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Success Stories of Adjustment: Results and Lessons from Africa and Latin America

Growth and economic development are major concerns around the world. Specifically, a number of developing countries still face major blockages to improving the well-being of the majority of their population. Therefore a fundamental issue arises: how can such countries go through a successful process of transition on the road to growth and economic development?

A number of transition strategies have been tried by different countries in various parts of the world. Some worked, others did not. Existing studies tend to focus on failures. However, there are success stories from which a lot can be learned. This paper focuses on several success stories of economic transition in Latin America and sub-Saharan Africa, two continents faced with major transition problems. Other important aspects of transition, in particular in the social, political and ecological arenas, are not addressed.[1] The paper attempts to elaborate a conceptual framework to analyse major kinds of transition; to identify success stories in transition in Latin America and sub-Saharan Africa; and to draw lessons for countries in transition.

CONCEPTUAL FRAMEWORK

In order to identify success stories of transition and point out the key factors behind them, several concepts must be defined. First Calkins ('Transition Strategies Towards a New World Order for Five Rural Worlds', this volume) defines *transition* as 'a process of directed bifurcation whereby a collectivity seeks ways to consciously restructure its socio-economic system so as to reduce chaos and evolve toward a higher and more desirable degree of order'. In a typical Latin American or sub-Saharan African context, we define *economic transition* as a process involving profound changes in economic structures over a period of time, from a relatively low-income, agricultural, subsistence, stagnating economy with highly skewed income distribution, towards a more middle-income, diversified, integrated, dynamic economy with a more equal income distribution.

On the basis of the empirical evidence of transition in some Latin American countries since the early 1970s and in some African countries since the early

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1980s, three major components of the transition process can be identified (Edwards and Dornbusch, 1994). First, *stabilization* means restoring major macroeconomic equilibria in the short run (IMF, 1987). Second, *structural adjustment* implies setting the economy on sound bases and providing an economic environment conducive to growth at the macro, meso and micro levels (World Bank, 1994). Finally, *structural transformation* involves decline in the relative importance of agriculture as a source of employment and income in the economy and a growth in the off-farm components of the food and fibre system (Staatz *et al.*, 1993).

More specifically, in a context of macroeconomic crisis, stabilization aims at keeping the government budget balanced or with a sustainable low deficit. Inflation must also be controlled, with monetary growth in line with production growth. Finally, the balance of current accounts must exhibit a surplus or at least a sustainable deficit; that is, one that is compensated by positive capital inflows. In a context of a commodity windfall, stabilization aims at avoiding a 'boom and bust' cycle in the economy. Stabilization is achieved by strict macroeconomic management. In a crisis context, public expenses are cut to reduce the public deficit. Credit to the economy is curtailed by increasing interest rates and reserve requirements and possibly by setting borrowing limits. Finally restoring equilibrium in external accounts involves modifying the exchange rate[2] to reduce imports and favour exports, and controlling capital outflows. In a commodity boom context, the government must slow down the growth of expenses, limit inflation and keep strict efficiency standards for investment.

Structural adjustment aims at improving the resource allocation within the economy and between the country and the rest of the world. Exploiting the growth potential of the economy means promoting sectors with comparative advantage and favouring intersectoral linkages. It also means reinforcing the economic capacity to adapt to internal and external shocks. Structural adjustment concerns two major areas of economic activity: institutions and prices. First, it involves redefining the roles and relationships among the three basic types of economic institutions:[3] market, state and community-and reciprocity-based organizations.[4] In most LDCs, structural adjustment has involved reducing the role of the state in the direct provision of goods and services and giving greater scope in the economy to the two other types of institutions. However, the state has an important role to play as a facilitator and a purveyor of public goods and services (infrastructure, communications, education, health and information). The state must also establish stimulating, transparent and fair laws and rules to establish property rights and enforce contracts.

Second, structural adjustment implies reviewing the incentive structure. Prices of inputs and outputs should reflect opportunity costs to ensure appropriate resource allocation. This usually implies moving towards economic prices, first by setting official prices close to world market levels for tradeables and to domestic market level for non-tradeables, and second by price liberalization. Macro prices should also tend towards their equilibrium levels. For most LDCs, this implies mini-devaluations or depreciations to keep the exchange rate close to the foreign market equilibrium, raising real interest rates at positive levels close to capital market equilibrium and keeping minimum wage increases in line with labour productivity gains.

Usually, structural adjustment programmes include reforms in three key areas. First, fiscal reform might include expenditure switching to more productive projects, increasing the tax base by cutting tax shelters and gradually formalizing the informal sector, better tax recovery, simplifying the tax rate and creating more efficient mechanisms for public finance to help cover public goods. Second, monetary and financial reform might include reforming the banking system to put it back on sound bases, setting credit controls and stopping monetization of the public debt by creating an independent central bank. Third, trade reform usually includes three steps: converting non-tariff barriers into tariffs; narrowing the spread of tariffs; and reducing the uniform (neutral to all sectors) tariff to a low level that is close enough to the world price level to transmit world market signals to domestic agents, but high enough to provide the government with enough revenue.

