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DEMOCRACY, MARKETS AND STRUCTURAL ADJUSTMENT

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Structural Adjustment Programs (SAP) have proliferated under the auspices of the international economic organizations such as the World Bank and the IMF. Given the rather bleak economic performance of many of the member countries some adjustment was inevitable. However, questions have been raised about the intended and unintended consequences of these programs. Many of the intended consequences of the programs seem at best only partially attainable and at worst unattainable (Khan and Sogabe, forthcoming). Unfortunate unintended economic consequences abound (Cornia, Jolly et al. (1987), Sonko (1992), Khan (1990).

It has been shown that disadvantaged groups will suffer disproportionately through financial liberalization, restriction of government expenditures and the lifting of subsidies of necessities such as foodstuff.

Although the economic consequences of SAPs have been explored quite extensively by now, rigorous examination of the political consequences is far less common. In particular the examination of theoretical linkages between SAPs, markets and democracy is a task that requires urgent attention. This is true not simply because of the extensive use of the SAPs in the LDC's but also because of similar liberalization packages being implemented in the former socialist countries like USSR and the Eastern Europe. In the happiest of all possible world's SAP (or similar privatization and liberalized market practices) will lead to an improvement of economic efficiency, growth and political democracy. Are there good theoretical reasons to expect that this will be the case? Or, are these economic policies simply neutral with respect to democracy? In the worst of all possible political worlds SAPs would lead to dictatorship and denial of human rights. What conditions determine the likelihood of these different outcomes? These are the questions that are addressed in this paper.

In order to be precise about the statement of the problem just posed we need to be clear about the nature of SAPs, the nature of the neoliberal arguments regarding the consequences of SAPs and the meaning of democracy. Much confusion and talking at cross-purposes can result unless these issues are addressed carefully. Hence the plan of this paper is as follows:

First the theoretical basis of both the IMF financial programming and the World Bank approach are discussed briefly. Secondly, the neoliberal arguments for the efficacy of market is taken up. Next, it is shown that there is no necessary connection between the market and a strong conception of democracy by considering the ideas of market and democracy rigorously. Finally, certain economic and political consequences of SAPs are shown to be potentially antithetical to progress towards even a weak form of democracy.

I. The Theoretical Basis of SAPs

At the broadest level it is the conception of the market as the best vehicle for promoting economic growth that underlines the technical approaches of both the IMF and the World Bank. At the level of economic organization of society this is informed by a classical conception of competition as atomistic and the

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neoclassical formulation of marginal cost of production as being reflected in price so that the pricing mechanism enforced through competition can lead to an optimal allocation on resources. On the monetary side the IMF financial programming model as developed by Polak (1957) and Robichek (1967,1970) relies upon the monetary approach to the balance of payments to emphasize the link between money supply, balance of payments and economic activity.

The IMF approach attempts to attack two targets- balance of payments and inflation. Two instruments are used in the attempt to meet these two targets. One is the domestic monetary policy. The other is the exchange rate policy. The basic monetary model can be expanded to include a ceiling on the expansion of credit. The financial programming approach of the IMF actually predates the more developed academic monetary approach to balance of payments by Frankel, Johnson and others in the '60's and '70's.

Let us assume that the authorities can decide an a credit expansion target. Denote this by ΔDp^*. The subscript p signifies that this target applies to the private sector.

We can write

$$\Delta D^* = \Delta Dg + \Delta Dp^* \text{ — } (1)$$

where D is the total domestic credit, Dg is total public credit and Dp is total private credit. The * denotes a target level. It is clear that when any two targets are fixed in equation (1) the third one is also fixed by virtue of their relationship in equation (1).

We can therefore write

$$\Delta Dg = \Delta D^* - \Delta Dp^* \text{ — } (2)$$

The public sector credit expansion is now fixed by the targets on the right hand side of equation (2).

