IV Regional Dimensions of Structural Adjustment in Southern Africa

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I Introduction

This paper attempts to draw out some of the important, yet imperfectly understood, interrelationships between second-generation regional integration arrangements (RIAs) and structural adjustment programmes (SAPs) which are being attempted simultaneously in Southern Africa (SAR).[1] In theory, these twin pursuits are neither contradictory nor mutually exclusive. In practice, however, they sometimes appear to conflict. As the whole of Africa provides too wide a canvas for a monograph such as this, its focus has been deliberately limited to integration and adjustment in one particular African sub-region which may have lessons for others.

Profound economic and political changes have occurred in SAR between 1990-94 suggesting the prospect of further transformations occurring in coming years which will influence integration and adjustment attempts in this region. Interestingly, in SAR and throughout Africa, RIAs and SAPs are being promoted simultaneously by the multilateral agencies and bilateral donor governments. The specific lending and technical assistance programmes of the International Monetary Fund (IMF) and the World Bank Group (WBG) point to the deep involvement of these agencies with both integration and adjustment in Africa. That is also true, if to a lesser extent, of the African Development Bank (AfDB). Judged by its efforts, the AfDB has, arguably, contributed more to the cause of integration in Africa than it has to original thinking about how African countries might adjust more successfully. The IMF/WBG, on the other hand, have been more obsessed with adjustment and have not focused enough on integration, often emitting ambiguous signals about whether they favour integration in Africa or not (Haarlov, 1995; Mistry, 1995c).

1 Throughout this paper, Southern Africa or the Southern African sub-region (SAR), is defined as comprising the 12 countries of the Southern African Development Community (SADC) in January 1996: Angola, Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

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Various United Nations agencies – including in particular UNCTAD, UNICEF, UNDP and the Economic Commission for Africa – have contributed to promoting the cause of integration in Africa while engaging more in critical commentary on adjustment. In the 1980s, the Economic Commission for Africa (ECA) advanced its own alternative notions of how adjustment programmes might be more appropriately designed for Africa (ECA, 1988), but unfortunately that initiative did not go very far because of opposition from the Bretton Woods twins in general and WBG in particular (World Bank, 1989).

Finally, the secretariats of the various regional integration arrangements (e.g. of the Southern African Development Community – SADC) which exist throughout Africa have also been caught up in concerns about the impact that SAPs are having on either advancing or compromising their particular RIAs.

It is astonishing, however, that while SAPs have become a feature in Africa since 1985, and RIAs have been pursued with renewed vigour especially over the last five years, there has been no serious, systematic attempt by any agency or donor to operationalise effectively ways in which integration and adjustment might be interwoven and made mutually reinforcing. The World Bank's landmark report in 1989, Sub-Saharan Africa: From Crisis to Sustainable Growth, placed considerable emphasis on regional integration as a means for overcoming the deficiencies of fragmented and small national markets which were economically unviable. Yet IMF/WBG adjustment programmes in Africa have contained little to translate those worthy thoughts into operational reality. The Cross-Border Initiative (CBI) for Eastern and Southern Africa supported jointly by WBG, the European Union (EU) and the AfDB provides an umbrella under which different experiments are being tried to induce greater regional interaction in trade and investment. But the linkage between CBI initiatives and adjustment efforts is not particularly clear.

To the author's knowledge at least, no attempt has yet been made to link SAPs with RIAs within either an intellectual framework, or an operational paradigm which is holistic, coherent and consistent. There have, of course, been frequent acknowledgements of an almost axiomatic nature that RIAs and SAPs affect one another. Obviously they must. And, indeed, a regional adjustment programme was attempted in the case of the Customs and Economic Union of Central Africa *(Union Douanière et Economique de l'Afrique Centrale* - UDEAC). But, other than that, the connections made between integration and adjustment have, by and large, demonstrated a lack of rigorous analysis.

The regional adjustment programme for UDEAC has not yet been repeated in other regions for understandable reasons despite calls to do so

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(World Bank, 1989; AfDB, 1993; Robson, 1993).[2] After all there is no example of a sub-regional arrangement in Africa which has an institutional structure that permits negotiating and enforcing adjustment policies on a regional basis. For this, and other reasons, RIAs and SAPs have invariably been pursued throughout Africa as two separate processes despite the fact that both involve drastic changes in economic policies. The artificial separation of RIAs and SAPs in this fashion may have harmed the cause and content of both, especially in Africa and SAR.

Of course, since (newer) RIAs and (improving) SAPs are both based on confluent market-friendly principles, it can be argued that SAPs will have a benign effect on RIAs. The converse possibility, i.e. that RIAs might be useful in fostering effective adjustment, however, is generally regarded with suspicion. This is on the grounds that RIAs, given the preferences implied to regional partners over non-regional ones, may actually dilute and compromise the strength of SAP medicine which, after all, is aimed at making African economies more competitive in the international (and not just regional) marketplace. Empirical evidence suggests, however, that such loose thinking based on first principles is contradicted by reality.

This paper attempts to examine the *regional* implications of structural adjustment being pursued at the *national* level across Southern Africa. The paper does not attempt primary research involving quantitative correlational or causal analysis to develop a framework of the kind that is necessary to understand fully the linkages between integration and adjustment in SAR. Instead, it focuses on developing an impressionistic understanding of how SAPs might impinge on RIAs (and vice-versa) through an analysis of existing literature coupled with reasoning based on the author's own empirical observations.

SAPs in Southern Africa

Over the last decade, most SADC countries have been subject to the intense economic and social pressures usually associated with macroeconomic stabilisation and structural adjustment programmes promulgated by the IMF and WBG. Some of these (e.g. Lesotho, Malawi, Mozambique,

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2 This despite a call from the World Bank at the January/February 1990 SADCC Consultative Conference held in Lusaka where the Bank's representative called for "... the promotion of regionally coordinated and rationalised macroeconomic policies and programmes." (Haarlov, 1995). A similar call was made by the World Bank in its classic 1989 study of Africa entitled *From Crisis to Sustainable Growth*, in which the Bank observed that "Donors can facilitate such initiatives by funding regional structural adjustment programs, which would support measures and help meet compensation costs aimed at both promoting market integration and strengthening selected regional institutions."

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Tanzania, Zambia and Zimbabwe) have had one or more IMF/WBG financed SAPs implemented over that time frame with their adjustment efforts being far from successful or over. Overall they still have a long way to go. Others (Botswana, Mauritius) have undertaken SAPs either on their own initiative or with the support of IMF/WBG. Both these countries have achieved structural transformations and output growth of a kind which have placed them in a sound position to confront the future. They still face major obstacles in terms of economic and export diversification which they must surmount. But the quality of their economic management, proven over a long period of time, is such as to engender a degree of cautious optimism about their future prospects. It is often said that both of these countries have certain unique characteristics which make it hard to replicate their success in other SAR countries, but such a statement needs to be carefully scrutinised before its validity is confirmed.

Still others (Namibia, South Africa and Swaziland) have made their own attempts at adjustment and reform within the framework of formal trade (SACU) and monetary (MMA) arrangements among these countries.[3] Under these, the major macroeconomic policy parameters are established and enforced by South Africa through its hold over customs revenue collections and distributions, its administration of joint reserve holdings and the pervasive presence of South African institutions and corporations in the economies of these countries. South Africa is now attempting (without immediate IMF/WBG tutelage) its own structural reforms in order to become more internationally competitive, diversify its production and export base, generate more employment for indigenous labour, and achieve higher levels of growth (5-7% per year) than it enjoyed under *apartheid* for the last 15 years (barely 1% per year). As it does so, some stresses and strains are bound to arise which will affect its neighbours both immediate (the BLNS countries) and more distant (the non-SACU members of SADC).

Finally, oil-rich Angola, is just emerging from the throes of a long and debilitating internal conflict which has crippled its economy. Doubtless, it will shortly be subject to the adjustment discipline and ministrations of the international financial institutions (IFIs) if it is to receive the external largesse it needs to revive its agricultural, non-oil mining and manufacturing

3 These arrangements include: (1) the Southern African Customs Union (SACU) comprising South Africa and the smaller countries of Botswana, Lesotho, Namibia and Swaziland, collectively referred to in SACU literature as BLNS or BLSN; and (2) the Multilateral Monetary Area Agreement (MMA) which comprises all the SACU countries except Botswana which specifically opted out of this arrangement in order to run its own monetary affairs independently especially as its reserves are larger than those of South Africa.

sectors. Angola must now make the transition from a quasi-command economy which has eluded effective official governance for some time (and is dominated by an uncontrolled parallel market) to a market regime with normal characteristics. For a country that has not been acquainted with normalcy of any kind for a very long time, that is a daunting task even under the most favourable of conditions.

