

ARE THERE IMPORTANT LESSONS FROM THE FAILED 1980s SAPs IN AFRICA?

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Abstract

The 1980s structural adjustment programs (SAPs) in Africa, initiated by the IMF/World Bank, were purportedly designed to relieve the continent of external and internal imbalances and facilitate the resumption of growth. The programs generally involved a set of policy reforms including, among others, financial discipline through demand management, and price reforms with currency devaluation as a policy instrument. The reforms should liberalize trade to maximize reliance upon markets. Government interventionist roles should rather be minimized by reducing public ownership, subsidies and regulation. The SAPs reflected a demand from international creditors for adjustment to allow for further fund disbursement, the result being that by 1989, 35 out of the 47 sub-Saharan African countries had adopted the program, including devaluation, argued to improve the region's balance of trade. We argue that African countries never experienced the benefits of devaluation and, by extension, the SAPs. For African governments, the interesting thing about implementing the SAP was the promise of overseas funds.

1. Introduction

The 1980s structural adjustment programs (SAPs) in Africa, initiated by the International Monetary Fund (IMF) in collaboration with the World Bank, were purportedly designed to relieve the continent of external and internal imbalances and facilitate the resumption of growth. The imbalances were generally caused by several factors. Typical of developing countries (Krugman and Obstfeld, 1991, p. 631), there was an extensive government ownership of the productive units in the region, with the result that government spending constituted a very high percentage of the national economies' gross

national product (GNP). African governments also set currency exchange rates, usually at overvalued levels, in their countries rather than allow the rates be determined by market forces in the foreign exchange market. The purchase of foreign exchange is also heavily restricted, making trading time-consuming as well as leading to black markets for foreign exchange. A large fraction of government outlays in Africa is financed by printing money, this practice argued to often cause high average inflation (Baye and Jansen, 1995, pp. 570-573), resulting in a chain of macroeconomic undesirables: nominal wages that are indexed to the price level, high production costs, unemployment, and political instability (Krugman and Obstfeld, 1991, p. 633). Governments in Africa also controlled private lending, and credit markets in general, tampering too often with interest rates to allow equalization of loan demands and supplies. This practice is argued also allows governments channel funds, at reduced rates, to favored individuals and industries, amounting to an implicit subsidy to those granted the cheap loans, but resulting in an implicit tax on the banking system which is denied profits had the national capital markets been less regulated (ibid).

The IMF structural adjustment programs generally involved a set of policy reforms to tackle these macroeconomic problems argued to be retarding growth and development in Africa. The policy reforms stressed on the need for the region to liberalize their economies, free their markets, facilitate investments, adjust their currencies to realistic exchange levels (most preferably through devaluation), control their inflation rates, reduce their states expenditures, and promote the exports of products in which their countries are comparatively advantaged to produce (Chabal and Daloz, 1999, p. 120). In

a nutshell, the programs demanded from African governments a financial discipline through demand management, and price reforms with currency devaluation as a policy instrument. The reforms should liberalize trade to maximize reliance on markets.

To poor African countries, though, an implementation of the structural adjustment programs would guarantee them international resource transfers, hence, the importance of the entire exercise. The result was that by 1989, 35 out of the 45 sub-Saharan African countries had adopted the program (Sandbrook, 1991). More than two decades later, though, these countries remain poor and actually claim to suffer from the consequences of the structural adjustments. Apparently, the programs had failed both in implementation and therefore in desired outcome. They are argued to have rather exacerbated Africa's problems, having starved the continent of its much needed imports through the worsening of the region's terms-of-trade. We will argue that the programs actually added more debt burden to the already massively indebted African countries, this burden only lightened by the recent debt cancellations by the group of most powerful eight industrialized countries. In what follows, we will first discuss the purported justifications for the structural adjustment programs, including some back-up theories for their success or their failure. These theories will also facilitate an understanding of why the programs were doomed as far as Africa was concerned. Thereafter, we will proceed by reviewing Africa's debt crises in the period before the programs and after, as this will help look into the question of whether Africa did learn anything from the failed programs. Finally, we will conclude the study with a brief recommendation.

2. Purported justifications for the structural adjustment programs

The IMF arguments for structural adjustments in Africa implied that the recommended policy reforms would, by liberalizing trade and maximizing reliance on markets, boost the dampened entrepreneurial spirit and therefore the disenabling investment climate in the region. It was further argued that the region perpetually lacked working capital and mechanisms that could be used as buffers against exogenous shocks. The region therefore needed a reverse of this trend if only it could focus heavily on both the restoration and expansion of its export capacity (Green, 1993).