Finally, structural transformation involves, first, a process by which increasing proportions of employment and output of the economy are accounted for by sectors other than agriculture (if narrowly defined to encompass only farming). The economy becomes less agriculturally oriented in a relative sense, although agriculture and, more broadly, the food system continue to grow absolutely and generate important growth linkages to the rest of the economy. Structural transformation thus involves a *net resource transfer from agriculture to other sectors of the economy over the long term.* Both time-series and cross-sectional data show that all major countries that have succeeded in substantially increasing per capita incomes have experienced this shift in the sectoral composition of their economies. Economists have widely analysed the forces driving this shift in the sectoral composition of the economy (Engel's law, gains from specialization and exchange, and increases in farm-level productivity) (for example, Chenery, 1979; Dovring, 1964; Kuznetz, 1964; Timmer, 1990).

Second, structural transformation implies a movement of the economy away from subsistence-oriented household-level production towards an integrated economy based on greater specialization, exchange and the capturing of economies of scale (Reynolds, 1985). Many functions formerly conducted on the farm, such as input production and output processing, are shifted to off-farm elements of the economy. Thus resources shift within the food system as well as between the food system (agribusiness and food retailing) and other sectors. The off-farm share grows relative to the farm-level share in terms of both value-added and employment.

One implication of this process is that driving down the real cost of food to consumers requires increased attention to fostering technical and institutional changes in the *off-farm* elements of the food system. Increasing productivity at the farm level is absolutely necessary, but is alone insufficient to ensure decreases in the real price of food to consumers. Another implication is that, for this process of structural transformation to go forward, the economy must develop low-cost means of exchange. High transaction costs in the economy can choke off structural transformation by making it too costly for people to rely on the specialization and exchange necessary to take advantage of the new technologies in the food system (Staatz *et al.*, 1993). Improved mechanisms to help households manage risk are also necessary. Currently, one of their only

means of risk management is through income diversification, which may hinder gains from specialization.

Finally, structural transformation signifies increased access of individuals to knowledge systems of the wider world, as embodied in new technologies, management practices and institutions. In the modern world, the sources of economic growth depend increasingly on these types of embodied knowledge. A critical challenge is to identify the most effective mechanisms to transfer this new knowledge to food-system participants in developing countries while at the same time ensuring that those participants share equitably in the benefits that derive from that new knowledge.

As the economy as a whole is transformed, so too is agriculture. Agricultural transformation is the process by which agriculture shifts from being dominated by highly diversified, subsistence-oriented farms towards more specialized production oriented towards, and dependent on, markets (Seckler, 1993). The process of agricultural transformation involves a greater reliance on input and output markets (the off-farm elements of the food system) and increased integration of agriculture with other sectors of the domestic and international economies. As this process of integration proceeds, the source of output growth shifts from expanded use of land and (especially) labour to increased use of knowledge from outside the farm, as embodied in new technologies, management practices and institutions (ways of organizing human interaction).

Agricultural transformation also involves incorporation of indigenous knowledge (for example, via farming systems research) into the 'modern' scientific knowledge base. Achieving this linkage of indigenous and external knowledge systems requires substantial investment in human capital. It also requires mechanisms to mobilize public and private investment in various complementary physical capital needed to exploit the new technologies. For example, to exploit new rice varieties, substantial investment in irrigation infrastructure is often needed.

From this conceptual framework, one can identify *major challenges* for each of the three major components of the transition process. In terms of stabilization, in a context of macroeconomic crisis, how to avoid economic chaos and disintegration of economic institutions and how to maintain social stability and help the poor and the vulnerable? In a context of a commodity boom and bust, how to keep the economy on the rails? In terms of structural adjustment, how to transfer economic activities from the state to the market and community- and reciprocity-based organizations? How to go from an administered prices and marketing system to a more market-oriented economy? How do you deal with equity in adjustment? In terms of structural transformation, how to transfer resources from agriculture to the other sectors in an efficient way, switching simultaneously from a subsistence-oriented agriculture towards a more integrated agriculture with strong backward and forward linkages? How to maintain regional balance? How to increase access of individuals to knowledge systems of the wider world, as embodied in new technologies, management practices and institutions?

SUCCESS STORIES OF TRANSITION IN LATIN AMERICA AND SUB-SAHARAN AFRICA

At the macro level, there have been several efforts to identify success stories: for example, Mosley and Smith (1989) and World Bank (1994) for Africa; Corbo and Fisher (1993b), Edwards (1993, 1994) and Williamson (1990) for Latin America). At the meso and micro levels, fewer studies have been conducted in a systematic way, in spite of several good publications (Commander, 1989; Goldin and Winters, 1992; World Bank, 1989a, 1989b). This paper has no pretension whatsoever to be exhaustive. However, it presents a few fairly widely recognized success stories identified as learning experiences. The emphasis is on analysing, in outline form, how the successful countries managed to address and overcome the challenges pertaining to each component of transition. Further details can be obtained from the detailed references which are provided.

It is worth mentioning that the data base in Africa is not as good as in Latin America since, in the former continent, the period under transition has been shorter and the pre-reform data are of quite poor quality. This is particularly true as one scratches below the macro aggregates and looks at the underlying data on particular sectors of the economy. Therefore some caution is needed in qualifying 'success', particularly when based on macro aggregates.

Success stories in stabilization

In terms of stabilization, three challenges needed to be addressed: how to avoid economic chaos and disintegration of economic institutions; how to maintain social stability and help the poor and the vulnerable during stabilization; and how to avoid a 'stop and go' economy.