RIAs in Southern Africa

Even as they have pursued adjustment programmes at different degrees of intensity and levels of foreign agency involvement, the independent countries of Southern Africa have also been engaged in various efforts towards regional economic integration since 1980. After unimpressive beginnings, these efforts have been pursued with renewed vigour in the 1990s. Indeed, SAR has had a century-long history of plurilateral cooperation with RIAs of various kinds; ranging from preferential and free trade areas to customs unions, joint infrastructural development initiatives, and common monetary arrangements which have bound together different countries of the region in both colonial and post-independence periods (Haarlov, 1995; AfDB, 1993). Current RIAs in SAR include plurilateral arrangements involving the now-competing frameworks of SADC and the Common Market for Eastern and Southern Africa (COMESA), and the smaller but more closely integrated SACU arrangement coupled with its sister MMAA. The most recent member of SADC, Mauritius, is also a member of the smaller Indian Ocean Commission (IOC), a RIA among the independent island states off the eastern shores of Africa. These arrangements are supplemented by a pastiche of bilateral agreements (negotiated mainly by South Africa with its neighbours).

It is important to note that whereas RIAs (both old and new) generally focus on *trade* as the centrepiece, in SAR one RIA in particular – i.e. SADCC (which preceded SADC) – was designed as a functionally (sector) oriented integration mechanism built to foster *other* economic interrelationships without emphasising trade per se.[4] Paradoxically, the two RIAs in SAR which were *trade-focused*, i.e. SACU and the erstwhile PTA, are now both taking a back-seat to the emergence of SADC as the primary Southern African RIA. However, as SADC evolves it is likely that, with South Africa as the pivotal member economy, trade issues will feature more prominently in SADC than they have before. Nonetheless, it would be reasonable to expect that SADC's agenda will continue to be driven for some time yet by the sectoral investment coordination and harmonisation approach which has become its hallmark.

A second noteworthy aspect of RIAs in SAR is that they have either

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centred around the regional hegemon, South Africa, (in the case of SACU and now even SADC), or aimed at reducing dependence on it (as was the case with the former SADCC and PTA). Where lessened dependence was the aim, the opposite was achieved largely because political resolve could not overcome geoeconomic and topographical reality. SADC economies are now arguably more, not less, dependent on South Africa than they were before. As the future unfolds, SADC's success will be gauged by whether it provides a framework within which the economies of SAR become genuinely interdependent under the new *realpolitik* of the sub-region. If SADC repeats the SACU experience in entrenching South Africa's regional hegemony and cementing the role of thc other Southern African economies as its dependent satellites, it will have failed and its future will be uncertain.

Third, it should be appreciated that apart from SACU, SADC and COMESA, other types of more limited regional cooperation arrangements in SAR also exist along sector-specific lines such as, for example, agricultural research (e.g. the Southern African Centre for Cooperation on Agricultural Research – SACCAR) and land use (the Southern African Centre Regional Commission for the Conservation and Utilisation of Soil – SARCCUS), unrelated as yet to the broader plurilateral RIAs (AfDB, 1993). Similarly, informal cooperation arrangements exist among transport corporations, telecommunications and power companies, as well as specific regional water basin management arrangements (which are mainly in the public sector in SAR). Many of these are covered by the SADC sectoral umbrellas although some are not.

Between 1985-93, the predecessors of SADC and COMESA complemented one another quite well even though both competed with (but were much looser than) the SACU/MMA arrangements. SADCC (Southern African Development Coordinating Conference) was set up initially to

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4 One early (1983) unpublished internal SADCC document entitled *Toward Regional Trade Development* went so far as to observe that, "To assume that expanding trade is the purpose of economic coooperation is one of the two basic errors of the standard free trade area approach to economic integration. States are less concerned with trade as such than with material production, employment and economic security. The second error is to argue for an unregulated, free-market approach to regional trade when, in fact, all the participating governments practice economic interventionism (even if to varying degrees) nationally. (...) Further, regionally as well as nationally, free markets (as opposed to managed markets) are inconsistent with ensuring an acceptable division of gains and costs among members." This quote illustrates how far Africa has had to come in its thinking over the last decade and explains why, with the ethos embedded in regional thinking of old, there was a fundamental conflict between the market principles of structural adjustment and those of interventionist regionalism. In the new regionalism the philosophical chasm between the two has been bridged although not entirely.

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concentrate on project and sectoral investment coordination. On the other hand, the Preferential Trade Area of Eastern and Southern Africa (PTA) which preceded COMESA – with more members than SADCC because of its wider geographical remit – concentrated largely on trade (tariff-reduction) and monetary (clearing-house) issues. Both were aimed at integrating African countries *excluding* South Africa, with the explicit objective of reducing their dependence on the apartheid regime. Indeed, many members of SADCC and PTA were *front-line* states unified in their militant opposition to apartheid. For that reason, they became targets of the old South Africa's efforts to destabilise them, overtly and covertly, through political, military and economic confrontation and subversion.

With the end of open conflict in the region in 1993, and the birth of a new South Africa in 1994 of the kind that most countries in the region had fought and sacrificed for, complementarity between SADC and COMESA has turned to competition, despite studied attempts on the part of their respective memberships to avoid it. Competition became unavoidable when the overlapping memberships of SADCC and PTA voted simultaneously to have both organisations aim at the ambitious, and perhaps unrealistic, objective of achieving full economic union among their members within the next 25-30 years.

Thus were SADC and COMESA revamped in 1993-94, with both organisations engaging in counterproductive rivalry to attract South Africa into their respective memberships. In the event, SADC – in whose predecessor organisation, the African National Congress (ANC) of South Africa had observer status – succeeded whereas COMESA did not. That difference is significant and may have a profound effect on the future prospects of each organisation and, hopefully, on the long overdue rationalisation of multiple overlapping RIAs in SAR (see Table 1). If South Africa so chooses, SADC may evolve at a faster pace while COMESA struggles to cope with the exigencies created by its unwieldy, fractious membership. Many of COMESA's members (Zaïre, Rwanda, Burundi, Sudan, Somalia, Ethiopia and Eritrea) are in domestic disarray. They can barely manage their national polities and economies, let alone engage meaningfully in, or keep any of their commitments or treaty obligations to, formal RIAs.

There is also the prospect of the former East African Community, comprising Kenya, Tanzania and Uganda, reconstituting itself and developing its own nexus with SADC. Though perhaps difficult for its Secretariat to accept, South Africa's absence from COMESA's membership deprives that organisation of the regional credibility it needs. Moreover, COMESA must now cope with not just the competing presence of SADC but also that of SACU-MMA in an entirely new political and economic environment. And it does so at a considerable disadvantage.

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After South Africa joined SADC in 1994, SACU-MMA represents a much tighter trade and monetary union, whose members constitute a fused *inner-core* of SADC while the non-SACU members are at the periphery.

The issues raised, and confusion caused, by this plethora of overlapping RIAs in Southern Africa has been well explored in the literature (AfDB, 1993) and need not be taken up again in this paper. They must however be resolved among the member states themselves (and by the donors who support these different arrangements) to ensure that competition across these frameworks does not become fissiparous and counterproductive.

Table 1 Membership of Different RIAs in Southern Africa

MMA	SACU	SADC	COMESA	IOC
Lesotho	Botswana	Angola	Angola	Comoros
Namibia	Lesotho	Botswana	Burundi	Madagascar
Swaziland	Namibia	Lesotho	Comoros	Mauritius
South Africa	Swaziland	Malawi	Djibouti	Seychelles
	South Africa	Mauritius	Eritrea	
		Mozambique	Ethiopia	
		Namibia	Kenya	
		Swaziland	Lesotho	
		South Africa	Madagascar	
		Tanzania	Malawi	
		Zambia	Mauritius	
		Zimbabwe	Mozambique	
			Rwanda	
			Somalia	
			Sudan	
			Swaziland	
			Tanzania	
			Uganda	
			Zaire	
			Zambia	
			Zimbabwe	

Neighbourhood Effects on Growth

This introduction, already too long, would be incomplete without mention of a recent analysis (Easterly and Levine, 1995) which underlines the

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raison d'être of this paper. Based on cross-country regressions (growth over a long period tested against several variables) they suggest that, in Africa, geography may strongly influence the outcome of policies aimed at inducing growth.[5] The authors conclude that,

> 'The relationship between particular policy indicators in one country and growth in its neighbours' economies suggests that there may be growth spillovers with strategic policy implications. While requiring much additional work to establish causal relationships, ... the results are consistent with the view that improving policies alone boosts growth substantially, but if neighbouring countries act together, the growth effects are much larger. Specifically, the coefficients suggest that a policy change by a set of neighbours will have an effect on growth ... 2.2 times larger than if a single country had acted alone.
>
> Each country's neighbours' growth rate has a surprisingly large and statistically significant effect on each country's own growth: one percentage point more growth by the neighbours in a given decade translates into higher own growth of 0.55 percentage points. ... a large policy change in unison would have a multiplier effect on the countries in the region that is even larger than the strong direct effect of a country's policies on its own growth rate. ... a set of neighbours adopting a set of policy changes that would have raised growth by 1.04% if they had each acted alone, will see growth increase by 2.2% if they acted together. This also works in the other direction: with a set of neighbours all simultaneously adopting bad policies like exchange controls leading to a high black market premium, the negative effect on all of them would be magnified.'

