1 INTRODUCTION AND OVERVIEW: BASIC ISSUES OF AGRICULTURE, STRUCTURAL ADJUSTMENT AND POVERTY

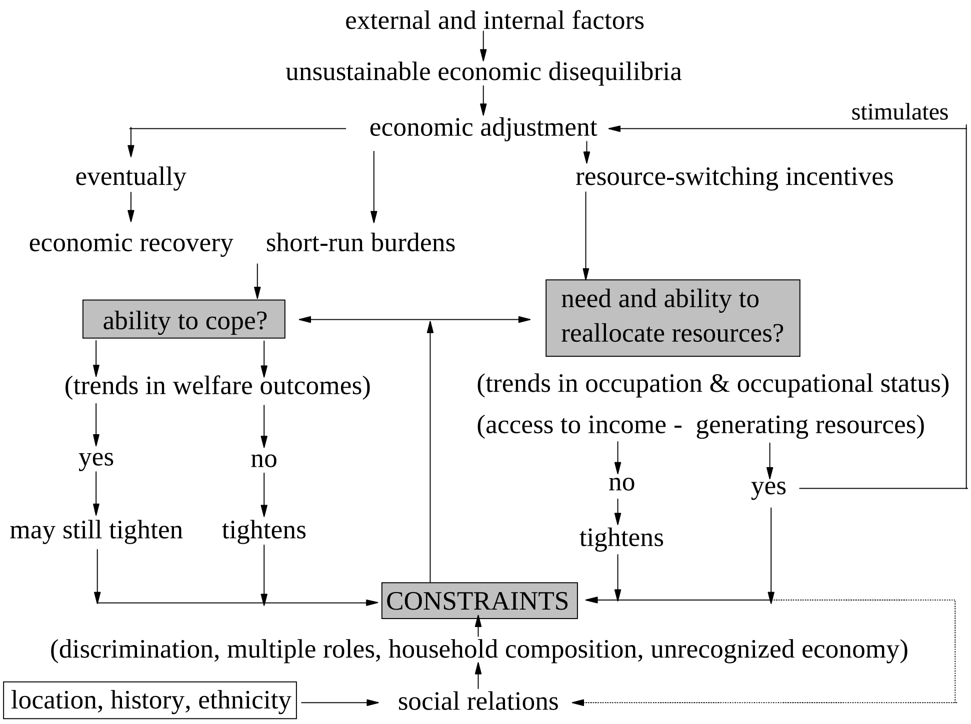
Many sub-Saharan countries where facing in the early 80s dramatic balance-of payments crises due to a worldwide economic recession, the collapse of the commercial lending to developing countries, and misguided national economic policies. Resolutions have required changes in the economic policy, and often under the pressure of the IMF and the World Bank, structural adjustment programs were introduced. However, Africa's unsatisfactory development process in recent years have fostered an intensive debate, if the economic failure is due to or in spite of the economic adjustments. The World Bank notes, that some improvements in macroeconomic and sectoral policies have been attained, although non of the countries surveyed has what it regards as a 'good' overall macroeconomic stance (World Bank 1994; Mosley/Substat/Weeks 1995). Especially for the African countries, poor implementation of the programs and the globalization trend of the international economy are factors, that have to be taken into account, if one wants to measure the impact of the policies. If impact at the macro level is hard to measure, it is much more difficult to quantify the effects of the policies on the welfare at the micro-level, since the population stratum is complex depending on their economic and social situation in the society.
The social dimension of adjustment with its poverty alleviation or aggravation effects, has therefore to be differentiated by several factors, such as the structure of the economy, the urbanization grade, or characteristics at the individual level.

In Africa, the term economic crisis is most applicable to the urban areas, where virtually all classes face problems with drastic decline in their standard of living. There is a controversial discussion to what extent the policies adversely affected the poor population, since they often rely on parallel markets. Due to the removal of food subsidies and drastic reductions in commodity imports the prices of the consumer goods climbed, thus favoring the terms of trades towards the rural areas. The biggest losers from adjustment policies were the urban elite who had access to official markets and prices, and the retrenched public sector employees. (Sahn/Dorosh/Younger 1996).

However, having generalized some main results of the economic adjustment process, a fundamental problem of policy evaluations exists of not knowing what would have happened in their absence. The evaluation of the effects of structural adjustment policies on the welfare of the poor requires special conceptual and methodological attention. First, one observes, that adjustment programs often are partially implemented concerning the scope, sequencing, and speed. In this sense, hardly any program has been a failure, thus not being implemented in its initial form (Johnson 1994). Second, a clear distinguishing between the effects of the economic crisis following the implementation of the adjustment policies, and the flow of foreign resources after their adoption is not always possible. Third, other external influences, such as climatic shocks, effects of war, or changing terms of trade conditions on the international platform are difficult to control. Fourth, empirical data of the micro-level setting are only available from a rather short period the policies have been in effect, thus limited time series have to be analyzed in statistical equations. Fifth, complexity occurs because of the combination, interdependence, and sequence of specific policies (Haddad et al. 1995). Pairing adjusting countries with „homogeneous“ non-adjusting countries as a reference situation is one attempt to cope with the „with and without“ problem, and implicitly doing so by using regression analysis. The „before and after approach“ has been widely used, but the conclusions in determining what has happened is closely related to the two time periods as well as the indicators chosen (Sahn/Dorosh/Younger 1996).