In *Chile*, following the economic and political crisis of 1972–3 and the coup d'état in November 1973, the Pinochet government moved firmly to restore basic macroeconomic equilibria with drastic, but basically sound, macroeconomic management. The public deficit was quickly adjusted, since it went from 25 per cent of GDP in 1973 to a surplus of 0.6 per cent in 1976. Similarly, the external deficit improved rapidly, going from a deficit of $86 million in 1972 to a surplus of $569 million in 1974. Exports increased, but so did imports, thanks to a relaxed foreign exchange constraint. Mini-devaluations from 1976 to 1979 helped keep exports competitive.

Inflation took longer to be brought under control, mostly as a result of previous policies and people's anticipations regarding government policies, and partly as a result of the government's own policies of lifting price controls and eliminating of subsidies. The CPI went from 119 in 1971 (100 = 1970) to 959 in 1973, and 27 518 in 1975! Stabilization also involved a high social cost. The purchasing power decreased by 50 per cent from 1974 to 1976 and unemployment went up 30 per cent during this period. Social stability was maintained partly because of the military regime, partly because there was no real alternative to stabilization, given the size of the economic crisis. However, the rapid economic recovery from 1976 to 1979 helped significantly by induc-

ing important gains in income and employment (Corbo and Fisher, 1993a; Edwards, 1993; EIU, 1993b; Williamson, 1990).

In *Bolivia*, following years of economic and political instability, the elected government of President Paz Estenssoro embarked in 1985 on a New Economic Policy (NEP). The official exchange rate was allowed to float more or less freely, which eliminated the gap between the official exchange rate and the parallel rate. The government imposed stringent control over the money supply and public expenditure. The public deficit was reduced from 28 per cent of GDP in 1984 to 6 per cent in 1988. Inflation moved from 20 000 per cent in August 1985 (a world record at the time) to 8 per cent in 1988. Interestingly enough, there was a trade surplus from 1980 to 1985, although exports fell. The major reason for this situation is the debt crisis which stopped foreign lending and thus imports during this period. With the NEP, exports and imports slowly recovered, leaving the trade balance slightly positive in 1988. As in Chile, the deep austerity programme hurt living conditions severely at first, then somewhat less with renewed growth in the late 1980s.

However, Bolivia exhibits several features distinct from the situation in Chile. First, the higher birth rate meant the growth rate per capita was negligible during this period, illustrating once more the impact of population growth on economic growth. Second, the population and trade unions accepted, if grudgingly, austerity measures because the government more or less represented them. Elected President Paz Estenssoro, who led the country from 1985 to 1990 and introduced the New Economic Policy, is the same president that launched the leftist-oriented revolution of 1952, which included universal suffrage, land reform, nationalization of major mines, and so on. Also the implementation of the NEP showed the government's goodwill to the international financial community, which led to substantial new lending to the country (EIU, 1993a; Morales, 1991) .

In *Ghana*, following years of economic mismanagement and corruption and the return to power of Lt Rawlings in December 1981, the Economic Recovery Programme was introduced in 1983. The bulk of the effort occurred in the first phase of the programme from 1983 to 1986, with strict fiscal and monetary management. The public deficit moved from 6 per cent of GDP in 1982 to zero by 1986. Inflation went from a high of 116 per cent in 1981 to 30 per cent in 1986. As in Bolivia, the pre-reform situation was such a shambles that post-stabilization macro indicators improved dramatically, leading to substantial new aid from the donor community, which found in Ghana consolation and justification for its policies, given the prevailing economic stagnation of most other sub-Saharan countries.

The exchange rate policy followed is of particular interest. At first, in April 1983, the government set up a system of surcharges on imports and bonuses on exports. This was equivalent to a devaluation, but was not officially made one to avoid possible domestic critics. From October 1983 to March 1986, the government followed a policy of official devaluation of the cedi. From September 1986 until April 1987, a two-tier system was set up, with a fortnightly auction to determine the exchange rate applicable to all goods, except cocoa earnings, oil imports and debt-service payments for which the official rate applied. In April 1987, the two windows were unified at the auction rate. From

March 1988 until early 1992, foreign exchange bureaux were permitted to trade currencies with a slight gap with the auction rate. Since early 1992, the auction has been closed and the prevailing exchange rate is the spot market rate of the central bank. This illustrates the gamut of possible exchange rate policies within the market system (Commander, 1989; EIU, 1993c; World Bank, 1994).

Botswana provides an interesting success story of stabilization in a context of commodity boom and bust. Faced with variable receipts for its major export commodity, diamonds, the government avoided excessive increases in public expenses in boom periods, built up reserves to be used in bust periods, manipulated the nominal exchange rate to avoid overvaluation and encouraged diversification. In general, the government was cautious, adjusted rapidly to a changing environment and anticipated and planned for future shocks (Hill and Mokgethi, 1989).

Success stories in structural adjustment

In terms of structural adjustment, three challenges were identified above. The first is how to transfer economic activities from the state to the market and community- and reciprocity-based organizations. This shift is commonly referred to as 'privatization'.[5]

Chile underwent a successful privatization programme after 1983. Based on the failure of the aggressive first privatization programme from 1976 to 1979, the second privatization programme was very careful. First, the government did not provide any financing and would-be purchasers had either to pay cash or secure financing from the banking system. This meant that the purchasers had the resources and the financial capacity to run the company and the motivation to succeed. Because investors had investment at risk, the approach avoided the moral hazard problem of the first privatization. This approach also required the capacity and will of the banking system to provide loans to private companies (Corbo, 1993; Corbo and Fisher, 1993a).