Cross-country regressions are, of course, subject to several shortcomings which require considerable caution to be exercised in drawing firm conclusions. Such regressions do not establish causality between growth and the

5 This seemingly self-evident proposition has many instinctively obvious parallels. Just as development failure is concentrated geographically in Africa, development success has been concentrated in East Asia, the debt contagion was largely synchronic in Latin America, and the transition crisis is concentrated in the former Soviet Empire. But these observations obscure more than they reveal. Correlations alone, even when they support instinct, are not enough to go on. A deeper understanding of why a good or bad neighbourood is as important for the economic performance of countries, as it is for ethnic groups, communities, families and individuals, is clearly essential to take us further. In Africa, where there are development successes (like Botswana and Mauritius), as in Asia where there are failures, even the exceptions seem to prove the rule. For now, proper understanding of causality in determining the effect of a neighbourhood remains superficial and elusive.

variables that are tested. The definition and quantification of the variables themselves (in this case the neighbours' average growth rate weighted by their economic size in terms of GDP) imposes certain problems and difficulties. Coefficients in such regressions cannot be interpreted as elasticities.

For these reasons, Easterly and Levine are cautious about speculating on how what they call the *neighbour spillover effect* actually operates in Africa. Having tested for it, they rule out cross-border trade with neighbours as having a significant effect in Africa. Even taking into account parallel market trade, the numbers usually quoted show that Africa's *intra-regional* trade is minuscule compared to its *international* trade (in SADC and PTA it was less than 5% of total trade of members).

But this observation may conceal more than it reveals. The numbers used in the past for trade within Africa did not include trade involving South Africa. This was because under a *sanctions regime* it was embarrassing for African countries to acknowledge openly that they were trading with South Africa; in fact, most denied vehemently that any such trade was taking place. Such trade was therefore, of necessity, clandestine even when governments were indulging in it. South Africa kept reasonably accurate records of such trade but refused to disclose these until 1993 (AfDB, 1993). In 1990, South Africa's total trade with other SAR countries (including SACU members) was recorded at about $5 billion (Maasdorp, 1992b). In 1994 that amount was estimated to have increased to about $7 billion.

But there was also a considerable amount of parallel or black market trade between South Africa and the rest of Africa usually estimated at between 50-100% of the recorded amounts. Excluding intra-SACU trade, which is recorded, within the rest of SAR (i.e. between SACU and other SADC members and among other SADC members themselves) such parallel market trade was estimated in 1990 as being as large as, if not larger than, the amount of recorded, if clandestine, trade. In 1994, that proportion is estimated to have been reduced substantially with greater economic openness throughout the region. Nevertheless, outside of SACU, it is still estimated at between 40-60% of recorded trade in SAR largely because parallel market trade still successfully evades taxes in countries of origin, transit and destination.

In SAR it is difficult to imagine trade (including parallel market trade) with South Africa *not* being important to its SACU and SADC neighbours. And perhaps even the reverse may be true even though the aggregate numbers may obscure that reality. Taking its total trade into account (but excluding its gold exports) even South Africa is quite dependent on its neighbours for some of its exports but much less dependent on them for its imports (see annex Tables 4-5). If trade in manufactures is looked at closely, South Africa's access to SACU markets certainly keeps a large part of its

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relatively inefficient (by world standards though competitive by regional standards) domestic manufacturing industry going (AfDB, 1993; Haarlov, 1995; Riddell, 1990).

In that sense South Africa's visible budgetary costs of compensatory flows to the smaller SACU members amount to an invisible tied-export subsidy to its own private manufacturing enterprises (AfDB, 1993) achieved by propping up public demand in the smaller SACU economies. It is debatable (more research is needed on this) whether that subsidy offsets fully the economic opportunity costs incurred by the smaller members of SACU in providing such protection for South African manufacturers at the expense of developing their own industrial capacity or availing of other global options.

One of the intriguing speculations triggered by the Easterly and Levine analysis is whether one particular pernicious neighbourhood spillover effect might be connected with the common types of rent-seeking behaviour (e.g. corruption) on the part of governments and the private sector which are clearly observable in Africa at large. Although this was not a specifically tested correlation, instinct and anecdote lend strong evidence that the connection might be quite strong.

As the authors suggest, more research is needed on growth interactions among countries to understand better the dynamics of the development process in Africa and how RIAs might influence SAPs (and vice-versa). What the analysis makes clear is that nationally-focused SAPs in Africa might perhaps have had more successful outcomes if they had been: (i) designed to take account of repercussions in neighbouring countries; and (ii) attempted to achieve harmonised policy changes on a coordinated, regional basis rather than on an isolated, national basis.

Taking that argument a step further, the paper in its succeeding sections turns to: exploring why regional integration may be important for structural adjustment to be successful in Southern Africa (Section 2), outlining briefly the key features of SAPs (Section 3) in major areas of policy reform, and discussing the regional dimensions and implications of each in the SADC context (Section 4) before concluding (Section 5).

II Links between Regional Integration and Structural Adjustment

Why might RIAs be important for SAPs to show a much higher degree of success in Southern Africa than they have shown thus far? From an economic perspective, in SAR (as in other parts of Africa) national boundaries, which were colonially imposed, are confining artifices which make little economic sense. That alone is an important reason for looking to subregions rather than nation-states in Africa as more appropriate objects for adjustment.

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Why might RIAs be important to effective adjustment? *First*, because the success of SAPs depends heavily on how well markets are made to work and how the supply side of the economy responds to overdue changes in the relative big prices. In Africa, after more than a decade of adjustment, markets have not yet begun to function as efficiently as might be expected from experience in other continents. Most observers, including the IMF/WBG, generally acknowledge that, because markets in Africa are not functioning in the way they should, the supply-side response of African economies to adjustment has been disappointingly sticky.

In Southern Africa, RIAs offer the opportunity for market functioning to be enhanced significantly in markets for goods and services, as well as in factor markets (capital, labour), through: (i) enlargement and resultant economies of scale; (ii) improved factor mobility; (iii) regional sharing of technology and of highly skilled human capital; and (iv) sharing of market-supporting regulatory capacity and institutional systems and structures.[6] There is little disagreement with the view that, in SAR, *regional* markets might offer better prospects for reducing market imperfections than *national* ones; particularly so in the smaller economies of the region (i.e. Botswana, Lesotho, Malawi, Mauritius, Namibia, and Swaziland) but also in the larger, less developed ones (Angola, Mozambique, Tanzania and Zambia). That argument may be even stronger now that South Africa is legitimately accepted as an integral part of the region than when it was not. Unfortunately, the era of apartheid and sanctions compelled regional actors to oppose *politically* a phenomenon that was inescapable *economically*.

This reasoning suggests that, under the right conditions, regional market development could be a potentially vital mezzanine step in the African adjustment proces-perhaps even the *missing link* in understanding the supply side weakness of African economies especially insofar as manufacturing industry is concerned (Riddell, 1990, AfDB, 1993; Haarlov, 1995). In many of the countries of SAR, structural adjustment carried to its logical limit would be beyond the capacity of local industry to cope with. Few local firms have the internal wherewithal (in terms of management

6 The argument was best expressed at the February 1988 SADCC Conference of Businessmen on Opportunities for Investment and Trade held in Harare, where the World Bank's representative observed, "The World Bank is coming around to the view that Africa's economic future may lie in economic integration. Why? The continent is simply too subdivided with 165 borders, 51 countries, 22 of them with a population of under 5 million and 11 with a population of under 1 million. There are too many trade barriers, too much competition for the same scarce resources, human, institutional and financial; and, from a business standpoint, markets that are simply too small to sustain industry and investment. "Since then, of course, the numbers of countries and borders have only increased. (Extracted from The Conference Proceedings published by the SADCC Secretariat; Haarlov, 1995).

capacity, information, technology, capital, quality, labour skills or extended market access) to adapt and adjust to the price/cost and import availability realignments that high-pressure adjustment, in a compressed time-frame, usually results in.