The success or failure of any measurement depends critically on the individual's possibilities of access to, control of, and the ability to move productive economic resources between sectors, and is therefore gender-differentiated. The gender bias lies not only in the macro policies per se, but also in the socioeconomic environment within which such policies are applied, which determine the ability to respond and/or to bear the costs of potential consumption, income, or employment effects of adjustment (Haddad et al. 1995). Any examination of the role of adjustment policies in promoting poverty reduction should begin with an understanding of the characteristics and the behavior of the poor within their social environment, thus providing the basis for constructing appropriate models to explore the differential effects, as well as giving an inside into the mechanisms of the individual, inter- and intrahousehold resource allocation (Sahn/Dorosh/Younger 1996).
This conceptional framework, that stresses the vulnerability, and the ability of resource allocation of individuals and/or households in the process of poverty alleviation, is shown in figure 1..

Figure 1 Resource allocation and the individual living standard



(Haddad et al. 1995)

In the following part, the main macro and sectoral policies will be examined focusing on their, social dimensions, i.e. how and to what extent they influence the living conditions at the micro-level.

2 INSTRUMENTS OF POLICY REFORM WITH SPECIAL EMPHASIS ON THEIR SOCIAL DIMENSION

2.1 Introduction

The expression ***"Structural Adjustment Programs (SAP)"*** is used to describe economic policy reforms adopted by developing countries to respond to the world recession and the "debt-crisis" of the late 1970s and early 1980s. The Programs involve two broad complementary strategies. The ***International Monetary Fund (IMF) Stabilization Policies*** designed to reduce both fiscal and external deficits through a combination of austere fiscal and monetary policies and exchange rate liberalization. As a complement to the IMF recommended economic reforms, the ***Structural Adjustment Policies*** recommended by the ***Word Bank (WB)*** are designed to change the supply-side, i.e. to shift the structure of the economy and output in order to improve international competitiveness and efficiency in resource use, with an underlying but key objective of increasing economic efficiency by allowing market forces to play a greater role in determining prices and hence guide the allocation of resources (H.de Haen, T. Aldington and R. Saigal, 1992).

Recent World Bank evaluation studies concluded that Structural Adjustment Programs have achieved positive results in many developing countries. The studies showed that economic growth rates have been higher with SAP in place than they would otherwise have been, and that a significantly higher proportion of investment projects succeeded in countries with good structural adjustment programs under implementation. This is in agreement with of Cleaver’s (1988) studies on Africa. He compared the agricultural growth rates of Sub-Saharan African countries under adjustment with those not under adjustment and found that, while there was no difference between the two groups in the 1970s, a slight difference began to emerge in the early 1980s when adjustment programs were initiated. The annual agricultural growth in countries under adjustment was about 1 percentage point higher than that in countries without adjustment programs and 2.6 percentage points higher in 1987, a bad year for agriculture throughout in Africa. The striking difference between the two groups clearly increases over time, showing the responsiveness of African agriculture to policy changes.

Despite these encouraging results showing that developing countries may gain from well implemented adjustment policies in the medium time, several common features related to SAP economic instruments clearly affect negatively distribution of social welfare Fall in per capita income, decline in social expenditures benefiting to the poor, rising unemployment and drop in real wages are evidences showing that SAP have not succeeded in reducing the adverse consequences of the economic recession and debt-crisis and that, in many countries under SAP, not only poverty and vulnerability persist, but the social conditions of the poor has even been worsened. Therefore, it has become crucial to carefully analyze what lessons can be learned from the first generation of SAP, as a basis for making recommendations for modifications or alternatives for future economic reforms.

This chapter of the module examines the social impact of Structural Adjustment Programs The first part is a review of the social effects of different types of structural adjustment policies, with particular reference to their impact on income changes and social structures (health, education, and food security). The second part is focused on policy recommended to render the effects of SAP on development more positive, i.e. what kind of recommendations to make SAP achieve economic stabilization, increase efficiency of the economy and increase supply, while enhancing socio-economic transformation with the sake of equity.

2.2 The social impacts of SAP instruments

2.2.1 Public sector policy

Public sector policy measures are among the most important macroeconomic instruments in SAP. They are recommended to bring fiscal deficits under control so as to attain stabilities in the fiscal account, restore the equilibria of the budget and current account, lower the level of the country's external indebtedness to a bearable level, and rationalize public investment. They include.

1. Reduction of Fiscal Deficit
2. Reduction of Public Sector Employment and Capital investment, Wage control.
3. Reform of Public Sector Enterprise.
4. Reduction of Subsidies and Price Policy Reform.

Reducing of fiscal deficits, (i.e. Reduction or Rationalization of Public expenditures), associated with tax reforms, is one of the most important economic instruments used by the IMF in its policies to stabilize developing countries' economy. The positive influence of public expenditure cuts in the long-run by providing macroeconomic stability is well recognized. However, this is often achieved through drastic cuts especially of expenditures on social services and other essential goods offered to the people, hence undermining the social conditions for the poor (health, education, social security and other social services). All income groups may be hit by such measures, but especially the poor, who lack savings and therefore cannot afford alternative services in the private sectors. Sheshamani (1988) reported that following SAP implementation Zambia faced a sharp rise in mortality rate, especially among the infant population because hospitals could not afford to import the essential drugs and other requisites necessary to support life. The country faced a situation where the social conditions were disintegrating, ending in a social unrest in 1990. Public expenditure cuts can hinder agriculture development. Indeed, it may affect not only expenditures on health, education and rural amenities, which are important requirements for sustainable increases in agricultural productivity, but also by reducing some essential investments in agriculture, including investment in physical infrastructure and supporting services such as agricultural extension.
Among other important measures recommended in SAP to reduce the heavy and costly public expenditure, the reform of public sector employment, wage control, and reform of public enterprises occupies a prominent place. In many developing countries wages have been controlled through the labor code which fixes minimum wage rates for all categories of workers according to their formal training, regional location and sector of the economy.

