At issue: Africa and the making of adjustment
How economists hijacked the Bank's agenda

The failure of development reflects a crisis in the economic theory that has driven the policies that the World Bank has imposed since 1980. Development economist and professor of African studies Howard Stein examines the evolution of policy in the Bank, focusing on how economists became hegemonic. In this essay he details the origin of structural adjustment, tracing its roots back to a set of neoliberal economists who gained influence at the Bank in the late 1970s.

Since 1980, the most ubiquitous and consequential set of policies affecting developing countries including those in Africa has been a series of economic reforms sponsored by the World Bank, IMF and other multilateral and bilateral donors. From its inception, these policy measures or structural adjustment packages, sometimes referred to as neoliberalism, assumed that growth and development would arise from the stabilisation, liberalisation and privatisation of economies.

At the centre of the origins and evolution of adjustment have been developments in Africa. The continent is a Petri dish for the international aid community. New aid modalities based on largely erroneous theoretical assumptions have been introduced with little regard to the consequences to local populations. In particular, pressures from social and economic crises in Africa were salient in the original formulation of adjustment.

The failures of adjustment in the 1980s in Africa were critical to the introduction of new forms of conditionality that could be used to explain the "exceptionalism" of the continent without challenging the basic premises of adjustment. The inability to raise the standard of living for most Africans led to the "rediscovery' of poverty reduction by the World Bank.

There was concern among the economists in the Bank that too much economic growth would be sacrificed to achieve social goals.

Origins of adjustment

The major reason why stabilisation became a core policy in bilateral and multilateral official lending had less to do with the IMF and more to do with changes in the World Bank. During the 1950s and 1960s, the Bank primarily lent funds in support of infrastructural expansion and upgrading. During the 1970s, under the presidency of Robert McNamara, the World Bank became more concerned with income distribution, basic needs and poverty reduction. They expanded their project support into areas like agriculture, education and rural water access.

There was some concern among the economists in the Bank that too much economic growth would be sacrificed to achieve these social goals. Moreover, the economics profession was becoming increasingly neoclassical and critical of most forms of state intervention in the economy including the kind being supported by the World Bank.

In July 1978 Ernest Stern became the Bank's vice president in charge of operations, and chair of the loan committee. In May 1979 Stern convinced McNamara to make, in a speech in the Philippines, a general point about protectionism not just a critique of developed country barriers, and to reward countries with loans "to undertake the needed structural adjustment for export promotion in line with their long-term comparative advantage." By midsummer the process was accelerated by the second oil shock and the rapid need for balance of payments support. McNamara saw the opportunity to increase lending and the profile of the Bank, while Stern saw an opportunity to promote his new policy framework. After considerable discussions, the directors approved a moderate allocation of Bank funds of roughly 5 to 6.5 per cent of total IBRD/IDA loans.

Still the strategy lacked a systematic theoretical justification. The opportunity arose when African finance ministers requested that the Bank conduct a new study of the continent in 1979. Stern commissioned Elliot Berg, an economist at the University of Michigan and expert on Sahelian countries, to write the report. Berg, influenced by neo-classical writers in the 70s, was a sceptic about planning and state owned enterprises and considered government failure to be the cause of many of Africa's problems. The Berg report, titled *Accelerated Development in Sub-Saharan Africa*, blamed the weakness of African industry on the countries' bias against exports and the incentive systems created by state-imposed trade, exchange rate and price interventions. It also blamed state intervention for a bias against agriculture since it lowered the internal terms of trade creating a disincentive to producers.

The report almost entirely ignored the underlying structural causes of African economic weaknesses. Stern jumped on the report with a memo to McNamara in April 1981, to justify his new agenda. For African economies to grow, it would require "governments individually coming to grips with the distortion of prices and resource allocation and the operational responsibility assigned to the public sector and making necessary changes." In the same memo Stern also blamed donor policies "which have supported domestic strategies which were inappropriate".

He called for closer donor coordination where the Bank should be prepared "to take a lead in assisting governments to undertake the changes indicated on the one hand and to raise the resources and strengthen donor coordination on the other." Thus the idea of the donor cartel pushing the structural adjustment agenda in Africa and elsewhere was born.

When structural adjustment was first suggested to the Bank's executive board there were some concerns over infringing the IMF's sphere of responsibility, and problems with the Bank's Articles of Agreement - which limited programme loans to "exceptional" examples. Senior staff promised to coordinate their efforts with the macro stabilisation policies of the Fund and convinced the Board that "exceptional" would be defined as countries with Fund programmes. Thus the IMF's stabilisation policies were incorporated centrally into structural adjustment packages. IMF standby agreements rapidly became the prerequisite not only for World Bank loans but also for bilateral assistance as the World Bank increased its coordination functions by, among other things, organising and chairing annual donor meetings.

In 1981, the Reagan administration put forward A.W. Clausen, a staunch supporter of free markets, as the new head of the World Bank. Anne Krueger, a very conservative economist became chief economist for the Bank in 1982. Krueger who was famous for her work on the rent-seeking inefficiencies created by any form of state intervention worked hard to change the nature of the research at the Bank to generate the intellectual basis of reform. By the early 1980s the prerequisites for the commitment to adjustment were in place.

Commitment to adjustment

After 1980, the IMF jumped into Africa with enormous enthusiasm, while the Bank moved more cautiously, awaiting intellectual justification. At a time when the Fund's role in the global system was being questioned, the IMF was trying to redefine itself in the wake of widespread criticism in the press and the demise of the Bretton Woods fixed exchange rate system which it was organised to manage. Lending money to the impoverished continent provided a valiant new purpose.