When traditional trade regimes are suddenly reversed with a lowering of protection they can, if firms are insufficiently robust and resilient, result in closure of most units designed to produce for fragmented national markets (i.e. de-industrialisation) with immediate consequences for large-scale lay-offs, unemployment and a dissipation of the internal tax revenue base. At the same time newer, more competitive industries whose emergence adjustment is supposed to encourage are not appearing at the rate needed to absorb the high social and political costs of adjustment-induced dislocations. Under the consequent threat of de-industrialisation, the vested interests of industrialists and investors (including foreign investors who invested with explicit assurances of protection), providers of supporting infrastructure and services, labour, politicians and the state bureaucracy, usually coalesce into slowing down or thwarting the adjustments that need to occur.

In Latin America and Asia, *national* firms in most industries have adjusted quickly to required changes in trade and exchange regimes. Some have gone out of business, but with manageable repercussions. In Africa, apart from a few exceptional cases, they have not adjusted and governments (which own most of them) are reluctant to let them go out of business. When most national markets in a region (as is the case in SAR and other African sub-regions) cannot support such units, and they are incapable of adjusting sufficiently rapidly to compete effectively in world markets, the adoption of a *regional* market approach to liberalisation through appropriate RIAs, can provide a useful temporary alternative. Regional markets can provide the needed environment in the medium-term over which local industries can be restructured, rationalised and merged with fewer overall costs and better long-run prospects of achieving international competitiveness. A regional approach can buy time for local firms to improve efficiency and quality, raise productivity, increase capacity utilisation, upgrade technology and improve international export performance through experience gained in regional markets.

In providing an opportunity for learning effects to occur without destroying viability, the regional market option can be constructively deployed in a manner congruent with adjustment and liberalisation through the adoption of common external tariffs (CETs) which are lower than prevailing national tariff regimes but higher than tariffs applicable to non-regional sources of products. But the *buying time for learning* approach can only work well, if it places time-bound limits on regional firms to

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achieve international competitiveness. Otherwise, like most import-substituting industrialisation experience, the regional approach risks becoming an entrenched soft-option for firms to operate for too long behind protective walls even if these are lower than they were under former national regimes (Mistry, 1995).

Second, in the capital-short economies of SAR, whose geography and topography makes them particularly inter-dependent on regional river systems and regional ecology (Mauritius being the isolated, independent exception), fiscal pressures as well as crowding-out pressures on private investment can be substantially ameliorated by employing regional approaches to infrastructure investment and service provision. The projected capital requirements for infrastructure investment in SAR are well beyond the capacity of governments to provide through the fiscus and yet retain a viable macroeconomic stance. Apart from substantial savings in capital costs, a regional approach to infrastructural investment in SAR is likely to produce savings through more cost-efficiently delivered services on an on-going basis, especially where electricity, water supply, telecommunications, transport (surface and air) and tourism services are concerned (Maasdorp, 1989; Blumenfeld, 1991; Kimaro, 1992; AfDB, 1993).

In all of these areas, large cost and price subsidies (to producers and/or consumers) distort the true costs of infrastructure and utility service provision throughout the region. Electricity and water in particular are grossly underpriced with subsidies on these goods (especially in South Africa) being directed more to relatively rich commercial farmers and large industries rather than to the poorer segments of the population. Indeed, because the tariffs charged to better-off consumers do not allow for sufficient cost recovery these services are rarely accessible to the poorest segments of the population in either urban or rural areas. Apart from being misdirected, ,such subsidies – which were rooted in a climate of apartheid, self-reliance and sanctions – impose large unaffordable burdens on the fiscus in every SAR country.

The progressive withdrawal of such subsidies (a key feature of SAPs) at a socially and politically acceptable rate, is likely to be more tractable if regional rather than national approaches are taken to infrastructure investment and service provision. Resultant cost savings in investment capital, and from cheaper sources of production, could be passed on to regional consumers without tariffs having to be raised to unaffordable levels. The supply response on which the success of SAPs so heavily depends is unlikely to be forthcoming unless adequate infrastructural support and services are provided to productive entities at affordable costs. Because the private sector, and the Southern African production structure, are heavily depen-

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dent on the provision of such services at prices which enable them to remain competitive and viable, a regional approach may provide the most cost-effective option for future infrastructural investment.

Third, the success of SAPs also depends on how quickly distortions and false price-signalling in major *factor* markets (especially for capital and labour) can be removed and these markets be made to work more efficiently. In SAR that is more likely to happen if factor price distortions are tackled on a regional rather than national basis. In some instances, e.g. in South Africa, it may actually prove easier to achieve *labour* market and wage adjustments through a regional rather than national approach in which localised social and political pressures would derail or delay the needed reforms (AfDB, 1993; Lachman and Bercuson, 1992).[7] The free movement of labour is of course a complex and contentious issue in RIAs, especially when the disparities in levels of development and income among the members of a regional arrangement are as wide as they are in SAR (Haarlov, 1995). Nonetheless, freeing intra-regional labour and capital markets to allow for unimpeded flows of capital and labour across the region can help to ameliorate national pressures and provide a more tractable approach for the South African government to adopt. Freeing intra-regional *capital* flows alone would have a moderating effect on domestic wage pressures by providing capital-rich SAR firms with the option of shifting production to areas where factor costs would induce greater cost-efficiency and favour greater competitiveness. Moreover, freeing capital flows within the regional market may have the beneficial effect of diverting outward capital flows (whether induced by flight or diversification motives) from extra-regional directions to intra-regional targets.

Fourth, the combined effect of (i) removing subsidies on electricity and water and (ii) opening up regional markets in *land*, along with free flows of labour and capital, could bring about a geographical and structural shift of agricultural and manufacturing production in SAR. Such a shift would favour more cost-efficient, agro-climatically favourable areas for grain production on a commercial scale and encourage the dispersion (through

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7 To illustrate, it is widely recognised that a major barrier which South African firms (and, by spillover, firms in neighbouring SACU economies) face in becoming more cost-efficient and competitive in the industrial sector, is the relatively high productivity-adjusted wage rate for labour employed formally. Any attempt to reduce that wage rate in real terms is likely to meet with powerful opposition from entrenched unions to whom a political debt is owed by the present ANC-led government. At the same time there is powerful pressure within South Africa to reverse its long-standing policies on migrant labour in the mining sector and to clamp down on illegal inward migration of labour, especially from the poorest countries in the region. Here the unions are caught in a bind since the mineworkers union has a large number of migrant members.

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market forces) of manufacturing investment to areas where cheaper labour and large cachement areas exist providing that the public sector focused on filling the gaps in infrastructure and supporting services which presently impede such dispersion (AfDB, 1993). A regional approach thus offers the potential – in theory at least – of achieving more in terms of *investment productivity* (i.e. improved incremental capital-output ratios), output growth, and efficiency effects for each country in SAR than nationally oriented SAPs could hope to achieve. In the latter case, while SAPs may remove policy distortions within confined geographical areas they can do little to remove the other significant impediments to increasing factor productivity, efficiency and output which exist in the individual countries of SAR.

Fifth, apart from South Africa, and to a lesser extent, Zimbabwe and Mauritius, no other country in SAR has the indigenous capacity to diversify its production and export base to the extent or as rapidly as is required for SAPs to show successful results by way of supply-side responses in the medium-term. SAR, and even South Africa, are far too dependent on unprocessed mineral and agricultural exports which, it has long been recognised, must account for a progressively diminishing proportion of their GDP and trade in the future. For that to happen, and for a reversal of the rapid increase in aid-dependency which SAPs have unfortunately caused in their wake, countries in SAR need to attract *foreign direct and portfolio investment* in much larger quantities, from more diverse sources (especially from Asia), than they have hitherto been able to do.

Regional markets in SAR present more viable investment opportunities for foreign direct investors than do fragmented national markets (especially ones with a recent history as debilitating and painful as that of many SAR countries). Such investment is likely to have a quicker, larger impact on diversifying SAR's manufacturing output and exports than if reliance were placed on indigenous investors alone (Riddell, 1993; Meier and Steel, 1989). To put it bluntly, foreign direct investment (FDI) in countries like Zambia, Angola, Malawi, Tanzania and Mozambique, and in the smaller SACU members, is likely to be materially larger, and probably of better quality, if coursed through Mauritius and South Africa (and to a lesser extent Botswana and Zimbabwe) as the region's investment centres and the region's prime locations for the regional headquarters of foreign companies.