Not all countries have the same financial capacity to support the privatization programme and they must find alternative ways of addressing the financing constraint. In *Bolivia*, the government is currently trying to implement a form of popular capitalism under the name of 'Capitalizacion'. State companies are supposed to be transformed into mixed companies (51 per cent private, 49 per cent public) with an elaborate scheme of share allocation to the public. In spite of a number of obstacles, including the lack of attractiveness of a number of small and ill-managed public companies and the operational difficulties in implementing the scheme, this promising approach has the advantage of offering a stake in national ownership to the population (EIU, 1993a).

With a similar philosophy, the government in *Ghana* is considering resource-pooling programmes through the Divestiture Implementation Committee for smaller domestic investors to facilitate privatization in the hands of nationals rather than foreigners (EIU, 1993c).

The Chilean experience also demonstrated the importance of several prerequisites for successful privatization. Labour legislation was modified to reduce

rigidity in wage determination as well as hiring and firing procedures. Successful experiences tended to be in cases in which there was effective demand for the products or services provided by the company. Finally, privatization was easier when the government proved that the company could be profitable. This often required a preliminary restructuring of the company by the state to put things in order to demonstrate real, or at least potential, profitability.

Moreover, there was a real political will on the part of the government to give away the economic power resulting from controlling important sectors of the economy as well as relinquishing the social and political power of being able to nominate political friends and family in key positions of the state-controlled companies. Initially, President Pinochet encountered opposition to his privatization programme from some of his fellow officers who were in favour of state capitalism, partly because they were hoping to get key positions in public-held companies after early retirement, as their predecessors did.

In some countries the private sector has also been providing several goods and services typically provided by the public sector, most of the time more efficiently than its public counterpart. In *Ghana*, private bus operators make a profit while respecting public regulation, but the public company is operating under loss. In *Gambia*, village-based contractors trained in a few months participate in labour-intensive road maintenance programmes in rural areas and generate important revenues in rural areas. Nineteen firms were operating in 1989, employing four times more personnel, for an investment 10 to 20 times lower, and rehabilitating roads 15 per cent more cheaply than capital-intensive methods. Public services can also be provided through joint ventures between the private sector, the state and community- and reciprocity-based organizations: for example, water supply in *Côte d'Ivoire* and *Malawi*, waste collection in *Togo* (World Bank, 1989a, 1989b). Even for private goods, the combination of the three types of economic institution has proved productive. For example, horticulture in *Kenya* has taken off as a result of cooperation between local producers, foreign investors and the Horticultural Crops Development Authority. This parastatal played the role of facilitator and coordinator while letting market incentives play their role (World Bank, 1989a, 1989b).

The second challenge of structural adjustment is how to go from administered price and marketing systems to a more market-oriented economy. The case of cocoa in *Ghana* is a good example of the impact of the structure of incentives and the organization of the marketing system on the performance of a given sub-sector. From 1910 until the early 1970s, Ghana was the world's leading cocoa producer, showing strong comparative advantage in this production. However, in the 1970s, cocoa production declined rapidly, from an average 450 000 tons in the 1960s (a record of 557 000 tons in 1964/5) to an average 250 000 tons during the period 1978/82 and a low 159 000 tons in 1983/4. Major reasons for this decline include declining real producer prices, an overvalued exchange rate, an erratic supply of agricultural inputs, transport difficulties impeding evacuation to the ports, and smuggling to better paying neighbouring countries (in particular Côte d'Ivoire), reducing official purchases.

The Economic Recovery Programme started in 1983 had a major impact on the rehabilitation of the sector. The real producer price was raised, increasing

the incentive to produce cocoa and to market it through the official channel. Successive devaluations and depreciations of the cedi made Ghanaian production more competitive on the world market. The Ghana Cocoa Board (Cocobod) was streamlined. Even though subsidies for production inputs and equipment were eliminated, access to inputs was improved, partly as a result of the availability of foreign inputs following exchange rate adjustments. As a result, cocoa production jumped back from its average low of 200 000 tons in the first part of the 1980s to nearly 300 000 tons in the second half of the 1980s. Exports experienced a similar growth.

Interestingly enough, food crops followed the same pattern as cocoa. Total food production fell by nearly 3 per cent per year from 1971 to 1983, resulting in a major increase in food imports. In 1983, Ghana was only self-sufficient in one staple food crop, plantain bananas. Since the inception of the Economic Recovery Programme, food production has increased substantially. In particular, maize, rice and plantain production more or less doubled from the mid-1980s to the early 1990s. This illustrates the complementary nature of the relationship between cash crops and food crops (EIU, 1993c; Okyere, 1990; Younger, 1989).

Nigeria went through a macroeconomic and sectoral structural adjustment programme in 1986 similar to the one in Ghana. In spite of clear successes in terms of growth of agricultural production and exports, changes in the structure of industrial production from the assembly of foreign-made parts to production based on local inputs, Nigeria still faced major macroeconomic and social problems. However, the Nigerian experience shows the important potential impact of a devaluation on the allocation of resources, agricultural output and income.