Between 1980 and 1983, the net flow of IMF loans to Sub-Saharan African countries reached $4.4 billion, compared to only $2.83 billion from the World Bank. By 1983, it was clear that the economic crises on the continent were not resolved and that pending repayments to the IMF would threaten the sustainability of the new strategy. The World Bank made a major financial and intellectual commitment to adjustment, which also allowed the IMF to be repaid. Between 1984 and 1987 the Bank loaned $4.7 billion at the same time as the IMF took out $3.22 billion.

A number of events combined to push the Bank to take the lead on adjustment lending. Within a few years of the beginning of adjustment, it was apparent that the situation was still not improving in many African countries implementing reform. From the Bank's perspective, the blame was not on the policies but "the lack of external capital," which the Bank could mobilise. The African famine of 1982 rapidly placed the continent to the fore inside the Bank.

The Bank produced *Toward Sustained Development in Sub-Saharan Africa* in 1994, a major turning point in the institutionalisation of the adjustment agenda for Africa with a large impact on operations. It set out what was called at the time a "deans list" approach which aimed at ensuring resources only flowed to the countries that best followed Bank reforms. The report carefully laid out the importance of getting prices right in agriculture through devaluation and deregulating state control of marketing. It also emphasised reducing the size and expenditure of the state and building up capacities to meet the financial targets of stabilisation. The report called for a greater coordination of donor efforts behind the reforms, including working closely with the IMF. At the core of the coordination effort were the annual consultative country meetings which were chaired by the World Bank.

Through these meetings, the document emphasised the importance of donor annual pledges, ensuring the cartelisation of aid behind the Bank's vision of transformation. The report also pointed to looming capital outflows to repay the IMF, and the resulting large declines in net inflow just when "donors must be willing to make available adequate financial assistance … to support those Sub Saharan African countries which are implementing major programmes of policy reform."

For these purposes, the report called for the creation of a special assistance facility to support countries embarking on reform and a new office for African affairs directly under Stern's purvey. The special facility to support reforming countries rapidly became a reality. In the wake of the US failure to meet its IDA 6 obligations (they paid them over four years rather than three), donors were permitted to reduce their payments proportionately in 1984, the first year of IDA 7. Since most of the money was already allocated, Stern was able to encourage governments, especially European ones, to redirect support to a new $1.1 billion Special Facility for Sub-Saharan Africa (SFA) formed in January 1985.

With these new funds, and strong reassertion of the importance of adjustment, the Bank rapidly filled in for the Fund, to perpetuate the reform agenda. Its commitment to structural adjustment went from $0.9 billion from 1980-83 or 13 per cent of the total to the region to $3.3 billion or 36 per cent of the total in 1984-87. Other bilateral donors got on board. Japan, for example, was committing 25 per cent of their aid to Africa for structural adjustment by 1990.

Poor performance, need for success

A 23 April 1986 briefing to incoming Bank president Barber Conable stated: "We must recognise that the role and reputation of the Bank Group is at stake in Africa ... We have been telling Africa how to reform, sometimes in terms of great detail. Now a significant number of African countries are beginning to follow the Bank's advice. If these programmes fail, for whatever reason, our policies will be seen widely to have failed, the ideas themselves will be set back for a long time in Africa and elsewhere."

Even with the new funds the situation was not improving, Part of the problem with Bank policies, as economists increasingly dominated the policy branch of the agency, was the ever-narrowing of the economics profession and its growing a-institutionalism. Yet, transforming institutions is at the central core of development. When the Bank began to use institutional theory it problematically drew on the neo-classical or new institutional economic variant and used it to buttress rather than to rethink the same orthodox agenda.

As the Bank turned to a series of new policies and conditionality without shifting from its core beliefs through the 1990s, it began to broaden to include governance, ownership, social capital, legal reform, institutions, participation, and poverty reduction. Four elements were evident in the new approach. First, there was an unwavering commitment to the core set of adjustment policies, with new elements being used to rationalise the poor performance of adjustment. Second, each new policy was seen as a complement to adjustment, which would enhance reform. Third, the micro-foundations of each new element were frequently based on the same neo-classical economic theory with all its problematic implications. Fourth, in most cases Africa's poor performance was the catalyst for the new agenda.

Africa has played the central role in the making of structural adjustment and structural adjustment has been central to the making of Africa, with terrible consequences. The region has seen a marked increase in absolute and relative poverty. Closely associated with this economic deterioration is a dramatic decline in the health of the population. Average life expectancy dropped from 50 to 46 years from 1980 to 2003. No area of the world has done as poorly and no area has been subjected to more conditionality or adjustment. Yet the Bank has never once fundamentally questioned their role in this outcome.

It is time to go beyond the World Bank agenda and the flawed economic theory that has driven it for far too long. Development is fundamentally focused on the transformation of human behaviour and in understanding the nexus of dynamic factors which lead to the evolution of new institutions. Institutional evolution is a process of cumulative change that is a product of a series of interactive dimensions arising from both economic and non-economic factors. Policy should be aimed at altering the way that people interact by generating new types of socially prescribed correlated behaviour. Institutions do much more than constrain individuals from acting opportunistically (as many Bank new institutionalist economists argue), they foremost enable and expand human potential.

September 2008

Howard Stein is a professor at the University of Michigan

This is adapted and condensed, with permission, from Howard Stein, *Beyond the World Bank agenda: An institutional approach to development*, University of Chicago Press, 2008.

Published by **Bretton Woods Project**
Hamlyn House, Macdonald Road, London N19 5PG, UK
Tel +44 (0)20 **7561 7610**
Fax+44 (0)20 **7272 0899**
info@brettonwoodsproject.org www.brettonwoodsproject.org/subs
A publication of an independent NGO supported by a network of UK NGOs, the C.S. Mott Foundation and Oxfam Novib.