Sixth, there may be a number of *political* reasons why RIAs might affects SAPs benignly in Africa and SAR. Citing Mansoor and Inotai (1991), Haarlov (1995) observes, with some scepticism about the market-focused adjustment process and about political intent vs. economic reality in Africa, that,

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'A regional approach may offer a new dimension to supplement the unilateral and uncoordinated national efforts of the sort currently being engaged in with World Bank and IMF support. Regional liberalisation may be more politically acceptable than unilateral concessions (because)

- governments can draw upon the positive connotations and sentiments of pan-Africanism and the OAU and ECA sponsored schemes of working towards a united Africa ... expressed in the Lagos Declaration (1980) and the Abuja Treaty (1991) aiming at African unification by 2025;
- in contrast to unilateral liberalisation, it implies trade-offs with neighbouring countries with a clear element of mutual concessions involved;
- internal vested interests (in individual African countries) which survive and profit (from rent-seeking behaviour in a controlled economy) would confront more difficulty in unwinding agreements with *regional* partners than they would in opposing unilateral reforms at the national level; by compelling competition among regional firms that are at comparable levels of inefficiency a regional adjustment process would reduce the costs of adjustment by encouraging mergers, acquisitions and takeovers to achieve competitiveness at an industry-level rather than forcing outright immediate closures of firms of the type that occurs when adjustment is focused at the national level'. (Haarlov, 1995; p. 42-43, paraphrased for brevity)

Seventh, a key aspect of SAPs in Africa goes well beyond the reform of trade and exchange policies and domestic demand management (the traditional realm of classical IMF stabilisation programmes). It involves structural change in production paradigms with an explicitly reduced role for the state in directly productive and infrastructural provision activities and a correspondingly enlarged role for the private sector. A key instrument under IMF/WBGs for achieving the desired restructuring is *privatisation.* Attempted at the national level, ambitious programmes of privatisation (e.g. in Zambia and Tanzania) are running into major problems caused by the absence of (i) properly functioning capital markets with any depth or width, (ii) an equity-ownership culture on the part of the general public (which has become so embedded in Asia), (iii) an effective capital market regulatory framework, (iv) a sufficiently large pool of private domestic financial savings to absorb the transfer of ownership within the national economy, (v) indigenous management capacity to restructure and run privatised enterprises profitably after their privatisation, (vi) interest on the part of acceptable foreign investors in these individual economies on a fragmented basis, and so on.

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There is also much social and political opposition to ownership of privatised enterprises being concentrated in the hands of a few wealthy indigenous business groups not known for their probity, or in the hands of indigenous, non-African resident communities, or of a few foreign multinationals well-established in Africa. All of these constraints which are hard and binding at the national level can be considerably eased if a regional approach were taken to the privatisation of state-owned enterprises (SOEs); relying on *regional pools* of technology, management, and savings and on *regional capital markets* in South Africa, Zimbabwe, Mauritius and Botswana for public flotations of privatised enterprises throughout SAR. These markets are relatively sophisticated and could serve as entry-points for willing foreign portfolio (institutional) investors in such enterprises from within the region and from outside.

The absence of speedy and successful privatisation in SAR may help to explain, in large part, the absence of the anticipated post-reform supply-side response which SAPs are supposed to bring about. It is clear, especially with South Africa as a member of SADC, that a regional approach to privatisation could have a much higher pay-off in accelerating the pace and improving the quality of SOE restructuring and privatisation programmes. Moreover, a regional approach to privatisation has the added attraction of providing privatisation-induced development and deepening of SADC capital markets by widening the number of listed securities on market exchanges and adding to trading depth.

The threat that opening up privatisation to regional investors would essentially result in a South African and Zimbabwean takeover of the regional economy can be countered with the construction of specific trust-fund arrangements (funded by debt-equity swaps) involving a syndicate of public international investors (like the IFC, CDC, OPIC, IFU, FMO, DEG and Swedfund) which hold privatisation shares in trust for local nationals gradually releasing them in local capital markets as such markets expand their absorptive capacity (Mistry and Griffith-Jones, 1992).

Eighth, the success of SAPs also depends on how rapidly countries undergoing adjustment can develop their own sources of free foreign exchange to ease balance of payments pressures without resorting to enhanced levels of already extraordinary concessional aid flows. As very few countries in SAR are creditworthy for borrowings on commercial terms, the only other options they have are to (i) diversify sources of export earnings from primary commodities, something which is not happening fast enough in the region; (ii) do more to attract foreign investment, both portfolio and direct, although most SAR countries remain unattractive to non-regional foreign investors except in mining and plantation agriculture for reasons already mentioned; and (iii) enter into regional payments and settlements arrangements which result in increased trade and output. The first two options have been explored earlier. Although the last of these options is being used in SAR (through the MMA and, in the non-SACU countries, the PTA clearing house) it has not yet been developed, outside of the SACU-MMA arrangements, to a degree which exploits fully the potential that the region has to offer its individual members in facilitating their adjustment.

Ninth, no attempt at structural adjustment in SAR can be successful without its member nations achieving basic *food security*. As events over the last three decades have proven, no nation in SAR other than South Africa can achieve food security easily over the near or medium-term, in a purely national context. The food security objective, however, becomes eminently achievable in a regional SAR-wide context providing the right macroeconomic, agricultural pricing, and infrastructure input pricing policies are pursued in harmony by all countries in the region. As the AfDB study points out (AfDB, 1993), such policies would also result in a major locational shift of agricultural production which would enhance regional and national welfare substantially. But the food-security argument on a regional basis applies even more forcefully to *energy security*, and much more critically, to *water security* which threatens, over the next 15 years, to become perhaps the most contentious and potentially explosive issue dividing neighbouring countries in the sub-region (AfDB, 1993).

These nine reasons for believing that appropriately structured RIAs can materially influence, if not positively enhance, the outcome of SAPs in SAR could be expanded much further. But there is little purpose in belabouring the point herein with a complete and exhaustive list, once the general thrust of the argument is clearly established in intellectually satisfactory terms. Assuming that to have been done in the foregoing pages, the next section (Section 3) moves on to outlining the features of structural adjustment programmes (especially in SAR) while Section 4 assesses their regional implications and dimensions in each case.

III Key Features of Structural Adjustment Programmes

The design, content and sequencing of structural (and supporting sectoral) adjustment programmes have been examined in a vast literature generated by the IMF, WBG and economic academia at large, which will not be revisited here. Suffice it to say that SAPs are partly *crisis-management* programmes which are aimed at restoring the liquidity and solvency of economies which have become unviable and partly *foundation restructuring* programmes creating conditions under which normal economic life can be resumed and development momentum can be maintained thereafter. For that reason SAPs are necessarily disruptive; but their dislocations need to be kept within social and political limits of tolerance for their effects to take hold.

In the absence of an economic crisis there is usually little need for a SAP though there may still be need for gradual and continual non-disruptive adjustment. Although no one would argue in favour of bad policies, wrong prices and non-functioning markets, the debate about virtually every aspect of SAPs continues to rage unabated. It is particularly intense about the effects and results of adjustment in Africa (Martin and Mistry, 1991, 1996; Patel, 1992; World Bank, 1992, 1994ab, 1995a; van der Geest, 1994; van der Hoeven and van der Kraaij, 1994; Mosley et al., 1995; Killick, 1995a). But in this debate there is little argument about what SAPs incorporate as core features and what they leave out.

Before going into these, it needs to be observed that there is no *theory of structural adjustment* as such. The IMF and WBG often issue edicts, postulate relationships, and make *ex cathedra* assertions, about specific reforms, instruments, targets and policies, which sometimes appear to suggest that there might be. The only theories underlying SAPs are those of markets, trade, money, price, public finance, and – regrettably, to a much lesser extent – rational expectations, public choice and new development theory stressing the importance of human capital. All of these theories, taken together, involve the practice of sound macroeconomics at the level of the economy and sound microeconomics at the level of the sector and firm. The design of SAPs is usually based therefore more on convention, empiricism, experience and – all too often – on crude heuristics combined in an IMF/WBG ten-point code of conduct which has come to be recognised as *the Washington consensus* (Williamson, 1990). It is relatively strong on the macroeconomics of adjustment but relatively weak on its *mesoeconomic* (sector level) and *microeconomic* concomitants.