On the other hand, the existing policy framework has been characterized by direct state intervention in the production and distribution of goods and services. Most of the time, these government-owned enterprises and monopoly marketing boards were extremely inefficient and money-losing. Reporting the case of Cameroon as an example, Ntansgi (1992) showed that between 1960 and 1990, a total of 200 public enterprises were created by the Cameroonian government. He stressed that the performances of these public enterprises has been unsatisfactory due essentially to their politization and use of patronage, a lack of autonomy and accountability in management and an environment that did not encourage productivity. As a consequence, they have contributed to the crisis in public finance, either directly through state operating and investment subsidies they required to survive, servicing of external guaranteed debt by the government for public enterprises in difficulty, and indirectly through default in the payment of taxes. They had become a burden to the rest of the economy also through their debt to banks and suppliers. The resulting necessity of reducing public sector staffing and cuts in public sectors salaries hit particularly the urban wage earners like civil servants and public enterprise employees who find themselves out of work and income as a result of reforming or liquidation of public enterprises.

Expenditure cuts particularly constrain operation and maintenance budgets, which implies most of the time the ***removal of production and food subsidies***. The removal of food subsidies can particularly hit urban poor who have to buy their food. The impact of these measures on the urban poor can be severed by additional cuts in subsidies on public transport, energy, water, or other goods they consume. Since much of the farmers, particularly in Africa, are in subsistence conditions, and since the important components of the rural population are food buyers (like landless laborers) rather than food sellers, they are affected by increases in food prices following the removal of food subsidies. The removal of other subsidies, such as those on gasoline or middle class housing, will affect the nonpoor more than the poor.

Inappropriate **pricing policies**, especially for agricultural products, is considered as one of the important domestic policy deficiencies responsible for the economic crisis facing developing countries, especially in Africa; hence the need for **pricing policy reforms.** As price controls are usually operated through a marketing board, the reforms consist in either reducing or eliminating the operations of the board to allow the private trade to become the dominant marketing channel and to let prices reflect more closely world market levels. These reforms are intended to encourage greater aggregate agricultural production, especially of trade crops for export, and to shift sectoral terms of trade in favor of agriculture. Gittinger (1991) stressed the inter-related nature of SAP measures and pointed out that these pricing adjustments are unlikely to result in increased production in circumstances of high inflation. *"Getting prices right"*, whether for goods or for services, interest rates, or exchange rates, has proven to be all but impossible in conditions of high inflation. Relative prices vary more than proportionally as inflation increases, adding to uncertainty and making price signals ambiguous and inadequate for agricultural producers. He concluded that when inflation is high, the priority should be given to restoring financial stability, particularly by controlling public sector spending. The social impact of pricing policy is mainly related to the fact that real prices for agricultural products may improve the welfare of farmers provided that the price increases reach them. However, they would reduce the real income of consumers in the cities, especially if they apply to food crops. Poor farmers can only benefit from increased producer prices to the extent that they are engaged in the production of tradable agricultural products and not merely in subsistence agriculture. Increased producer prices are important but not the only way of providing incentives for increases in cash crop production. It has to be part of a package measures, in which incentives would take their place alongside infrastructure, credit and related institutions, research and development work, extension services and efficient government investment in improvements of transport, irrigation, etc.... Otherwise, agricultural policies promoting only higher producer prices will have limited positive effects on alleviating poverty among small farmers and could even have a detrimental effects (Singer, 1991, P. Pinstrup-Andersen and R. Pandya-Lorch, 1992).

2.2.2 Monetary policy

The two main monetary policy instruments in IMF agreement are **credit ceilings** and raised **interest rates.** They are aimed at reducing the growth of domestic credit supply, and thus inflation., increasing real savings and to rationalize use of domestic savings, including switching it from government to productive sectors. They are usually associated with **financial system reforms** intended to improve financial sector policy i.e. to achieve competitive returns on financial assets, increase the marginal productivity of capital and boost the saving rate. These measures are not socially harmful as fiscal measures. Basically, they tend to have an adverse impact on borrowers and therefore on industrialists (and large farmers to the extent that they are borrowers), while they have a favorable impact on savers like urban wages earners and more particularly urban professionals.

2.2.3 Balance of payment policies.

Balance of payments policies recommended in SAP implementation include mainly **exchange rate reforms**, **restructuring of tariff system**, **import substitution drive** and **export promotion measures,** but among these measures, exchange rate reforms can have a particularly severe impact on the social conditions of the people. In most developing countries, and particularly in Africa, balance of payments deficits have traditionally been associated with over-valued exchange rates. Therefore, one of the most important instruments used in SAP measure is the establishment of a market exchange rate to reflect more closely the true value of the currency (usually by devaluation), so that exports become more profitable and imports more expensive, and hence reduce the volume of imports, encourage producers to use more labor-intensive methods and more domestic raw materials, and increase production of tradable goods, aiming at positively affecting the balance of payment of the country.

Abalu (1992) reported that while devaluation is likely to raise the volume of agricultural exports, its effect on non tradable agricultural products is, at the best, doubtful. Even in the case of exports products, volatile commodity markets, international competition, low demand growth due in part to low price elasticities in developed countries can lead to real difficulties in predicting the effect of devaluation. Considering the Zambian experience and the severe effects that followed several currency devaluations, he pointed out how a generalized currency devaluation, especially under the African economic situation, can lead to socially insupportable increases in the prices of critical goods and services. It is also associated with increases in the domestic cost of imported inputs which can undermine capacity utilization, raise the general inflation level if not properly supported by a tight domestic monetary and fiscal policy, divert scarce foreign exchange to speculative activities and capital flight, and worsen income distribution patterns. Thus devaluation is not a panacea for reviewing economic growth: it requires proper support by domestic and monetary supply side policies.

The Zambian case shows how the social impact of currencies devaluation can be very severe. In general, devaluation increases the price of tradable goods relative to nontradable goods, and initially benefits exporters including farmers, processors, and manufacturers. Consumers, particularly those of imported goods, are also affected by higher prices for food and other goods. At the end devaluation improves the welfare of export-oriented producers (that is those who export more than they import) but it will negatively affect the consumers of import products particularly the urban wage earners and all other consumers of imports. Normally these are not the poor.