Finally,

$$\Delta Dp^* = (Dp/y)_{-1}\, \Delta y \text{ — } (3)$$

Here the minus sign on the right hand side indicates lagged periods. y is total output (GNP or GDP).

Clearly, equation (3) sets what the public sector deficit would be from the financing side. Thus the typical IMF package would involve a ceiling on credit expansion through monetary policy, devaluation and monetary contraction. The intended effects would be the amelioration of balance of payments deficit and inflation.

Historically, the quasi-division of labor between the World Bank and the Fund has resulted in the Bank's being charged with the economic development aspects of the LDC's. Through project and program loans on concessionary terms the medium term development goals are pursued.

The Bank's Revised Minimum Standard Model (RMSM) was initially designated to serve as a frame work for analysis for development planning. The RMSM complements the monetary models at the IMF by concentrating on the real side of the economy. The model does not determine the price level but takes the inflation rate as exogenous. At the same time it links the national accounts and the balance of payments. Given the savings rate, marginal propensities to import, ICORS (incremental capital-output ratios) and some other parameters, consumption, investment, imports etc. can be endogenously determined. Change in GDP and once again the external balance are the main targets. Government expenditures and taxes are used as principal fiscal instruments. Exchange rate variation can also be introduced by extending the basic model. Recently Khan et al. (1990) have proposed a merger of the Fund and the Bank approaches. The merger of the roles of the two institutions in designing SAPs already preceded this proposal. A typical SAP with the previously discussed analytical foundation will usually include the following:

(1) Ceiling on public and private sector credit
(2) Ceiling on government expenditures
(3) Lifting of subsidies on foodstuff, health care, education
(4) Wage-fixing or setting the ceiling for wage rate change
(5) Making available more incentives for the private sector. A general deemphasis on the public sector.
(6) Liberalization of the external sector. Devaluation if the exchange rate is overvalued

Increasingly SAPS have been accompanied by the privatization of both the real and the financial sectors of the economies. In fact, for most countries, particularly, the former USSR and East European countries it will not be inaccurate to say that privatization is the cornerstone of SAPs.

II. Some Neoliberal Arguments

The proliferating literature on SAPs and their consequences is striking in the lack of clarity on various neoliberal positions. Neither the advocates nor the critics of SAP have bothered to disentangle the webs of different arguments advanced by the neoliberals. In an earlier paper (Khan 1993a) I tried to distinguish among four different positions taken by the neoliberals. I summarize them here and add two more - the monetarist and the rational expectations approaches, since these theories also often underlie SAPs.

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The traditional laissez-faire economics argument is in fact a 19th century ideology that often masquerades as a theory. The name of Smith is invoked often, but there is no evidence of the subtle and nuanced reading of Smith's arguments that one would expect. Both with respect to the LDC's, the former USSR and Eastern Europe, a group of politicians and ideologies try to justify policies in pseudo-deductive, pseudo-scientific fashion by rhetorical appeal to the virtues of the free market.

Libertarianism is a philosophically motivated defence of the market system. A sophisticated moral defense of capitalism, it starts from a conception of rights and freedoms and attempts to define an economic structure that involves a minimum state and an equal distribution of rights to the individuals. Inequalities of other kinds are to be tolerated as long as there are equal rights. Certain rights including the right to property are fundamental and absolute. Later on we will see that the operation of SAPs (more generally of markets) may actually lead to the erosion of the libertarian conception of rights in a paradoxical manner.

The Austrian school also justifies philosophically the market system (Von Mises, 1969, Hayek, 1976). In addition the role of markets in generating growth and capital accumulation in a non-coercive way is emphasized (Kirzner, 1982). Also, like the Walrasian approach discussed below the Austrian school pinpoints the role of markets in coordinating information and complexity (3).