Essentially, SAPs are designed to achieve two things: (i) get countries over the immediate crisis they face with the unsustainability of internal and external accounts through demand and debt management measures which usually involve major price and budgetary realignments, i.e. *macroeconomic stabilisation;* and (ii) create conditions for maintaining macroeconomic stability over the long term by *transforming* productive and institutional *structures* of the economies concerned by removing non-market distortions, improving price signalling and making economic agent behaviour responsive to price changes. In a theoretical sense the process of adjustment is never complete; healthy, stable economies adjust continuously to changing internal and external market conditions. But, SAPs imposed and monitored by external interlocutors, in particular the IMF and WBG, are supposed to

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have a definite time-bound limit by which time the crisis is supposedly relegated to history with macroeconomic stability being re-established, and sufficient headway having been made with transformation to leave further adjustment to governments and markets within the economy itself (Corbo and Fischer, 1992).

Stabilisation measures under SAPs are usually those which try to restore macroeconomic equilibrium by reducing the level and composition of demand to match the availability of financing (external and internal) and of output. The three principal means of doing so quickly are fiscal compression (for internal balance), devaluation of the exchange rate (for external balance), and tight monetary control connecting the two. *Structural reform* measures are usually aimed at creating markets (where there are none) and/or making them work as well as possible by removing distortions and creating the right types of incentives. These invariably involve liberalising trade and exchange regimes, reforming the financial system, deregulating markets for goods and services, removing artificial constraints operating on factor markets (land and capital), removing bureaucratic and tax obstacles to savings and investment, rationalising and reforming the public sector, reducing the role of state-owned enterprises, concomitantly encouraging privatisation and private-sector development, and reforming market-supporting systems and institutions.

Although it is generally the case that stabilisation measures precede structural transformation attempts, sometimes certain structural reforms are needed before stabilisation can be achieved. For example, in Africa and many Eastern European countries in transition, public enterprise reform and privatisation may be needed in the early phases of a SAP for the fiscal deficit to be brought under control and a supply-side response to be felt. Or, financial systems may need to be reformed in certain aspects of their functioning for monetary control to be properly enforced before stabilisation can be achieved. Conversely, because adjustments in the financial sector take hold more rapidly than in the real sectors, there may be a case for achieving certain real sector adjustments before full-scale financial liberalisation is attempted (World Bank, 1994ab).

This issue of course brings to light the third key feature concerning SAPs, i.e. the importance of *sequencing*. The wrong sequencing of adjustment measures and reforms (as may have been the case with many SAPs in Africa and SAR) can result in prolonged macroeconomic instability which then feeds back into vitiating the impact of structural reforms aimed at improving the quality of resource allocation and efficiency of resource use through changes in relative prices. Unfortunately, it is not always as clear in prospect (i.e. before the fact) as it seems in retrospect that the sequencing of adjustment measures, or of the relative pace of adjustment between financial and real sector liberalisation, may be (or have been) wrong. When it is clear that sequencing may have been flawed the realisation usually dawns after damage has been done; the costs are then invariably borne by the adjusting economy and never by the prescribing agency.

Faulty sequencing (along with faulty policies or poor SAP design) can result in a vicious cycle of spiralling inflation, continued devaluation, and rapid debt-accretion, coupled with a loss of control over public finances, which eventually results in an implosion of domestic output when levels of external finance needed to support the cycle are no longer affordable. There is no ready-made recipe for sequencing (or even for the precise content of policy changes) which can be applied mechanistically to all countries. Country characteristics and initial starting conditions are critical factors in determining what needs to be done, how and when.

It is often the case that what are frequently seen as implementation failures, when SAPs do not bear the expected fruit, are, in retrospect, failures of design and sequencing (World Bank, 1994a, 1995a). Since SAPs usually enlarge the multilateral debt burdens of adjusting countries very rapidly, they should be prescribed with caution unless there are reasonable prospects that they will succeed. Sadly, in Africa, most SAPs have not yet yielded the results that were expected when they were launched (World Bank, 1994a; Mosley et al., 1995) resulting in too many African countries now having built up levels of debt, especially of multilateral debt, which they can no longer afford to service without incurring massive opportunity costs (Mistry, 1995e; Martin, 1993; Killick, 1995b).

As this section is not intended to be either a compendium or critique of SAPs per se, but a reminder of what the main ingredients of SAPs are, in terms of policies and reform measures, further general discussion of the *intent-vs-effects* of SAPs will be eschewed at this point although it will be taken up again in discussion of SAP aims and outcomes in each of ten key areas of policy reform (Section 4). Instead attention is focused on highlighting the ingredients of adjustment programmes in abbreviated form. Most SAPs, usually supported by one or more sectoral adjustment programmes (SECAPs) usually require countries to undertake broad policy reforms aimed at: (a) reducing *absorption;* (b) improving *switching* from imports to domestic production; (c) reviving growth through a *supply-side* response achieved by improving the structure of incentives. The specific policy reforms prescribed for achieving these three broad objectives are as shown below.

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Table 2 Specific Policy Reforms for Adjustment

Absorption Reduction	Switching Policies	Supply-Side Policies
Fiscal Policy		Trade Regime Reform
	Exchange Rate Reform	Real Sector Reform
Monetary Policy		Financial Sector Reform
	Labour and Wage Policy	Public Sector Reform and Privatisation
		Social and Other Policies

The specific sub-policies and adjustment measures which are agreed as conditions under SAPs or SECAPs in each of these broad policy areas are enumerated in Annex 1. Under each policy area, broad policies and objectives are listed in the left column and the specific policies/measures designed to achieve them on the right. The problem with such schematics is that, while helpful as aide-memoirs, they risk leaving the impression that things are simpler and more cut-and-dried than they are in reality. It needs to be stressed therefore that although sets of policies and actions are shown as discrete sections, they are intricately interrelated. These interrelationships are not easy to explain. Many of them are imperfectly understood even by experts. Different macroeconomic policies have much to do with one another. Improperly synchronised, failure in any one policy area (fiscal, monetary or exchange rate) will usually have immediate and large repercussions in other areas causing the failure of the adjustment effort as a whole.

Similarly, sector-specific adjustment policies are not likely to be effective if the overall macroeconomic regime is not functioning well. In the absence of proper signals being emitted by fiscal, monetary, exchange rate and other key *big price* policies, the effects of sector-specific adjustment measures are likely to be vitiated or obscured in the industrial and agricultural sectors (World Bank, 1994a; 1995a). It is equally true that unless the key productive sectors of the economy respond well to relative changes in prices and other macroeconomic, sector-specific and micro-level policy reforms – by way of increased output, greater productivity and higher efficiency – then macroeconomic adjustment is unlikely to occur effectively within any reasonable time span.

These critical interconnections point to the importance of overall adjustment programme design and the distinctions that need to be drawn between the whole and its constituent sectoral parts. African adjustment experience certainly suggests that much more learning needs to be acquired about adjustment in Africa's somewhat unique conditions which are dissimilar to those in Asia, Southern Europe and Latin America where much adjustment experience has been gained. Architectural knowledge in this area is distinctly weak and countries can be caught in a trap when the architects themselves are learning by doing and making it up as they go along.

Annex 1 shows lists of indicative and reasonably comprehensive (though not exhaustive) impressions of the content and complexity of SAPs. An in-depth assessment of the *regional vs. national* approach to adjustment would need to undertake quantitative econometric analysis on the relative effects of each of a large number of different variables reflecting specific adjustment measures whose independent effects on outcomes could not easily be isolated from the effects of other variables operating at the same time. That task is not attempted by this paper.

Instead the next section turns to an impressionistic analysis of national adjustment experience in Southern Africa on the first ten of the eleven broad areas of policy identified in the boxes above, discussing (i) the observed impact in each of these areas at the national level based on adjustment experience in SAR countries, (ii) indulging in educated speculation about what a regional perspective in each of these ten areas might have had to offer as an alternative to nationally focused adjustment, and (iii) hypothesising about whether desired outcomes might have been more efficaciously achieved had a regional approach been taken.

Such an analysis of course has one major weakness. It has to be recognised immediately that, in SAR and SADC, the political conditions did not exist until 1994 for a genuinely regional approach to adjustment. The former SADCC and PTA structures did not provide the right frameworks under which regional adjustment programmes could have begun to be conceptualised, leave alone designed, negotiated and implemented. The interesting questions now are (i) whether the emerging SADC structure offers that opportunity, and if it does, (ii) whether that route is worth taking?

Without South Africa as the region's centrepiece, it is debatable whether a regional approach to adjustment confined to the other SAR countries would have achieved very much. In the present SADC structure, the macroeconomic and sectoral interlinkages among countries are perhaps best represented by a spoked-wheel with South Africa (and to a lesser degree Zimbabwe) at the hub while the other countries at the other end of separate connecting spokes; the rim connecting the smaller economies is weak and, in some cases, broken. The SADC arrangement does not have the features of the European Union (EU) in which countries are linked through a web of well-established intra-industry and inter-industry trading and cross-ownership arrangements among companies.