Structural adjustment in its totality is based on a model of the same name associated with neoclassical economists (Lal, 1980; Balassa, 1982; Bhagwati, 1982). In this model as represented by Walrasian equilibrium, intervention in the market by institutions is strictly forbidden, and personal ties between the market players, including buyers and sellers, are assumed not to exist. Exchange simply arises spontaneously from atomistic interaction of self-seeking individuals. The impersonality of the market players is considered very important for efficient trade as these players would base their decisions to trade with one another mainly on the characteristics of the goods, including their prices (Rose-Ackerman, 1999, pp.104-105). Sales are made to those that place the highest value on the good, and one does not need to like or respect a person to trade with him or her (ibid). Individuals are powerless to interfere with prices, and the decision of market players is rational based on perfect information. Equilibrium is attained in the market facilitated by a Walrasian auctioneer who has access to information from all markets, making it

possible for individual players through a groping process to adjust their decisions, removing all market excesses. In this way, the society maximizes its welfare through the attainment of Pareto optimality. The drive for structural adjustments in Africa had been based on the argument that the economic policies of most African governments were not viable because of these governments' interference with the fluidity and efficiency of competitive markets. African governments should rather place more emphasis on the rational maximizing, self-seeking behavior of individuals.

The structural adjustment programs had also placed great emphasis on currency adjustments to more realistic levels preferably through devaluation. Currency devaluation affects the commodity terms-of-trade along with the productivity of resources of the devaluing country. It is likely to decrease the country's external deficit, improve its current account (Krugman and Obstfeld, 1997, p. 483; Kreinin, 1979, p. 113), reducing the physical volume of imports relative to the physical volume of exports. The validity of the effect on current account will depend on the response of export and import volumes to real exchange rate, i.e., if these volumes are sufficiently elastic with respect to real exchange rate. Though considered the primary burden of devaluation (Machlup, 1966, p. 199), the change in the import-buying power of a given physical export-mix can be compensated only if the increase in the volume of export sales is more than proportional to the decline in price, i.e. more than sufficient to compensate for the fact that each export unit now sells for less. It implies that even though the inverse relation between price and quantity is assumed to hold for most products, the value of importers' purchases in the devaluing country may be uncertain in that this value may or may not increase.

Importers' purchase value as a result of price changes will depend specifically on the ratio of the percentage change in quantity purchased to the percentage change in price, i.e., the price elasticity of demand. A unitary elasticity (equal to 1) will leave the value of sales basically unchanged; a relatively elastic demand (greater than 1) will signify a more-than-proportionate increase in sales and an increase in total value; a relatively inelastic demand (less than 1) will signify a less-than-proportionate increase in sales and a decrease in total value.

A devaluation that fails on its intended objective, especially as a result of a relatively inelastic demand, will adversely affect the physical efficiency of an output-producing input, contracting output and employment, and in a case of a poor region like Africa, exacerbate poverty. It means that currency devaluation may create, aggravate, mitigate, or remedy a misallocation of resources and thus reduce or increase their productivity. A price inelastic import demand for an export commodity could, for example, signify a case of an inferior good as opposed to a normal good. Inferior goods, not necessarily goods of poor quality, have substitutes assumed to be superior or normal goods. A decrease in price of an inferior good (caused, for example, by a currency devaluation), assumed to suggest an increase in the consumers' real purchasing power in the form of a real income increase, sets in motion two opposing forces – an income effect and a substitution effect. The substitution effect encourages increased consumption of the good whereas income effect discourages increased consumption, but because the substitution effect more than offsets the income effect, the total effect is positive, implying increased consumption demand and therefore sales of the good. The fact that the substitution effect more than

offsets the income effect is explained by the assumption that the income effect is rarely large enough to outweigh the substitution effect, even with inferior goods (Pindyck and Rubinfeld, 1995, p. 104). The problem, though, is that the increase in sales may be insufficient to compensate for the fact that the good now sells for less due to devaluation. This inability to compensate for the decrease in price is because of low income and price elasticity of import demand. Had the good been a normal good, the income effect, measuring an increase in consumers' purchasing power, moves in the same direction as the substitution effect and therefore both reinforcing each other to produce a substantial increase in consumption and sales following the decrease in price of the good.

Studies have revealed that decreases in prices of African export commodities are often unaccompanied by increases in demand with equal intensity even with income growth in the importing developed countries. This implies that commodities produced by Africans are treated as inferior goods. A failed devaluation therefore, and by extension the structural adjustment programs, is bound to have pushed African economies deeper into foreign indebtedness. The IMF had argued that Africa could, at best, be bailed out of indebtedness through Official Development Assistance (ODA) flows, such gains, though, incapable of compensating for the enormous exogenous losses due to lack of exports (Green, 1993).