The general equilibrium approach of Leon Walras has been refined and extended, mainly by Arrow (1954) and Debreu (1953, 1959) and their followers. It is now the dominant paradigm in both the epistemological and sociological Kuhnian sense within economics. In a perfectly competitive set of markets the market-clearing set of prices carry all the pertinent information the agents need to know in order to act rationally. One theorem of welfare economics proves that every competitive equilibrium is Pareto optimal. That is to say, no agent can be made better off without making another agent worse off. Another theorem shows that any such Pareto optimal situation can be supported as a competitive equilibrium (4).

The so-called rational expectation (R.E.) revolution consists in handling the fact of imperfect information within the above model. Starting from Muth's (1961) hypothesis that the expectation of the economic agents are to be equated with the mathematical expectations of the economic model Lucas (1971), Prescott and others have shown the existence and optimality of equilibrium in models with imperfect information. R.E. is the most sophisticated attempt to maintain the conclusion of a laissez-faire position in a world of imperfect information. Nevertheless it assumes perfect competition and economic agents who are merely *utility*-maximizing.

The monetarist approach of Friedman and others predates the R.E. approach, but as discussed before forms the theoretical basis of part of the SAPs. Non-interference in monetary policy, rules rather than discretion are advocated. A paper by Prescott and Kydland uses the R.E. hypothesis to establish the conclusion in the domestic context.

Thus the close connection in terms of markets, composition and economic efficiency among the last four schools are quite clear. What is not so clear is any connection between the free market and democracy.

III. The Free Market, Weak and Strong Democracy

What is the connection between an ideally free market system and democracy? Before the question can be answered a more precise characterization of strong democracy is required. This is to be contrasted with a weak democracy. The formal rules in weak democracy are the existence of multiple political parties and voting in regularly held elections under a legal constitution. However, purely formal criteria for democracy ignore the conditions that determine the freedom under which the citizens can genuinely participate in a formal democracy.

Liberal theorists such as Popper and Berlin have considered negative freedom as the relevant aspect of democratic freedom. The absence from coercion would seem to make a polity democratic in their view. Such a weak democracy may coexist with a perfectly competitive market system if certain formal political conditions are met. These conditions would have to include the existence of a constitution, formal rules about the separation of powers of the various branches of the government, formal declaration and guarantees of rights etc.

A strong conception of democracy requires, in addition to a formal specification of rules and procedures a politics which is «something done by, not to citizens» (Barber, 1984, P. 24). A fundamentally Rousseauian concept of politics, Barber's view of politics as the realm of no truth is still problematic. A more consistently objectivist account of democratic politics is given by Gilbert (1990) who defines democratic politics as the realm of exercising citizenship. All can participate because all possess what Rawls, Gilbert & Taylor have called «the universal capacity for moral personality».

As discussed in Gilbert (1990), Khan (1992) and Khan (1993a) the strong conception of democracy requires a further set of background conditions. The most important of these conditions such as a more egalitarian economic structure, emphasis on internationalism, individuality, cultural opportunities, anti-patriarchal and anti-hierarchial practices are all preconditions for a democratic individuality in society.

Khan (1993a) argues that *even* the best market arrangements (i.e. Walrasian general equilibrium) can not guarantee the conditions for a strong democracy. This is because of several reasons. First is the non-existence of mechanisms which prevent the generation of economic and social inequalities in these regime. Secondly, the utilitarian conception of individual as a maximizer leaves very little room for the consideration of a moral personality or democratic individuality. As Khan (1993b) discusses doing well in utility terms may still be far from exercising a rich individuality. Sen (1992) shows how important the consideration of such issues as freedom, achievement and resources are in this context.

Does the R.E. model or monetarism improve matters? Not at all. The former merely shows that uncertainty can be handled if it is formulated in a certain way. All the utilitarian baggage is still carried over to the R.E. general equilibrium. Furthermore a Pareto optimal R.E. equilibrium is quite consistent with enormous inequalities.

Monetarism (and more generally SAPs as discussed in the next section) prevents the government from achieving economic change in a discretionary manner. In doing so it makes it impossible to correct any distributional inequalities. Only a Keynesian, interventionist government might be able to do that.