However, the analysis, bringing South Africa into the picture as the 1993 AfDB study has done, may nonetheless be a useful exercise in sharpening thinking about the future. It opens the possibility of a different approach being taken to structural adjustment in the African environment – and, concomitantly, to closer economic integration. For this to happen, all parties (i.e. SADC countries, AfDB, IFIs and the major donors) should be prepared to seriously consider and negotiate regionally designed adjustment programmes.

IV Analysis of National vs. Regional Approaches to Adjustment in Southern Africa

Of the twelve countries of SADC, seven have undertaken SAPs financed by the IFIs, with Zambia having had the longest, most difficult and as yet inconclusive experience. Zambia has been adjusting, on-and-off, with various IMF and WBG programmes since 1979, but with the most intense pressure being felt between 1987-93. Malawi has had successive SAPs since 1984, Mozambique and Tanzania since 1986, while Lesotho has been adjusting since 1988 primarily with IMF assistance (SAF/ESAF), and Zimbabwe with WBG assistance since 1990.

Of the SADC countries, only Mauritius has adjusted successfully between 1981-85 having exited from IFI-supervised adjustment by the late-1980s. Its government recognises, however, that it still faces major challenges of economic diversification and finding new sources of future growth. It is perhaps the one member of SADC whose ongoing adjustment process depends less on regional influences than on what happens in its principal international markets. Nonetheless, it is possible that Mauritius' growth and economic relations over the next decade may be influenced more by regional developments than has been the case previously.

Angola has undertaken its own partial stabilisation measures since 1991 including several devaluations and unsuccessful attempts to cut the fiscal deficit, restrain money supply and control inflation. Its political circumstances, however, need to stabilise further for any progress to be made on the economic front. As observed earlier, it is likely that Angola will need to undertake IFI financed SAPs in the second half of the 1990s in order to secure the external financing that it needs for a massive rehabilitation and reconstruction effort.

Other than Lesotho none of the SACU members have undertaken IFI-designed SAPs although in one way or another most have faced upto the need for adjustment. Botswana has applied rigorous financial discipline and

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prudent (if cautious and risk-averse) economic management approach to self-correct swiftly when growth has fallen and exogenous influences have threatened to become malign. Botswana, Swaziland, and to a much lesser extent, Namibia benefited from the sanctions regime during the 1980s and early 1990s as conduits for South African transactions with the rest of the region although that benefit may now be reversed.

Severely constrained by externally imposed sanctions, South Africa has pursued relatively cautious economic policies but with *stagflation* for nearly 15 years. It has now entered a period when it must undertake long-delayed adjustments to accelerate growth. That process, whether guided by the IFIs (a prospect South Africa is valiantly and sensibly attempting to avoid) or not, must occur inevitably. The question is whether it occurs in a controlled manner with the government in full command of the process or whether it occurs disruptively with the consequences that South Africa's neighbours in SADC have suffered. Adjustment in the new South Africa cannot be delayed if the political expectations created during the process of democratic pluralisation are to be met over the foreseeable future (Lachman and Bercuson, 1992; Howe and le Roux, 1992).

That of course raises an issue which cannot be ignored, either by the South African government or the international community, i.e. that South Africa's adjustment process will have major repercussions for its neighbours in SACU and, beyond that core, to the periphery embracing other SADC members as well. Whereas adjustment in the other (non-SACU) SADC economies caused barely discernible ripples in South Africa, the opposite is not likely to be the case. Major adjustments in the region's largest economy over a short time-frame could generate tsunamis for its neighbours.

That is not surprising when South Africa accounts for 76% of the region's GDP (see Annex Tables 1-3) and when its total trade with these economies (including unrecorded trade) is not large from its own perspective but is large when seen from the other end (see Annex Tables 4-7).

When South Africa adjusts, the rest of the region will inevitably need to "adjust to its adjustments". Reactionary *nationalistic* policy responses of the wrong kind by its neighbours, if triggered suddenly and arbitrarily, could risk vitiating what has been achieved by adjustment thus far in the other SADC countries. They may even feed back to destabilise, or at least impede, South Africa's own adjustment process. Consequently, a powerful intellectual case could be made that the need for a regional perspective on the adjustment process in SAR has perhaps never been stronger nor more urgent than it is now.

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1. *Fiscal Policy*

Bringing large budget deficits under control and reducing them to sustainably financeable levels has been a major concern under all IFI-financed SAPs; nowhere more so than in Africa and SAR. Reducing the overall fiscal deficit and, in particular, the primary deficit (before grants are taken into account) has been a key objective in order to restore internal balance and debt sustainability. The focus of fiscal stabilisation in SAR countries has generally been to achieve an immediate reduction in domestic *expenditure* (especially government and public sector expenditure) and diminishing resort to monetisation (i.e. an inflation tax) for financing the deficit. Fiscal *adjustment* on the *revenue* side has focused more on revising the structure of taxes to: remove biases and distortions; increase tax neutrality, yield and buoyancy; widen the tax base while lowering very high marginal tax rates reduce overdependence on trade taxation; and increase taxation of domestic transactions with broadly based indirect taxes such as value-added taxes.

Other (and belatedly introduced) objectives in the context of overall fiscal compression have been to achieve expenditure *switching* so as to reduce: unproductive expenditures (e.g. defence, excessive foreign representation, etc.); widely entrenched producer and consumer subsidies which are enjoyed mainly by middle and upper income groups (e.g. on food, electricity, water, secondary and tertiary education, other utilities, transport services etc.); and to protect social expenditures aimed at human capital development (health and education), social security and targeted subsidies for the poorest groups. Attempts have also been made to protect priority development investment expenditures while reducing the burden of recurrent costs imposed by excessively large civil services and chronic overemployment in state enterprises. Administratively, SAPs have placed a considerable amount of emphasis on improved tax compliance and on increasing collections largely because actual revenue yield in the non-SACU members of SADC was estimated to be less than 30% of what it should have been with proper compliance and enforcement.

What has experience in SAR been with improvements in fiscal performance through nationally focused SAPs? Mixed, as Annex Table 8 illustrates. Lesotho has perhaps achieved the most striking turnaround from an overall deficit of over 20% of GDP in 1988 – largely as a result of parastatal losses and imprudent military expenditures – to a surplus of 3.6% in 1994. This turnaround was attributed to parastatal reform, cut-backs in non-essential expenditures, civil-service rationalisation, and increases in revenues supported by enhanced output growth in manufacturing (stimulated by South African and East Asian inward foreign investment). From an

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average fiscal deficit of 6% of GDP in the mid-1980s, Mauritius has maintained a steady and sustainably financeable overall deficit of 2-3% of GDP through the 1990s represented mainly by its capital expenditures on development. Zambia's fiscal deficit was reduced from an average of 15% of GDP between 1981-86 to an average of 5% between 1990-94, dropping to around 1% in 1994. This impressive performance was attributed to (i) Zambia's moving to a cash budgeting system in 1993, and (ii) the creation of a single Zambia Revenue Authority with foreign assistance which resulted in tax collections increasing by 2% of GDP in that year alone. Whether that improvement proves to be yet another Zambian flash in the pan or whether it presages the arrival, after nearly three decades, of a stable macroeconomic regime remains to be seen.

Apart from these three countries, the record has been poor. Tanzania's deficit was reduced from 11% of GDP between 1981-86 to a low of 3% in 1992 but has risen again to an average of 13% in 1993-94. Similarly, in Malawi the deficit fell from an average level of 11-12% of GDP in 1981-86 to below 7% in 1991 but rose again to nearly 15% in 1994. In Zimbabwe, the deficit has remained stubbornly at an average of around 9-10% of GDP (fluctuating in a range of 6-12%) through the 1990s, and is roughly at the same level as in the 1980s; while Mozambique's fiscal deficit has actually increased from an average of 16% between 1981-86 to around 28% of GDP between 1990-94.

Lesotho apart, in SACU, Namibia has run large fiscal deficits averaging about 19% of GDP in the late 1980s. These were reduced to around 12% in 1992 although the decline was reversed in 1993-94 due to drought. Botswana has generally run a budget surplus. South Africa kept its overall fiscal deficits to between 3-5% of GDP between 1980-90. The deficit increased to a peak of 9.8% of GDP in 1993 before being reduced to 6.4% in 1994-95 and a targeted 5.8% in 1995-96. Swaziland averaged a deficit of around 4% of GDP through the 1980s, generated budget surpluses in 1990-91, after which the deficit has again grown from 1.6% of GDP in 1992 to 7.8% in 1994.