3. An overview of Africa's debt crises

A sizeable number of African countries are richly endowed with natural resources but

could not guarantee meaningful national income for their populations because of skill shortage, lack of technology, poor governance and capital flight. As a result, these countries, especially the sub-Saharan countries, are considered poor in these resources for real development. The lack of meaningful national income also means that these countries often lack national saving to finance investments, the consequence being that they are often burdened with current account deficit financed by borrowing. Poor governance is reflected in poor policies and unnecessary imports of consumption goods, all these pushing these countries even deeper into debts. For several decades, African countries have relied on capital inflows in form of loans, very often confused with aid, to finance domestic investments. The situation changed drastically in the 1980s, considered a period of international debt crises and a contraction of rich-country lending to poor countries (Krugman and Obstfeld, 1991, p. 641).

The oil shocks in 1973 and 1979 brought surges in the current account surpluses of the main oil exporters. Importers of oil were not so lucky, though, as these shocks worsened their deficits. Poor African countries were especially hardest hit. There was a compensation, though, in the form of loans to these poor countries, granted them by the industrial countries. Such loans were made possible because even though oil exporters declined from taking the risks of direct lending to poor countries, their oil wealth, converted to acquired-safe assets, was located in the industrial countries whose banks found it more profitable, at relatively higher interest rates, to offer loans to the poor countries (ibid, p.646). African countries accepted the loans at the charged interest rates, their indebtedness escalating to new heights. In the first half of the 1980s, just about half

a decade after the 1979 oil shock, even the oil exporters were themselves running a deficit, having engaged in spending sprees in expectation of more oil wind falls. The result was that the funds for recycling (the so-called petrodollars) to poor countries dried up, resulting, in turn, in more problems for these countries to contend with, namely shortage of funds to finance large deficits as well as service large debts. This was in addition to that fact that, at the time (1981-1983), the world economy was experiencing a serious recession, having been caused years earlier in 1979 mainly by the US Federal Reserve's adopted anti-inflation monetary policy that increased both the US interest rate and the dollar exchange rate (ibid, p. 648).

The increases in the US rates inspired the London inter-bank offered rate, to which the interest rates on developing-country loans were tied, to increase sharply too during the same period, making new borrowing more expensive. Old debts also became more expensive, influenced by a key institutional feature of bank lending, using loan contracts with adjustable interest rates called floating-rate contracts (ibid, p. 646). The floating-rate contracts protected banks from being "trapped" with low-interest-rate loans. They allowed banks to change the interest on their loans as market interest rates change, the main burden falling on debtor-poor countries. These developments meant more problems for African countries that depended, to a large extent, on foreign loans for sustainability. Added to the burden on these poor countries whose debt is denominated in dollars was the dollar's appreciation which also increased the real value of these countries' debt service, namely the flow of interest payments and principal to their creditors (ibid, p. 649). This debt had, in the first place, partly sparked the need for the 1980s structural

adjustments in Africa. The countries in the continent had accumulated large current account deficits financed by borrowing. The recommended reforms contained in the structural adjustment programs to turn Africa's export sector around and solve the deficit problem had the opposite effect, though, throwing the continent deeper into debts. In other words, the structural adjustments actually exacerbated the very same problem that they were supposed to solve. The effect of dollar's appreciation on African debtor-countries was actually similar to the effect of currency devaluation in the same countries whose export goods exhibited inferior good qualities, with low price and income elasticities of import demand, at best, and, at worst, negative price and income elasticities. In both cases, the countries fell deeper into foreign debts.

4. Are there any lessons from the failed structural adjustment programs?

The 1980s structural adjustment programs in Africa were supposed to promote export-led growth in the continent. They were supposed to reverse the decline in production as well as tackle the question of resource wastage by African governments. In reality, though, the programs reflected a demand from international creditors that African countries structurally adjust their economies to allow for any further fund transfers to the region (Wuyt, 1991). Africa, being notorious for economic dependency, yet refused to see such fund transfers, often labeled aid, as being perpetually at the root of the region's economic predicament. Foreign aid, in whatever form, is often followed with stringent and often detrimentally silly conditionality. African countries, on the other hand, view aid at face value, seemingly accepting it to furnish them with, otherwise impossible to reach,

financial resources. These seemingly two opposite sides of the same coin have been conceptualized by Chabal and Daloz (1999, pp. 110-111) as the resource respective constraint components of dependence. They mean that the actual effects of aid and dependence can be determined depending on the relative weights of their resource and constraint components (ibid). Apparently, African governments are usually attracted to the resource components but overlooking the constraint components. This oversight truly explains the rush by African countries to implement the IMF policy recommendations contained in the structural adjustment programs, the consequences of failed policies having little significance and therefore given little or no consideration. After all, countries that complied with implementing the policy recommendations were promised fund transfers.

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