The case of irrigated rice production and marketing in *Senegal*, *Mali* (Morris, 1987; Diarra, 1994) and *Mauritania* (Koita, 1986; Berg, 1989) shows how reforms including greater decentralization of irrigation perimeter management and market liberalization led to rapid adoption of cost-reducing technologies in irrigated rice production and milling. Particularly striking in the Malian case is how the marketing reform has stimulated new investment and management practices by farmers. In each case, the state was previously involved in very costly and heavy-handed monopolies of irrigated rice. Moreover, one round of reforms (market liberalization of rice in Mali) is increasing the pay-offs to a second round of macroeconomic reforms (CFA franc devaluation): that is, the newly competitive market structure has been very effective in transmitting higher prices resulting from devaluation back to farmers (SIM, 1994).

The case of maize milling in *Zimbabwe* illustrates how removal of policy restrictions on maize movement within the country, legalization of small private hammer mills and the lifting of subsidies previously given to large industrial roller mills led to widespread adoption of the small mills. The small mills were much more labour-intensive than the large mills, thus generating increased employment. Perhaps more importantly, they produced a lower-cost whole-grain flour that many lower-income consumers preferred.

The removal of policy restrictions that previously prevented consumers from having access to this lower-cost food may have a substantial impact, not only on the food security of the poor, but also on other sectors. The lower-cost food provides an 'invisible transfer' to other sectors that might stimulate

broader employment growth. In the short run, it has helped temper the fall in real income for many urban residents resulting from Zimbabwe's economic structural adjustment programme. Similar stories can be told for *Kenya*, *Mozambique* and *West Africa*: how a reform leading to breaking of monopoly/oligopoly power (this time in private hands) had important consequences for longer-term growth (Jayne and Rukuni, 1993; Jayne *et al.*, 1994).

Mauritius provides an interesting example of the impact of liberalization on industrialization following the strategy of the Asian Four Dragons. In the early 1970s, Mauritius was mainly exporting sugar (93 per cent of total exports) and manufactured exports were nearly non-existent. The government passed an Export Processing Zone Act in 1970 aimed at attracting local and foreign investment. Incentives included tax exemptions on benefits and inputs, free capital movements, flexible employment rules, available land, and exchange rate and wage policy reoriented to permit profitability in the export sector. These policies led to a fourfold increase in investment and a 10 per cent yearly increase in GDP between 1970 and 1975. The number of companies grew from 195 in 1984 to 586 in 1988. In 1987–8, manufactured exports (coming from the export zone) overtook sugar as the leading export, representing 61 per cent of total exports (Bheenick and Shapiro, 1989).

The story of horticultural exports in *Chile* shows how a combination of macroeconomic reforms and sectoral policy led to a spectacular increase in Chilean horticultural exports to North America. One of the keys to the success was developing mechanisms for effective transfer of technical knowledge on varieties and market opportunities from California to Chile. The human capital investment was very important (Jarvis, 1994).

The third challenge of structural adjustment is how to deal with equity in adjustment. The first aspect of this challenge is dealing with lobbies. Building political support for reform means giving information and voice to the potential gainers to counterbalance the efforts of potential losers to cancel or postpone adjustment. Potential opponents can modify their attitude if associated with the government's decisions, as did, for example, trade unions in *Argentina*, the centre-left opposition in *Bolivia* (Haggard and Webb, 1993, 1994; Williamson, 1994). The second aspect of this challenge is how to integrate the poor and the vulnerable in structural adjustment. The integration of poverty-alleviation concerns in structural adjustment programmes (SAPs) increased significantly over the 1980s to become a major component of today's SAPs, for example, in *Burkina Faso*, *Cameroon* and *Madagascar* (Morasse, 1991). However, these concerns are fairly recent.

The limited empirical evidence on successful experiences in this field so far (*Chile*, *Costa Rica*, except for nutrition programmes) shows the importance of directing health, nutrition, education and social security programmes to the poorest groups and their specific needs (World Bank, 1992). In several countries, the government is promoting projects with high returns to the poor, mainly in urban areas. For example, the Ghanaian government set up in 1989 a Programme of Action to Mitigate the Social Costs of Adjustment (PAMSCAD) aiming at creating 40 000 jobs in providing services to the poorest.

Making sure general social programmes work for the poor as well, and setting up specific programmes for the poor do not mean that the delivery

mechanism need be the state. There are good examples where the market and community-and reciprocity-based organizations are better suited to deliver these programmes. In *Benin*, *Burkina Faso* and *Senegal*, the governments set up in the early 1990s private not-for-profit agencies to improve urban road and sewage systems through high-intensity labour works. There are similar examples of success in labour-intensive rural road rehabilitation programmes in *Gambia*, *Ghana*, *Kenya* and *Malawi*. With the same objective, the Nutrition and Food Security Programme in Burkina Faso is supporting income-generating activities in rural areas. NGOs can also play a key role. They are particularly well suited to involve poor client groups in the conception and realization of projects and programmes, another key element of success.

Finally, social programmes are not enough. Success in alleviating poverty in the long run can only come with higher economic growth, with a large distribution of its benefits.