Therefore, it follows that markets even at their best can not lead to strong democracy in the absence of political mechanisms which explicitly restrict the operations of certain markets and certain aspects of markets. In light of this it will be shown in the next section that in all probability the situation is worse for the countries faced with SAPs. It is entirely possible that even weak democracy will be threatened as a consequence of SAPs.

IV. SAPs and Democracy

A rigorous formulation of the operations of the market system has the virtue that the lack of political processes that can lead to a strong democracy can be revealed. While there are automatic adjustment processes for some economic disturbances, there are no such automatic adjustments for disturbing a democratic political process. Thus one consequence is that if SAPs are implemented in as *undemocratic* polity, by themselves they will not lead to democracy.

But what if SAPs are to be implemented a democratic [polity. Leaving aside the question of how a strong democratic polity could ever generate such economic chaos (excepting natural disaster or war in self-defence) as would necessitate a SAP we can nevertheless consider such cases theoretically. Perhaps a democratic revolution (such as in the Philippines whereby Marcos was overthrown) leads to either a strong or a weak democracy but the misdeeds of the previous regime have left the economy in chaos. Imposition of SAPs under such conditions will lead to predictable *economic* consequences: inequality will increase, standard of living will decrease especially for the vulnerable groups and government budget will still not be balanced in the short run.

Under such circumstances political unrest is likely to increase, as the cases in many of the African countries attest. Ironically, given the existing patron-client bonds in some of these countries the authorities implementing SAPs may have to repress some of their former clients. Thus Herbst argues.

Given that there may be no way to continue previously established clientelistic networks in the new environment, African leaders may have no choice other than to procure future stability by repressing their former clients. The real repression that results from structural adjustment programs may not be from quelling food riots when IMF packages were first instituted, but from the elimination of some of the noncoercive measures that African governments would previously use to keep potentially threatening groups under control.

Especially in economies with large public sectors the extent of repression may touch a large number of socio-economic groups. One study of SAPs claims that in Senegal SAP increased repression. At the same time one instrument of repression, namely the police, became alienated from the government as well (Bathily, 1989). Given such widespread political effects of SAP it would be unlikely for a strong democracy to implement SAP. It is the non-existence of strong democracies in the program countries that may explain the adoption of these programs. In some cases, such as Nigeria there was an initial rhetoric against SAP by the rulers. However, the reality of international political economic relations seemed to have forced their hand. After the rhetoric of patriotism and the visits by the IMF team the inevitable followed.

However even weak democracies may have problems implementing SAPs. Kaufman (1985) finds that only authoritarian regimes have succeeded in implementing the IMF programs. At the same time both Kaufman and others state that the performance of democracies (weak democracies in our terminology) and authoritarian regimes has been equally mediocre in implementing these policies.

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We can pose here a slightly different question. Supposing SAPs were implemented more stringently. What would be the likely *political* effect? One must recognize the difficulties in answering the question from an empirical analysis of a cross-section of countries as Moore and Scarritt have tried to do. The variation in the specific countries and the timing of policies may give rise to no systematic patterns in the aggregate. Furthermore, not distinguishing carefully between strong and weak democracies conceptually lead to the silence over the possibly negative connection between specific democratic practices and SAPs. What is needed is a number of single country studies where the inter-connections between the economic and political effects of SAPs are brought to light in a detailed procedure. No such work has appeared in print so far. I report on a theoretical approach that is in the process of being implemented for some African countries.

