Causal Analyses of Public Debt and Structural Adjustment

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ABSTRACT

The impact of structural adjustment program on the economic situation in many African countries can not be overemphasised. Over two decades of implementing neo-liberal economic policies by the Bretton Woods institution, it is of great importance to document the lessons learnt. This paper elicits the structural mechanism representing the intended effect of structural adjustment policies and the unintended effects observed from the implementation of the structural adjustment policies. The assumptions and hypotheses implicit in the main structural adjustment policies, as well as the observed unintended effect of the policies are clearly elicited with a causal loop diagram.

KEYWORDS

1. INTRODUCTION

It has been argued that the structural adjustment program (SAP) policies of the International Monetary Fund (IMF) and the World Bank implemented in the developing world tend to contribute to economic and financial vulnerability. This can be traced by examining the economic crises of Mexico in 1980s, some countries in Asia and Africa in the 1990s. Evidence from studies on countries that implemented SAP suggests that the financial and economic vulnerability that these countries experienced arose due to, and not in spite of, these policies (Apps 2002).

That developing countries which implemented the SAP experienced significant economic and public debt challenge is not in doubt. What is often debated among researchers, scholars and policymakers is the consistent causal mechanisms that necessitated these challenge and the leverage points to mitigate its undesired outcomes (Olusanya and Olukoshi 1989). Understanding the main causal mechanisms of the economic and financial vulnerability that preceded and in some countries persisted after the implementation of SAP is as important as solutions to mitigate it.

The purpose of this paper is to elicit and present the dynamic relationships between the intended and unintended consequences of SAP policies and public debt, across many developing countries with the systems thinking tool of causal loop diagramming (CLD). The intended and unintended consequences of SAP policies discussed herein are anything but complete. However, any attempt to capture all the consequences will render the CLD hopelessly complex, confusing and less insightful. To avoid unnecessary complexity without compromising the fundamental objective, this paper systematically captures the main linkages of SAP policies to public debt—focusing on evidence-based intended and unintended consequences. This paper is the first, to the best of our knowledge, to consistently integrate all the SAP policies into one framework to serve as a boundary object to engage stakeholders and scholars in a qualitative discussion of the consequences of SAP policies to generate insights and explore plausible alternative strategies. This is important because integrative

thinking of economic development is difficult to achieve, and too often omitted in favour of intuition or linear thinking. In contrast to the usual analysis of SAP, the systems thinking view of hypothesized cause and effect considered herein accounts not only for the separate policies of SAP, but also take into consideration the interactions between these policies, as the system operates through time. In addition, the output from this paper—the qualitative model—can serve as a foundation for developing a simulation model to fully understand the relative effect of SAP policies on public debt accumulation.

This research is relevant and generalizable to many developing countries, because current loans from the IMF and World Bank have similar conditionality, hence the need to understand the intended and unintended consequences of these policies.

2. STRUCTURAL ADJUSTMENT PROGRAM

Structural adjustment is a policy package of "free market" economic reforms sponsored by IMF and World Bank, by which lending to developing countries facing balance of payment problems is based on certain conditions—implementing SAP policies (Mohan 2000). SAP was designed to enable the adjusting countries to change the structure of its economy in order to meet its long-term need of efficient utilization of factors of production to ensure sustained growth (Woodward 1992). Thus, SAP refers to the process whereby the economies of the adjusting countries are reshaped to be more market oriented. The introduction of SAP was influenced by a shift in intellectual opinion away from the earlier structuralist view of economic development. The structuralist approach, first hypothesized in the 1950s by Paul Rosenstein-Rodan (1943), Ragnar Nurkse (1953), and W. Arthur Lewis (1954), attempts to identify specific rigidities, lags, and other characteristics of the structure of developing economies that affect economic adjustment and the choice of development policy.

Supported by influential studies by Little, Scitovsky and Scott (1970), Balassa (1971), Bhagwati (1978) and Krueger (1978), it was argued that deficiencies in national policy-making processes in developing economies and structural weakness in their economies were a significant, contributing factor to their worsening economic performance (Mohan 2000, Konadu-Agyemang 2001). To address the worsening economic performance, the IMF and the World Bank introduced SAP to address these challenges. The stabilisation measures of SAP were primarily designed to reduce short term imbalances between demand and supply, which are normally manifest in balance of payment and budget deficits (Chahoud 1991, Konadu-Agyemang 2001). The SAP measures seek to address a wider range of obstacles to growth, many of which limit the ability of the economy to increase supply (Chahoud 1991, Konadu-Agyemang 2001).

From the perspective of the IMF, the World Bank, and the supporters of SAP, the problems of underdevelopment and inefficiencies in the developing countries are primarily generated and sustained by internal factors. These factors such as state interference in the working of the price mechanisms, over-bloated public service, exchange controls, corruption, state ownership of manufacturing enterprises and investment in social services only serve to clog the wheels of efficiency (Konadu-Agyemang 2001). These ills pertaining in the developing countries were intended to be addressed by SAP policies. Within the context of this paper, and that of developing countries, the SAP discussed herein is assumed to consist of four policies: debt rescheduling, financial reform, trade liberalization, and privatization. Table 1 below presents a brief overview of the actions, intended and unintended consequences of the four main SAP policies considered herein in this paper. The actions represent decisions taken to implement the policy, whereas the intended and unintended consequences represent the expected and unexpected impacts of the decisions.

With the SAP in place, the IMF and World Bank base their lending to developing countries on a precondition. According to Mohan (2000), the precondition concerns drafting and implementation of economic policies that are acceptable to the IMF and the World Bank based on the SAP policies as indicated above.

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