Success stories in structural transformation

In terms of structural transformation, three challenges were identified above: how to transfer resources from agriculture to the other sectors in an efficient way, switching simultaneously from a subsistence-oriented agriculture towards a more integrated agriculture with strong backward and forward linkages; how to maintain regional balance; and how to increase access of individuals to knowledge systems of the wider world, as embodied in new technologies, management practices and institutions.

In order for growth in one sector to lead to growth in another sector, it is not enough that reforms lead to increased production (a surplus) in the first sector. It is also necessary that the surplus be mobilized within the sector (as opposed to, for example, simply spurring additional population growth). Then the surplus must be effectively transferred to other sectors and be productively invested in new activities.

Historically, four main intersectoral transfer mechanisms have been used.[6] The first is the expropriation of farm products, for example through forced deliveries by farmers to state marketing agencies at below-market prices. The second mechanism is the capturing of land rents, either by the state or by private landlords. The value of the economic surplus gets capitalized into the value of the land. This economic rent can then be appropriated directly by landlords for investment in other sectors or be captured by the state through a land tax. Both mechanisms were extremely important in transferring resources from agriculture to other sectors during Japan's structural transformation of the late nineteenth and early twentieth centuries (Okhawa *et al.*, 1970). The attractiveness of taxing economic rents is that in theory such taxes do not decrease production incentives because the rents represent a return to resources above that which they could earn in alternative uses. In practice, imposing land taxes requires good cadastral records, which many poor countries lack.

The third mechanism is the fostering of private intersectoral resource transfers. Historically, a major way in which resources have been transferred across

sectors is by farmers and landlords voluntarily investing earnings from agriculture into other sectors. This investment has involved movements of both human and financial capital. For example, a major transfer of resources from agriculture to industry took place during South Korea's structural transformation by rural households investing in their children's education. Many of these educated rural youth then went to work in industrial and commercial enterprises in urban areas (S.M. Lee, 1988). In *Mali*, earnings from cotton cultivation have served as a major source to allow rural households to invest in other sectors, particularly commerce (Dioné, 1991). For this type of voluntary intersectoral resource transfer to work successfully, mechanisms must be available to farmers and landlords that allow them to invest easily in other sectors. Well functioning capital markets and widespread access to educational systems reduce the costs of this type of intersectoral resource transfer and therefore facilitate structural transformation.

The fourth mechanism is the reduction of the price of agricultural products relative to non-agricultural products (turning the terms of trade against agriculture, or 'invisible transfers'). Perhaps the most important, yet least obvious, way of transferring resources intersectorally is to lower the price of agricultural products, particularly food, relative to non-agricultural products. This change in relative prices can be achieved through taxation of agricultural outputs and inputs or through simply allowing the price of agricultural products to fall if productivity increases within the agricultural sector allow the growth in supply or agricultural products to exceed the rate of growth of effective demand. The fall in consumer food prices relative to the price of other goods has the effect of transferring resources from the food system to other parts of the economy, as it now takes fewer resources from the non-food sectors to buy a unit of food. Such invisible transfers have played a crucial role in the structural transformation of many countries, such as Taiwan (T.H. Lee, 1971; Mellor, 1973). Lower food prices to consumers allow industrialists to hold down money wages, making their firms more profitable and competitive internationally.

All of the options for intersectoral resource transfer outlined above require continuing productivity growth in the food system in order to be economically and politically sustainable. Over the long run, the invisible transfers, stimulated by productivity gains within the food system, are likely to be the most important mechanism to foster structural transformation (Mellor, 1973).

With the exception of highly dual economies, like those of *South Africa* and *Zimbabwe*, there is little evidence in most of Africa that growth in a particular sector has led to broader structural transformation yet.[7] Historically, this lack of structural transformation appears to be related to social structures in which strong demands for those who succeed to provide insurance for kin and redistribute wealth make it more difficult to accumulate capital. Also the mechanisms for transfer of the surplus on a sustainable basis to other sectors are poorly developed, as with access to capital markets, effective input and output markets to transmit productivity gains at the farm level to consumers, tax systems that do not greatly depress incentives. Finally the surplus, if extracted, in the past has frequently been invested in ways that do not stimulate expanded growth in other sectors: for example, imported luxury goods, arms, foreign

bank accounts, prestige projects (Bates, 1981; Hyden, 1986; Kabou, 1991; Manguelle, 1993; Martin *et al.*, 1989).

Note that in Southern and Eastern Africa, the settler economy was able to induce some structural transformation because the settlers did not feel obliged to redistribute to their indigenous neighbours. Furthermore, they created a land tenure system that allowed them to extract substantial rents by forcing indigenous people to work at marginal product. The settlers had preferential access to European-based capital markets, educational systems and other mechanisms that fostered intersectoral resource transfers. And because the settlers thought they would be in Africa for a long time, they reinvested their earnings both in agriculture and in non-agricultural sectors to improve the local economy, which they controlled. All this came, obviously, at great expense in terms of equity (the distribution of benefits of the economic growth process). Dealing with that legacy of unequal distribution is one of the chief challenges of these economies today.