Other balance of payments measures like **trade liberalization** (by abolishing licenses and quantitative restrictions), **tariff policy** (intended to move towards low and uniform tariff rates, removals of imports restrictions ...) etc..., do not affect directly the poor. **Removals of import restrictions** can however reduce the protection of industrialists' manufacturing for the home market and lower the cost of imports. Liberalization of imports associated with currency devaluation can lead to a greater and more entrenched external competitiveness encouraging economic growth and employment and thus benefiting the labor force.

2.2.4 External borrowing

Lyakura (1989) reported that in many cases, the IMF economic reforms and associated conditionality could only be sustained through recourse to additional external borrowing. Even if temporary relief can be obtained by way of rescheduling agreements with creditors, rescheduling is itself a cost, besides that it postpones and increases the debt. The case of Tanzania is cited as an example. In 1988, the Tanzanian government faced a problem in implementing the SAP recommended exchange rate policy due to non-availability of sufficient external funds to support the objectives of the program. Two years after the agreement the economic recovery program established in 1986, only half of the credit agreed for the program with the IMF, the WB and joint financing arrangements had been disbursed: This was principally due to the non-fulfillment of the performance criteria and other disbursement delays. These delays of inflows of foreign resources affected the performance of the ERP particularly in the areas of physical and social infrastructure and in the maintenance of social services. This example shows clearly, that external finance and contingency arrangements are essential to support the sacrifices and risks often involved in SAP. In fact, there is a danger of a vicious circle in that external finance is conditional upon strict adherence to the adjustment program, while the adjustment programs depend on the maintenance of external finance. As there is a risk that temporary and perhaps unavoidable lapses from original adjustment targets may result in a cessation of external support and the collapse of the whole program, with severe economic and with the social consequences for the country.

2.2.5 Institutional reform

These crucial measures of SAP covers the reform of the institutions, legal and regulatory framework and necessary rationalization of the role of the State. The strategy is to reduce the role of the public sector in the direct production process and distribution of goods and service that are non-strategic or do not have a public good character, and to increase reliance on the private sector. These reforms are needed to match with the growing complexity of the modern economy which makes overly centralized decision-making inefficient. Reformed institutions, especially public procurements, marketing boards, public and private enterprise services become more responsive to market forces, more accountable and more cost effective. To attain this objectives it is necessary to eliminate many functions that the State has attempted to perform in the past, while strengthening a number of other functions. Two keys function of the State are generally reinforced. One is creating an enabling environment that promotes economic activity through the provision of a fair and transparent institutional, legal and regulatory framework (liberalization policies, privatization and liquidation of private enterprises, the simplification of laws and procedures for contracts, new investment code, laws governing commercial activity, new labor law, the accessibility of information to investors and consumers, ...). On the other hand, the state should aim at developing its capacity for analyzing and managing macroeconomic and sectoral policies.

2.2.6 Summary

The analysis of the socio-economic effects of SAP instruments shows that the income-distribution effects of structural adjustment do not just cut in one direction, so one can not say that they make income distribution "worse" or "better" . For the very poorest like landless people and subsistence farmers, the effects of SAP are complex. For an example, devaluation will hit those that buy imports, while increases in crop prices will help them if they sell those crops. Broadly speaking, the heaviest losses resulting from SAP measures fall on those just below the middle level of income distribution i.e. urban wage earners rather than the very poor or the very rich who are more favored by the measures, especially the producers in the export sector (Mosley,1991; P. Mosley, J. Harrigan and J. Toye, 1991)

Mosley (1991) pointed out that all these conclusions are somewhat hypothetical as there are estimates of what would happen if SAP were carried out in full, while very few of them have been fully implemented. Considering 40 countries where structural and sectoral adjustment programs had been designed by the WB, he found that only about 20% had been fully implemented; about 60% incompletely implemented, and 20% not implemented at all, showing an enormous gap between what had been intended to achieve through SAP and what SAPs really achieved. He related this to the fact that implementation of SAP inevitably aroused opposition on the part of those enjoying the benefits that the reforms were trying to remove (industrialists protected by import quotas, license holders protected by licenses, farmers protected by subsidies, etc ....). Since a large part of the loan is disbursed before the SAP measures are implemented, it is tempting to keep the money while avoiding to antagonize the vested interests threatened by SAP. The interesting case of Malawi shows how recommended SAP were differently implemented. Only public expenditure cuts were totally and devaluation measures partially implemented. Of the recommended increases in agricultural prices, the government choose to raise the prices of food crops rather than of cash crops, such as tea, tobacco and sugar. However, fertilizer subsidies were not cut at all. The result was that the Government managed to avoid that part of the SAP that would have involved the elimination of the specific benefits enjoyed by influential farmers. Consequently, the urban consumers were hurt even more than intended by the original WB measures.

This example was taken among many others to stress that the politically easiest measures (i.e. those that can be carried out quickly by a government officials without reference to the legislature or mass political debate) tend to be carried out first and are generally fully implemented. And these are measures intended to deflate demand such as public expenditure cuts and exchange rate changes. On the other hand, those measures intended to increase supply, which take a long time, involve mass consultation and are politically the hardest, were often carried out late or not at all. This points out the necessity of proper timing and phasing of these measures. The stabilization often measures tend to come first and have an immediate effect. The structural adjustments measures which are growth-oriented take much time to be effective. To avoid that the contractionist pressure of the reforms become cumulative and prevent the country from the subsequent economic-growth, with the danger that the measures become politically and socially insupportable (I. Husain and R. Faruqee, 1996, S. Commander, 1989) it is essential that SAP measures are implemented at an appropriate pace and proper sequencing according to specific countries’ circumstances.

