed as institutionalised in environments characterised by imperfect, costly and incomplete information. Hence, market participants incur transaction costs. The theory further emphasises that in order for markets to function properly, appropriate governance mechanisms and arrangements are required to reduce agency problems arising out of opportunistic behaviour such as moral hazard and adverse incentives. In the imperfect information paradigm this advanced, institutions are seen to be created and refined to deal with market failures, including those arising out of imperfect and costly information and agency and incentive problems.

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

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

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

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

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

In this framework, predatory and developmental states are seen as polar opposites on a continuum. Unlike the public choice view that bureaucracy is the source of predacity, embedded autonomy sees the paucity of bureaucracy as the major impediment to development. The absence of a Weberian bureaucracy with institutionalised rules and established norms of status and professionalism inhibits private capital accumulation. Ironically, when the market has thoroughly penetrated social consciousness and everything is for sale, personalism rather than collectivism governs state behaviour. However, for development to occur, the bureaucracy must be more than Weberian caretakers and must initiate a Gershenkronian or Hirschmanian transformation. The project of capital accumulation must be almost invented. Lowering risk is not sufficient. Entrepreneurship must be generated, encouraged and complemented.

Also ironically the implied autonomy of the ideal neo-liberal state is historically most often associated with predacity. It is the lack of a linkage to the private sector that encourages states to prey on civil society. In contrast the developmental state combines the insulation of the Weberian bureaucracy with an "intense connection to the surrounding social structure" (Evans, 1995).

Thus, in place of the static equilibrium analysis underlying Structural Adjustment Programmes, we propose to base policies for institutional and structural transformation in Africa on a new theory of dynamic, structural and institutional embeddedness. By nature this alternative framework engenders strategies and policies, which relate to the concrete conditions of each African country.

Further, any policy debate concerning future African development should address a question of strategic integration of African economies into the global economy. Africa has been condemned to marginalization from the international economy. While SAPs have tended to encourage static comparative advantage based on cash crops and resource extraction, global production increasingly emphasizes technologically intensive production. African countries need to diversify their exports and to create new comparative advantages, which will give them greater access to global markets.

To participate in global flows of trade, investment and communications, African countries need to generate new capacities, incentives, regulations, organisations, and institutions. The aim is towards the enhancement of competitiveness, economic diversity, economic depth and economic linkages. All of these dimensions are important. Competitiveness might mean increasing participation in the global economy, but unless there is depth, diversity and linkage effects, dualism or enclaves might arise (e.g., successful free trade zones are where mechanisms have been put in place to increase depth, diversity and linkages). Policy must be both multifaceted and multileveled. For instance competitiveness or increasing access to markets is really a product of the conditions that effect micro, meso, national and regional contexts. Policy must be formulated with each of these levels in mind.

Policies, as they relate to education, labor, finance, foreign investment, trade etc., should be seen as feeding into the development of agriculture, industry and technology in ways that increase competitiveness, depth, diversity and linkages. The generation of policy frameworks allows one to transcend the arid often ideologically-driven dualities of states vs. markets, public vs. private, import substituting vs. export orientation, regulation vs. deregulation etc., to better reflect the complex relationships that are an integral part of economies that will generate an improved standard of living for the majority of its population, which is the ultimate test of a development strategy.

Naturally, these daunting developing agenda African countries would face as challenge cannot be facilitated in a hostile global environment. While discussion on new international architectures tends to focus on management of global private financial flows with a view of the enormous costs incurred by emerging market economies in the recent financial crisis, the problems facing low-income economies because of the continuing dominance of the neo-liberal thought in international institutions such as IFIs and WTO require equally an urgent attention. In particular, a thorough review is imperative towards the prevailing international economic management framework, in which each small nation-state is required to adopt deflationary macroeconomic policy for

attaining an equilibrium in its external account in response to frequent large-scale shocks arisen out of global economic forces. Such a macroeconomic stabilisation framework, which takes a nation state as an unit of policy analysis and action, is clearly antiquated for dealing issues associated with the contemporary phase of globalisation.

Thus, new development economics, as this conference tries to re-establish as a policy-relevant academic discipline distinct from standard mainstream economics, faces a challenging task ahead. Such aspiration cannot be met by simply reconstituting back classical and Keynesian economics into mainstream economics in teaching as well as policy analysis. The scope of development should be expanded to incorporate a dense web of *transformational* prerequisites at various institutional and societal levels, since development is explicitly treated as a dynamic process in contrast to the static nature of adjustment. Development economics should cover such issues as transforming trade, industry, agriculture and finance as well as the industrial-agricultural-financial nexus, firmly anchored in institutional development of markets, the state and entrepreneurship.

Since development is a multidimensional process, all aspects of development cannot be addressed within a single subject discipline such as development economics. What is required is a fruitful co-operation on the part of all the social science disciplines concerning development in collective efforts to advance the cogency of an analytical framework appropriate for tackling new challenges and issues.

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