In contrast, in some Latin American countries (*Chile*, *Mexico*, *Argentina* and *Brazil*), agricultural growth has contributed to broader structural transformation.[8] In Latin America, the last three intersectoral resource transfer mechanisms were used. The second mechanism, the capturing of land rents, was used in two ways. First, a number of countries tried land reforms giving landless farmers access to land and small farmers access to greater plots. Even though the scope of most of these reforms was fairly limited, they contributed to raising the value of land. Second, the traditional feudal system of latifundio/minifundio evolved over time in several countries into a more capitalist system. Many absentee land owners who were essentially conducting extensive and low-productivity farming either turned into capitalist entrepreneurs oriented to increasing production, productivity and exports, or sold their property. The peasants, who used to have a quasi-'serfdom' relationship with the latifundio owner, either turned into agricultural wage labour or moved to the city slums (De Janvry, 1981).

The third mechanism, fostering private intersectoral resource transfers, was also used in Latin America. Latin America is different from Africa in that its intersectoral transfer benefited from massive immigration. Immigrants brought with them, to varying degrees, a minimum financial capital, various agricultural and non-agricultural skills, and a motivation to succeed in America, in contrast to the problems they faced in their country of origin. The will to improve one's family well-being favoured the education of children who developed new skills and new sectors of economic activity.

The fourth mechanism, turning the terms of trade against agriculture, was widely used in the 1960s. Latin American strong nationalism pushed for diversifying economic activities through import-substitution activities. An often inefficient industrial sector oriented towards satisfying the domestic market developed behind high protection, resulting in worsening terms of trade for agriculture. Moreover, during this period, the frequent overvaluation of the exchange rate favoured imports of inputs for industry and penalized agricultural exports. Finally, the generalized inflationary context favoured borrowers investing in diverse economic activities (Corbo, 1992). However, because little was reinvested to boost agricultural productivity in some of these countries,

agriculture eventually stagnated and became a drag on the general economy, helping prompt the economic reforms of the 1980s.

The second challenge in structural transformation is how to maintain regional balance. The initial resource endowment and the effects of transformation create differential effects on growth of various regions, which can create social tensions and threaten national unity, as with the Chiapas revolt in Mexico in early 1994, and coastal countries in West Africa versus Sahelian landlocked countries. Regional imbalances during structural transformation can be compared to poverty and vulnerability during structural adjustment in terms of lessons on process and success. Success stories tend to support the role of growth poles in pulling growth and generating resources, some of which can be captured by the state for redistribution in less favoured areas to reduce regional inequality.

The third challenge in structural transformation is how to increase access of individuals to knowledge systems of the wider world, as embodied in new technologies, management practices and institutions. Tapping into the international reservoir of knowledge can contribute significantly to raising human capital and therefore inducing or accelerating structural transformation in at least two ways. First, it can contribute to technological transfer. There are many success stories of countries which went and found know-how on the international market and adapted it with success to their own context: winery and horticulture in *Chile*, feedlots in *Argentina* and *Brazil*, shrimp production in *Madagascar*, tomato greenhouse production and processing in *Morocco*, cotton cultivation with animal traction in *Mali* and *Burkina Faso* through a French–African joint venture (CFDT), artisanal fishing pirogue motorization in *Senegal*. Second, it can contribute to raising economic policy analysis capacity which can contribute significantly to structural transformation, given the importance of designing appropriate economic policies. This was a key factor behind changes in economic policy in Latin America. Following T.W. Schultz's emphasis on the role of human capital, many young Latin Americans were trained as economists in North American universities (the 'Chicago boys', but also others) and gained a clearer view of the goals and process of transition. Now they occupy key positions as advisers or directly as decision makers and are the leading force behind policy reform (Edwards, 1993).

As a final comment on structural transformation, even in Africa one can identify some signs of structural transformation in several countries that have been under structural adjustment for a number of years. One sign is the growth of output, exports and capacity utilization of the industrial sector in countries in which the agricultural sector benefited from economic reforms, illustrating the importance of intersectoral linkages, the beginning of resource transfers from agriculture and the demand pull of the industrial sector on agriculture. For example, *Ghana*'s annual growth in manufacturing output, exports and capacity utilization went from –17 per cent, –10 per cent and 19 per cent, respectively, in 1980–83 to 15 per cent, 51 per cent and 32 per cent in 1984–7. Another sign is the emergence of new agricultural entrepreneurs combining training in international production, marketing and banking know-how with traditional networks, for example in *Côte d'Ivoire* (World Bank, 1989a, 1989b).

CONCLUSIONS: LESSONS FOR COUNTRIES IN TRANSITION

Using case studies of success stories in Latin America and sub-Saharan Africa, this paper draws some lessons for countries in transition. First, the more messed up things are initially, the greater the scope for dramatic, large-scale change. For example, Ghana's economic achievements look so good because the economy was in such bad shape to start with. The potential for a large change in policy is highest for those countries that have the least growth-oriented policies to start with. At the sectoral level, the larger the rents protected by policy decisions, the greater the scope for rapid change once those policies are changed.

Second, sound macroeconomic and sectoral policies are a critical condition for a successful transition. Avoiding overvaluation, investing in agriculture to lead to structural transformation through technology–price–institution packages, combining the strengths of the market, the state, and community- and reciprocity-based institutions, providing sound incentives and clear legislation, promoting efficient investment in physical, human and institutional capital and finally taking advantage of the world knowledge base are among the most important policies that contributed to success stories. Note that, while a conducive macroeconomic policy is necessary for successful transition, it is not sufficient: sound sectoral policies, solid programme design and good implementation are also required.