2.3 How to render the effects of SAP on development more positive

2.3.1 Solution to protect the poor

Analysis of the social impact of SAP shows clearly that adjustment programs take longer time to be implemented and their poverty-related aspects are not simply short-term problems. Even though SAP is intended to spur long-term growth and improve standard of living for the poor, it has become obvious that, in the meantime, there is a need for a political approach which should be aimed at protecting the poor and counter-balancing those interests opposed to implementation. This can be achieved by using part of SAP loans to maintain investment in the high priority areas benefiting the poor. It may also be necessary to compensate affected poor and vulnerable groups in a way that preserve the allocative advantages of the planned policy reforms.

Suggestions made to build in compensatory measures into the adjustment process itself include **short-term measures** and **long-term measures**. They are intended to help three groups of people: **The new poor** i.e. those impoverished by adjustment programs in the short term (such as retrenched civil servants, public and private enterprise employees who were laid off because of austerity measures or shift in production); **the borderline poor** which includes low income, vulnerable groups that are most affected by changes in the availability and price of major items of consumption, especially food, and by cutbacks in social programs, and which are severely hit by recession and adjustment, and **the extreme or structural poor ,** known also as chronic or ultra poor (V. Thomas, A. Chhibber, M. Dailami and J. de Melo, 1991).

2.3.2 Short-term measures

Temporally short-term measures are intended to ensure the continued output of subsistence crops and to protect outlays to the poor in social sectors such as primary education, health care, nutrition, as SAP typically raise agricultural producer prices and reduce subsidies, thereby causing higher food prices that hurt the urban poor and rural landless (V. Thomas, A. Chhibber, M. Dailami and J. de Melo, 1991). This can partly be achieved by increasing more slowly producer prices for certain food crops and carefully targeting food subsidies. Moreover, for the new and existing poor, short-term solutions should include transitory compensatory measures that provide temporary employment, to ensure that the basic needs of these new poor are maintained (such as emergency public works, food-for-work programs, severance pay for retrenched workers and targeted food programs based on food stamps or rations to guarantee a minimal nutritional level).

The borderline poor and extreme poor require greater public social expenditures in both the short and the long-term, and the programs intended to them must be protected even when budgetary constraints require that total social expenditure be cut back. Three methods have been proposed (V. Thomas, A. Chhibber, M. Dailami and J. de Melo, 1991):

- Targeting available resources to the poor, based on the principle that those who can afford to pay should do so. This can be achieved by gradually recovering some of the public social services that are provided to the better-off and redirecting these resources to fund social services specifically for the poor, and shifting some service supply functions from the public to the private social services and programs, thereby enabling more public expenditures to be directed specifically to the poor (ex privatizing some hospital services while maintaining essential public health services for the needy).
- administrative reform to make social service more efficient in order to achieve needed savings
- and a progressive taxation reform designed with equity objectives to assist the poor.

2.3.3 Long-term measures

Short term compensatory schemes are designed as temporary addition to SAP to alleviate hardships only temporarily. What is really needed for reducing poverty are long-term antipoverty measures aiming at increasing the incomes, employment and productivity of the poor. Therefore, the design of SAP should be focused on bringing the vulnerable and extremely poor into the production system as contributors (V. Thomas, A. Chhibber, M. Dailami and J. de Melo, 1991).

2.4 Overall Summary

Adjustment is a difficult process with serious political and social implications, especially stabilization measures, which can be enacted rapidly and may have an immediate effect with associated political and social dangers. In designing SAP, there should be more dialogue and persuasion, making greater allowance for shock effects and difficulties rather than imposed conditionality. Adjustment policies should be country-specific as most of the time the programs reflect too much a "standard approach". There is also a necessity of proper phasing and sequencing the measures. Attention should be given to the "fallacy of competition", as SAP measures could lead to increased competition between developing countries with declining prices. But overall, new SAP should be more concerned with income distribution and the social impact of stabilization and adjustment programs.

There is an increasing recognition of the need for adjustment programs to be more "growth-oriented". This objective should dominate both stabilization and adjustment measures. However, the social dimension of adjustment should be an integral part of any program since the objective of adjustment is not only stabilization and growth, but also a better distribution of wealth and a more equity-oriented society. In particular, food security is crucial and should be placed at the center of adjustment programs; food security is best served by adequate incomes.

3 STRUCTURAL ADJUSTMENT POLICY, RURAL INSTITUTION BUILDING AND POVERTY[1]

Institutions are vital for improving the socio-economic conditions of poorer population groups. The structural adjustment programs (SAPs) that predominantly rely on neoclassical economic theory presume that privatization and economic market liberalization lead to a more efficient factor allocation and thus to economic development. Measures under SAPs consist of policy and institution reforms. However, institutional reform often just meant privatization, leaving the privatized institutions relatively unprepared to the market forces. While neoclassical economics hypothesize that anonymous market forces will lead to the most efficient factor allocation, the New Institution Economics (NIE) proposes institutions as non-anonymous steering mechanisms to reduce risk and information asymmetries in markets.

Neoclassical economics and NIE should be considered a joint venture that provide worthwhile theoretical concepts to be considered when implementing development policies under a SAP in developing and transformation countries. Costs that arise when building and restructuring institutions through the privatization policy of SAPs can be reduced through the integration of conceptional work on institutions. At the same time, the concepts provided by the NIE

[1] This section is based on the paper „Schaffung ländlicher Institutionen im Kontext von Strukturanpassungsprogrammen“, published in entwicklung + ländlicher raum, 1997, 31 (1): 21-24.

facilitate the outreach to the traditional target groups in developing countries, the poor, and the newly created target groups in transformation countries, the newly impoverished and small private entrepreneurs.