SAPs have *direct* and *indirect economic* effects. This is because of the interdependent systemic nature of the economy. These effects may also affect the *politics* in an indirect way. These are what might be called the induced effects of SAP by following the terminology introduced by Khan (1989) in the economic sanctions context.(5) The more widespread the economic effects are, the more widely diffused the political effects are also likely to be. The economic effects are measurable via economy-wide modeling. In particular, models based on the Social Accounting matrices trace the impact from the sector of origin to production, distribution, savings, investment and the external sector including the feedback effects throughout the economy in a closed loop fashion. It can be shown for the cases studied that these effects of SAPs are destabilizing in a political sense. The attack on the standard of living, shifts in inter- and even intra-class distribution of income and wealth, rise in interregional disparities and an increase in unevenness will induce stresses that will be accompanied by new social and political movements. Sometimes existing social and political movements will take these up as further issues. For example the coincidence of ecological and distributional consequences of SAPs may mean opposition organized across a wide spectrum. A democratic government will either accede to the demands of such movements or be forced to suppress them. In the first case SAPs will have to be dismantled or at least largely abandoned. In the second case even weak democracy will be undermined. Authoritarianism of the state apparatus will become even more apparent than before.

Given the non-existence of strong democracies in the LDC's and the absence of positive freedoms it is far more likely that authoritarianism will increase. The weak or formal democracies will come under attack both from above and from below. From below because of the economic effects of SAPs. But also from above because of the stake the technocrats and the section of the ruling elite dependent on the good will of international capital will have in preserving their power and privileges. As alluded to before any social equilibrium of this nature is highly unstable. One possible transition is to the state of strong democracy. Under the existing circumstances the new social and political movements are unlikely to achieve this. Therefore, the only remaining possibility, dynamically, is to transit to a more repressive regime.

Conclusions

In this paper I have examined the theoretical basis of SAPs and their likely implications for the program countries. Although decades of economic mismanagement, rent-seeking and revenue seeking by the elite have made adjustment necessary for these countries, the particular packages being implemented will have unfortunate economic and political consequences.

On the economic side it is doubtful if even the immediate intended goals of balance of payments improvement and stability of price level can be achieved in most cases. The longer term prospects of growth (especially growth that is sustainable) look dubious as well. In the short run the distributional and standard of living consequences are likely to be quite severe.

On the political side the distributional effects will lead to greater stress on the social and political fabric. The coincidence of several longstanding political (e.g. ethnic/regional issues) problems with the effects of SAP may indeed give rise to a crisis situation.

The distinction between the weak and strong democracy made in this paper can be helpful in understanding the political impact of SAPs. A strong democracy can mitigate many effects of existing SAPs. However, the effects of existing SAPs are likely to erode even the weak democracies that exist in some countries.

In order to design new and popular (that is beneficial to the people as a whole, not just politically popular) adjustment policies, the standard of living of vulnerable groups must be protected. The rent and revenue seekers and individuals engaging in wasteful and unproductive activities must be made to pay the price of the bulk of such a popular adjustment. Some preconditions for this different type of adjustment (not just with a 'human' face) are popular government, genuine independence in policy making, and popular participation. In other words, a strong democracy in our formulation is a *sine qua non* for a strong economy leading to equitable and sustainable development.

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1. The standard neoclassical modelis static. It would seem that what the supporters of SAP must have in mind is a dynamic general equilibrium and optimality over time.

2. In what follows only the theoretical implication of the SAPs and not their institutional nature are examined.

3. The role of the markets in reducing the seeming random and complex behavior to a simple order has been an appealing feature of economic thought since Adam Smith. The feature of economic thought since Adam Smith. The instability of the process is what makes this elegant structure breack down. But since Keynes, first demonstration of this many restoration attempts (discussed in the text of this paper) have been at work. For a very lucid discussion on the instability problems see K. Iwai, Disequilibrium Dynamics, New Haven: Cowles Foundation, 1981.

4. For rigorous statements and proofs of these theorems see G. Debreu, The Theory of Value, New Have: Cowles Foundation, 1959. In particular, the second theorem requires a reallocation of the endowments of economic agents.

5. See H. A. Khan. The Political Economy of Sanctions Against Apartheid. Bouder & London: Lynne Rienner, 1989. Induced effects are quite complex and sometimes difficult to measure.

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