Third, a strong, committed and politically aware government increases chances of success. Transition is a painful process involving social traps; often negative consequences in the short run have to be traded for possible long-run benefits, with gainers and losers. In quite different styles and at opposite positions in the political spectrum, both Pinochet in Chile and Sankara in Burkina Faso were strongly convinced that a major adjustment was needed, even if that entailed national sacrifice, and the population came to believe them. Experience has shown that the population is often ready to accept short-run sacrifices if the example comes from the top, if there is a perception that sacrifices and benefits are shared by the vast majority of the population, and if the benefits are large, not too uncertain and due in a reasonable time scale.

Fourth, an endogenous capability to define, implement, monitor, evaluate and adjust the transition process is critical to success. This definitely contributes to an adequate time management of the transition process, which involves several aspects. First, the government must be able to ensure continuity in policies. It takes time to get policies passed and even more to get results. Chile started economic reforms in 1974, 20 years ago. Then the government needs a flexible and pragmatic perspective. There is no unique recipe for success. Actually changing the recipe to adapt it to changing domestic and international conditions is a condition for success. For example, when faced with a major depression in 1982, the Chilean government reversed its privatization movement, buying back some enterprises and banks. When the economic situation improved, the government started a second privatization movement in 1984. Finally, the government must choose the right speed and sequencing of reforms. The choice between shock therapy and gradualism depends on the type of transition. Stabilization must go fast because the country faces bankruptcy

and procrastination can be deadly. Also speed leaves less time for potential losers to regroup and lobby against reform. However, countries which met success in structural adjustment and structural transformation proceeded much more cautiously. For example, following the failure of the first aggressive privatization programme in Chile, the second privatization programme was very careful. A gradual strategy allows microeconomic agents to adjust their production, marketing and consumption decisions to the new price and institutional regime and take advantage of new opportunities.

In terms of sequencing, success stories show that some reforms should precede others. For example, macroeconomic stabilization is a prerequisite for all other forms of transition. Similarly, fiscal reform should precede liberalization of the domestic financial market, which itself should be conducted before freeing capital flows in order to avoid high domestic real interest rates or rapid real exchange rate appreciation (Edwards, 1990). Also trying to address too many issues at the same time might lead the government to be short on preparation or monitoring and to face too much opposition from potential losers. However, there is also virtue in simultaneity, since a government moving in different directions at the same time might confuse potential opponents to reform.

In any case, an integrated approach to transition is required because of linkages across countries, commodities, inputs and outputs, cash crops and food crops, urban and rural areas and so on (Staatz *et al.*, 1993). Transition must be thought of as a package deal with consideration of trade-offs among various objectives at different time horizons. A classical example is when severe public expense cuts made for the sake of stabilization reduce agricultural supply response and threaten the success of structural adjustment measures (Mosley and Smith, 1989).

Fifth, success resides to a large extent in the nitty-gritty of the transition process. More than a rather simplistic 'privatization' strategy or 'export-led' strategy, empirical evidence suggests that successful transition implies a lot of attention to details, such as choice of wording in legislation, identification of market 'niches' for specific products to improve coordination between supply and demand in terms of quality, form and delivery time, and various kinds of market arrangements and contracting (Schmid, 1992; Shaffer *et al.*, 1983). The most successful countries were the ones that not only applied the above sound principles, but found innovative price and institutional mechanisms to implement the principles.

NOTES

[1]Therefore a success story does not mean that the transition was perfect in all respects. For example, Chile is considered a success story, even though the first years of the Pinochet regime were characterized by a number of human rights abuses.

[2]A devaluation in a fixed parity system or a depreciation in a dirty floating system.

[3]Defined as ways of organizing economic activity and coordinating economic agents.

[4]Community- and reciprocity-based organizations are various forms of locally based endogenous collective action such as cooperatives, producer groups, women's groups, youth groups, local NGOs, religious and non-religious groups involved in social action, and so on. For more

details on the concept of reciprocity, see Calkins (1993). We do not mean to imply that either the market or the community- and reciprocity-based organizations exist independently of the rules established by the state. Rather, in the following paragraphs we use the term 'state' as a shorthand for direct state involvement in the production and distribution of goods and services. Clearly, the way in which the state structures the rules for the market and other organizations influences their performance.

[5]Although we use the term 'privatization' below as a shorthand for this process of shifting economic functions from direct state involvement to other organizations and institutions, we recognize that the term is misleading. It implies that the state has withdrawn from the economy. In reality, the state has just redefined the rules under which the economy operates.

[6]The following draws heavily on Mellor (1973).

[7]There have been some sectoral shifts in the composition of employment, particularly a growth in tertiary sector employment in cities, in many African countries. These shifts, however, are due more to the 'push' of rapid population growth and the lack of productive employment opportunities elsewhere in the economy than to the 'pull' of new demand for workers in non-agricultural sectors.

[8]An irony of the Chilean success is that the country appears to have maintained an important part of GDP in agriculture (around 10 per cent) over the past 30 years, defying the stereotype of structural transformation. But the structure of agriculture has changed dramatically and its export orientation has increased. So here agriculture has transformed in response to policy reforms and technology transfers, and appears to have contributed resources to other sectors (particularly port facilities, transport and handling). But in a small, open economy, such transformation does not necessarily mean that agriculture's contribution to GDP needs to fall continually (Coeymans and Mundlak, 1993).

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