The justification of institution building results from the imperfection of a neoclassical defined market which is most critical when the market support infrastructure is least developed. There is also empirical evidence that successful economic development is closely correlated with agricultural productivity and this, in turn, relates strongly to the institutional environment such as markets, extension, research and property rights.

SAPs primarily rely on reforms regarding economic policies and institutional infrastructure. Institutional reforms affect the public as well as the private sector (World Bank 1988). By reducing governmental intervention in all sectors, their efficiency is assumed to be improved and economic development accelerated. Kahn and Knight (1985) state that without structural adjustment, today's growth takes place at the expense of tomorrow's growth. Economic growth in the context of neoclassically oriented development policies is hypothesized to accelerate when inefficiencies are reduced through structural adjustment in developing and transformation countries (Egger and Stöckli 1990).

SAPs have recognized the dominant role of institutions in the development process and operationally integrated. Frequently, however, the integration of institution building consisted solely in privatizing public institutions such as marketing agencies or research institutes. This transfer of public services (i.e. agricultural research, seed reproduction) to the private sector, however, did not always entail the expected positive market effects.

Obviously, the privatization of institutions or the change of institutional structures is not a trivial task. This is because premises of the neoclassical market model, complete information and zero-cost transactions, do not apply in real markets. If these premises do not apply, market and price mechanisms do not lead to pareto-optimal results (a.o. Hartig 1989, Hoff et all 1993). In contrast to the neoclassical theory which presumes that anonymous market forces, will allocate resources in an optimal way, the NIE offers institutions as non-anonymous steering and adjustment mechanisms of risk and information asymmetries. The creation and operation of institutions, however, causes investment and operational costs. Moreover, in many developing countries, particularly in Africa, a process of institutional degeneration was observable, that became particularly apparent in the institutions' decreasing capacity to excerpt power and to bind resources. It is in this context that the institution economic interpretation efforts, that are discussed in the following, have to be seen with regard to the building of efficient and sustainable institutions (Hoff and Stiglitz 1990; Richter and Furubotn 1996; Schneider 1987).

3.1 The social dimension of structural adjustment[2]

According to neo-liberal theory, the reduction of governmental intervention in the market should have reduced economic inefficiencies. The success of such measures is among other things dependent on the scope of civil order as well as the socio-cultural and institutional conditions in the particular countries. In reality, SAPs overestimated private and privatized corporate bodies as they have not always been capable and/or ready to assume duties that have been delegated to them. Adjustment is thus not a painless exercise and this has repeatedly

[2] This part draws partly on Jayarajah and Branson (1995), 173-182.

caused significant economic losses particularly regarding public welfare for some social groups. For this reason, in 1986, SAPs started to take into consideration the social dimension of their reform measures. The social dimension was addressed by granting poverty oriented loans that were not directly linked to adjustment or transformation measures. The social dimension loans were particularly targeted towards health, food security, education, micro-enterprises and agricultural development (Egger and Stöckli 1990; Lele 1990). Also, starting in the 1980s, a multitude of national and international non-government organizations (NGOs) have emerged. Some of these NGOs adopted a non-profit-making legal form others were limited companies created by former public employees, consulting firms that competed for contracts in the framework of the SAP's social dimension. These NGOs frequently pursued socio-economic mandates thereby attempting to compensate the negative consequences from market failures and institutional inefficiencies for the poor.

Depending on the design of the adjustment package, the same adjustment goals can be achieved with more or less pain. While compensatory measures will continue to be relevant and improvements in their design and implementation are important, the focus is now on tackling the more fundamental determinants of poverty and human development within SAPs. However, this change in approach would require an increased financial and managerial capacity, especially in the countries undergoing structural adjustment, to analyze the social impact of alternative policy mixes and to monitor developments in the social indicators. This, in turn, would require the development of databases and institutional capacities within developing countries governments.

The social impact of adjustment primarily affects primary incomes. Primary income of a household/enterprise is the income derived from the production process. It is a function of the household's/enterprise's stock of productive assets and the return to these assets. Adjustment measures excerpt an impact on primary incomes by affecting the productive assets and the rate of return to the assets. In the short run, the rate of return to assets is usually affected the most. Thus, cuts in public expenditures may reduce employment and real wages, or, in other words, lower the rate of return to labor. A devaluation that increases the price of tradables relative to that of nontradables may increase the rate of return to assets, such as land and physical or human capital, that are involved in the production of tradables. It can equally reduce the return to assets involved in nontradable production. Some adjustment measures, such as those that lead to changes in the availability and cost of credit, may also affect the acquisition of productive assets. However, the most substantial impact of adjustment on the stock of productive assets owned by different social groups, especially the poor, usually materializes in the long run. It is now increasingly recognized that the most important way to affect the long-run incomes and human development potential of the poor is to enhance their stock of human capital. The nature of adjustment measures, especially the public expenditure policies and institutional framework, can have a profound impact on human capital formation, and thus on the prospects of increasing the participation of the poor in the long-run growth of an economy (Jayarajah and Branson 1995).

3.2 New Institution Economics (NIE)

Most often, when the term „institution“ is used in development aid, it is applied to „organizations“. Frequently, enterprises or ministries are meant (Hartig 1989; Heidhues 1990). However, the term „institution“ comprises more. The NIE defines an „institution“ as a commonly accepted and continuous system of formal and informal rules and norms that determine the coordination among individuals and structure their incentives towards a joint aim or bundle of aims (Hoff et all. 1993; Richter and Furubotn 1996; Ruttan an Hayami 1984). If an institution realizes its aim by applying its rules, the institution brings order into daily activities, reduces insecurities and stipulates societal and economic incentive structures (North 1990 and 1993). Nevertheless, institutions may encounter functional limitations. The NIE explains this through the information asymmetry, imperfect foresight, incomplete contracts and the subsequent transaction costs.

Institutions in combination with the participating persons are called organizations, in as far as they are deliberately created (Heidhues 1990; North 1990). According to the definition of institution and organization, the following terminology applies: with regard to public an private enterprises, Richter and Furubotn (1996) talk of structured (formal) organizations and with regard to market-communities of unstructured (informal) organizations. North (1990) explains that „Institutions are like the rules of the game in a competitive team sport. Organizations, the agents of institutional change, are analogous to sports teams“. Institutions, on the one hand, determine to a large extent which organizations are created and how they develop. Organizations, on the other hand, influence the development of the institutional framework.

Literature explains the question of how institutions come into being twofold. The extreme historical explanation attempt claims that institutions are formed spontaneously out of the self-interest of individuals (Menger 1983). In the other extreme, institutions may be the result of a purposeful plan/model. A competent authority (e.g., the Government, the World Bank etc.), that acts entirely rational may be capable of introducing a certain, conducive institutional set-up. The former can be attributed as a situation of evolutionary rationalism and the latter as constructivistic rationalism (Hayek 1973).

3.3 Rural institution or organization building?

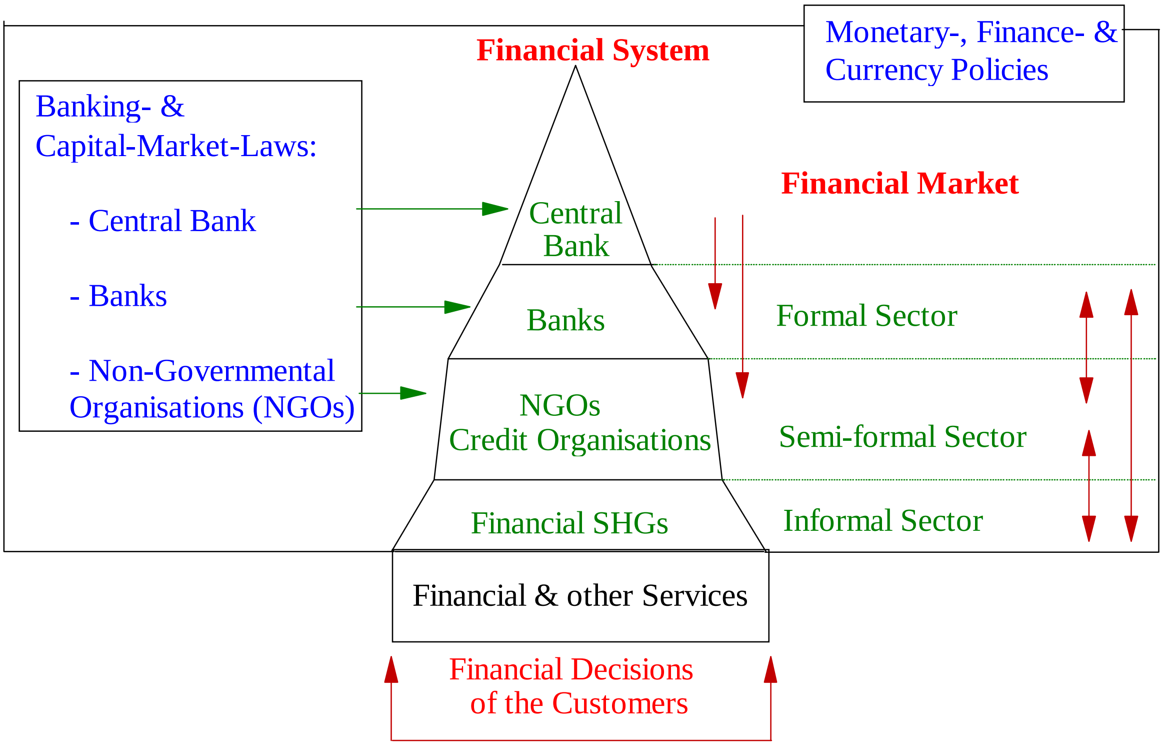
According to the definition of an „institution“, one can identify the following institutions within a rural economic systems. These are markets, property rights, land, tree and animal tenure systems, indigenous insurance conventions, and other systems of exchange that are determined by implicit contracts, rules or social norms. (Hoff et al. 1993). The term „organization“ includes civil agencies (i.e. political parties, parliament, administrative bodies), legal personalities in business (i.e. enterprises, labor unions, cooperatives, agricultural family farms) as well as institutes of health and education (i.e. schools, universities, vocational centers, hospitals). With respect to this differentiation, the focus of this review is on institutions as the given rule-set and in as far as organizations are addressed, the focus is on their role regarding their welfare increasing realization of the rule-set.

The creation of functioning institutions is therefore a two-step process. First, the rules for the interaction are stipulated in such a way that a maximum of social acceptance can be expected. In the second step, the rules must be operationalized efficiently by building or allocating the corresponding organizations. The sciences of public and business administration provide conducive approaches and instruments for the realization of congruent institution-organization frameworks. As previously discussed, the building and adaptation of an institution is a long, stepwise, complex, sensitive process that is difficult to predict. Also, it can have different properties in formal and informal sector. As a result of political or legal decisions, formal rules can be changed over night, e.g., limitations of a public monopoly for grain marketing in Niger during the SAP in the mid 80s. It is more difficult to act on informal rules as imposed by manners and customs, traditions and habits, i.e. passing rights for nomadic cattle raisers that are linked with a temporary limitation of the land use rights for farmers. This perseverance of institutions, often complained about, their aversion towards change, can also be interpreted positively as a necessary pre-condition for stability and survival and, thus, necessary for their societal acceptance. In Niger, the institutional land tenure stability was severely interrupted in 1975. It was a result of one of President Kountché's speeches in which he announced that the land belongs to the one who cultivates it. This announcement caused violent confrontations between the traditional land owners and their tenants, the latter just declared the new land lords. In situations, likely to cause disputes, such as is frequently the case when land tenure is concerned, institutional changes should be organized in a participatory way, i.e., with the active co-operation of all persons affected. Due to its experience in the 1970s, Niger tries to first test in pilot projects and then implement the new land law that was issued in 1995 by Parliament. The long terms prospective is to build a land registry office similar to the German model.

Altered institutional requirements, e.g., through the implementation of a SAP or the globalization of markets (i.e. patent-rights for genes) demand competence of the authorities engaging in institutional design. This expertise is crucial for the introduction of institutional innovations acceptable for society (Hartig 1989). Frequently, however, political and economic agents have to act based on incomplete information. They are expected to integrate this information into policy or economic models to increase market efficiency. The recent history of the Zimbabwean public administration right gives an eloquent example on how incomplete information can cause institutional inefficiencies. During the campaign of democratizing African nations, Zimbabwe's political leaders decided in 1982 to withdraw the lower jurisdiction and the land access control from the traditional, feudalistic oriented village chiefs. The lower jurisdiction and control was transferred to the newly created administrative committees. Often, this institutional change caused difficulties in the execution of development projects, particularly in cases where the collaboration between the new administrational committees and the traditional village chiefs was not achieved.

In the process of building and/or restructuring rural institutions due to a SAP, it is important to maintain, respectively to initiate access to these institutions for the traditional and new target groups of development aid (apart from securing social acceptance). In many cases this necessitates a stronger collaboration between formal and informal institutions and their organizations (Zeller et all 1997). In this context, many NGOs offer valuable intermediation services. The standard example of inter-institutional cooperation, often facilitated by NGOs, is observed in the financial system of developing countries that comprises a formal and informal financial sector (see Figure 2.).

Figure 2 Financial System Outline



Source Schrieder (1996)

This type of financial system innovation (Schrieder and Heidhues 1995) permits the formal financial sector to shift transaction costs that arise from incomplete information and contracts, i.e. borrower selection, loan repayment incentives, and repayment monitoring to the informal financial sector. At the same time, this inter-institutional cooperation of the formal and informal financial sectors can reduce market access constraints of the target group (Heidhues, Sossoh and Schrieder 1997). In the case of the poor rural population that lack conventional credit collateral, a socially accepted and competent institution, the informal financial sector, is capable of playing the intermediary role to the formal domestic financial market.

In Asia, South America and Africa the drastically increasing urbanization, combined with a higher consumption level of modern goods, necessitates the building of formal and informal rules regarding the supply of energy and water, waste management and recycling (Hasenritter 1995). In particular waste management presents a challenge. In order to limit the uncontrolled, hazardous waste dumps in the densely populated valley of Kathmandu in Nepal, the GTZ tried to initiate a learning process among the population regarding city-cleanliness. An important instrument were awareness campaigns with respect to the health risks of uncontrolled waste. At the same time, waste management rules were worked out in a participatory process. These waste management rules ought not to destroy the existing system but to complement it. In the case of Nepal this meant that the function of the street sweepers and second-hand dealers was maintained. The collection of the waste in the roads through the street sweepers was, however, extended by introducing waste removal, recycling and final waste storage facilities.

3.4 Sustainable institution building increases welfare

Politicians, practitioners and scientists are more or less unanimous in their view that a short-term and narrow sighted structural adjustment or transformation process does not suffice to put an economy on a sustainable and poverty reducing development path. Sustainable and poverty oriented economic development is based on continuos investment in human capital, infrastructure, institutions and an effective framework for maintaining civil order (World Bank 1994). Also, it could be empirically documented that the successful economic development is closely linked to a higher agricultural productivity. Agricultural productivity, however, is positively correlated with the institutional environment (Heidhues 1990; North 19990).

Nevertheless, there exist no generally valid recipes for quick and welfare increasing institution building. This shows the brief discussion of the neoclassical and institution economic theories above. One should always keep in mind that institutions depend on the humans that make use of them and in this respect a saying of Popper (1987) applies, namely it is impossible to create foolproof institutions, therefore, they have to be architectured intelligently.

As soon as the basic institutional pre-requisites in the public and private sector of rural economies are built, new public and business organizations (local political bodies, family farms, trade- and transportation enterprises) follow and existing ones become more efficient. Their economic maximization activity causes anew an productivity increase and thus contributes to economic growth. These productivity increasing effects of an institution may, of course, also induce negative external effects like any form of change. One example for this are environmental costs resulting from the transition of farm rotation to permanent crop cultivation when soil fertility treatment is neglected. Another example is the possible deterioration of food security if public extension offices foster primarily the cultivation of export-tax creating cash crops and neglect food crop production.

In summary, the investment in sustainable institutions and the corresponding organizations benefits domestic welfare most if

- social acceptance is reached by allowing for a maximum possible participation of the target group and by taking into account informal rules and traditions;
- access constraints for weaker market participants are reduced (e.g., through cooperation with or adoption of informal institutions);
- information asymmetries and incomplete foresight of the market participants is reduced (e.g., through radio broadcasted market information);
- risk is diminished by means of producing more complete contracts (e.g., through the introduction of joint liability in group lending instead of physical collateral in individual lending) and if
- domestic welfare can be increased through a reduction of the transaction costs in the production and exchange process.

Finally, it ought to be pointed out that the willingness of the people that operationalize the rules in organizations to apply them appropriately is a necessary condition for more efficient institutions. Thus, it is necessary, apart from building an acceptable institutional framework, to foster the ethical behavior of the market participants. The dedicated execution of ones duties in the public and private sector has to become self-evident. This is of particular importance to reduce insecurity institutionally in reality. As long as clients (and not the organizations) have to offer work incentives to the agents, weaker market participants will continue to face a large degree of insecurity.

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