At first glance it would appear that fiscal policy is an area of adjustment where a *regional approach* in SAR might not have significant pay-offs in enhancing adjustment effectiveness. But first glances would be superficial and misleading. To begin with, the most telling example of fiscal adjustment in SAR, i.e. Lesotho, has as much to do with its internal reforms as with what happens in South Africa. Lesotho is encircled by South Africa which accounts for 82% of its total trade, employs 40% of its male labour force – whose remittances are about the same size in money terms as the total value of Lesotho's GDP and therefore constitute 50% of its GNP. Lesotho will generate substantial future revenues from the Highlands

Water Project, the output of which will be purchased entirely by South Africa. Its customs revenues, which constitute 50% of its total revenues, are collected by South Africa under SACU and repaid through unencumbered budgetary transfers with compensatory and revenue stabilisation elements added.

Under the MMA, Lesotho's use of monetary and exchange rate tools to effect adjustment when its economy hit a crisis in 1988 were circumscribed. For Lesotho, it was perhaps just as well that was the case. Had these options been available, the unsustainable fiscal deficit in the mid-1980s would almost certainly have been monetised leading to escalating inflation, a collapse in the exchange rate, and resulting in a much larger burden of eventual adjustment which would have taken much longer to achieve, and been more painful in terms of social and political costs. In fact that is precisely what happened in Malawi, Tanzania, Zambia and Mozambique. It is interesting to speculate on whether their internal and external imbalances, and consequent burdens of adjustment, would have got so far out of hand had their monetary and exchange arrangements been anchored in the same way that Lesotho's were, however inconvenient that may have seemed.

Although Lesotho perhaps represents an extreme case of suffocating fiscal dependence on its elephantine neighbour, the same type of arguments can be made for Swaziland and Namibia, albeit to a lesser extent, and to an even lower extent for Botswana. However, a closer look would suggest a relatively high degree of indirect fiscal dependence on South Africa even on the part of more distant Malawi, Zambia and Mozambique (with Southern Mozambique rapidly becoming an economic extension of the Eastern Transvaal) and of Zimbabwe. Perhaps the only countries in SAR which are presently least fiscally affected by South Africa are Angola, Mauritius and Tanzania.

In Malawi and Zambia, a large part of unrecorded trade and therefore untaxed transactions are directly with South African enterprises and privateers many of whom use Zambia's open capital account as a convenient route for arranging capital flight. A typical arrangement would involve container loads of second-hand clothing, other scarce consumer goods and contraband purchased in rand in South Africa, being driven into Malawi or Zambia (which is least efficiently administered) to be sold on the open market for local kwacha, with these being converted through bureaux into dollars which are then kept in dollar accounts in Zambia or remitted abroad.

Illicit South African dollar holdings in Zambia were estimated to have become substantial by 1993-94. They were suspected of playing a major role in destabilising both the foreign exchange markets a well as the 30-day

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Government Treasury Bill (T-Bill) market in Zambia thus increasing Zambia's deficit in 1993. This was possible through arbitrage transactions aimed at seizing opportunities offered by transient and extraordinarily high real interest rates during a monetary squeeze, or by the profits offered when mismanagement of the exchange rate resulted in unexpected appreciation of the kwacha unwarranted by the fundamentals (Mistry, 1993; Adam et al., 1993; Musokotwane and Ndalamei, 1993). These types of transactions were not seen to any extent in Botswana and Zimbabwe largely because of the domestic availability of goods which were scarce in Malawi and Zambia and because of the more efficient policing of their internal regimes.

Another regional aspect which affects government budgets and deficits in SAR is the recurrence of periodic, severe droughts which destabilise government finances despite substantial external emergency relief and food aid. The last such drought occurred in 1992-93 and resulted in extra-budgetary burdens on almost all SAR governments. Deficits (as a percentage of GDP) for 1992-93 showed a significant rise (and in Botswana the surplus showed a fall) over 1990-91 in the case of Malawi, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe, partly to cover the extra expenditures governments had to incur to cope with the drought and to mitigate its significant repercussions on agricultural output in the affected SAR economies. Had the response of donors not been as generous and swift, and had regional coordination on grain transport (by sea, rail and road), storage and distribution not been as effective, the deleterious fiscal impact could well have been much larger. From the viewpoint of food security, permanent regional arrangements for financing and holding grain buffer stocks, as well as for grain storage, transport and distribution, would go a long way towards ameliorating exigent, unanticipated pressures on government finances in SAR, which are fragile enough.

Although several other regional phenomena have an impact on government budgets and fiscal deficits in SAR, there is little value in belabouring a point already illustrated. Three specific observations are, however, worth making. *First*, as observed earlier and as later paragraphs will elaborate on, common regional approaches to infrastructural investment and service provision could have major implications for easing public development expenditure as well as recurrent expenditure burdens thus contributing significantly to deficit reduction and fiscal stabilisation throughout the region. To quote one instance, the individual airlines of SADC countries (including South Africa) are insatiable consumers of foreign exchange and incur significant annual operating net losses requiring state subsidies of between 3-8% of GDP each year (AfDB, 1993; Medhane, 1990).

Rationalisation of airlines, airport networks and air traffic control and navigation systems in the region would result not only in improved services at lower costs with more customer-friendly schedules but would probably save 4-5% of the region's GDP with a relatively even distribution of such savings across SADC countries. Privatisation of these airlines would induce not only market-based rationalisation and merger; it would eliminate the need for governments to provide operating subsidies and investment capital to the industry. In recognition of the drain that national airlines impose on public budgets, the IMF/WBG eventually forced closure of Zambia Airways in 1994. But that was only one case and similar action has not been taken elsewhere. Extending the airline example to railways, road haulage services, ports, coastal shipping and other infrastructure, a regional approach to infrastructure service provision would have a major beneficial fiscal impact enabling governments to focus scarce budget resources on higher priority social and development expenditures which would facilitate adjustment rather than having it impeded by vested interests which see themselves as losing out from it.

Second, as the region enters a new era of peace and security for the first time in over a quarter-century, opportunities have arisen for drastic reductions in military expenditures (milex) which could be reciprocally negotiated among SADC countries under a regional protocol. Excluding Angola, for which official recent figures are not available, milex in the region averaged about $6 billion (in 1993 dollars) annually between 1986-93 dropping from a peak of nearly $7 billion in 1989 to around $4.5 billion in 1993 (Mohamed, 1995) but nevertheless accounting for about 4% of regional GDP in 1993 (see Annex Tables 9-11). Angola's milex in 1993 was estimated at roughly $1.2 billion. For individual countries, milex in 1993 ranged from 0.4% of GNP (Mauritius) to 7.6% (Mozambique) and (an estimated) 12% of GNP for Angola. Although milex has already been substantially reduced by countries like Tanzania, Zambia, Zimbabwe, Lesotho and South Africa (albeit increased by Botswana) there remains scope for further reductions to an average for countries across the region of no more than 2% of GDP. Regionally agreed reductions of that scale, coupled with mutual defence and security arrangements binding SADC countries together, would release around $2-3 billion for either budget savings or for other higher priority public expenditures across the region. That is perhaps the least that SADC members and the IFIs should seek to achieve following a decade in which the cost of physical destruction and loss of GDP resulting from regional conflict is conservatively estimated at having been around $10 billion annually (ECA, 1989).

The *third* and final point about approaching fiscal adjustment under SAPs with a regional perspective in mind is concerned less with the size of savings that could be derived from regional cooperation on various fronts

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and more with the prospect of increasing revenue yield across all the members of SADC by (i) harmonising tax and tariff structures (to avoid intra-regional tax arbitrage by individuals and corporations), and (ii) collaborating on revenue administration and collection to enforce greater compliance with more reasonable rates of direct and indirect taxation. The experience of the SACU vs. non-SACU members of SADC in that regard is salutary.

Much could be gained by contemplating the coordination of customs and revenue administration throughout the region especially by employing common taxation codes, training practices, standards, principles and information sharing, as well as engendering higher levels of probity throughout the region where revenue administration is concerned. In many instances in SAR (e.g. Malawi, Tanzania, Zambia and Mozambique) sweeping changes in the tax code have been prescribed which call for massive legal, regulatory and administrative efforts, the capacity for which simply does not exist within individual SAR countries except perhaps South Africa. And these changes are being prescribed at a time when simultaneous prescriptions are made to cut expenditures on the civil service, restructure and privatise state enterprises and generally increase the administrative burden which relatively incapable governments must bear to effect the transformations desired. A regional approach, involving a large dose of tax regime harmonisation during the redesign stages, would probably offer a far more effective way of improving tax administration and revenue enhancement than relying solely on national capacity.

Moreover, given the dependence of SADC countries on mineral production for their output and exports, and the complementarity of production in similar minerals (copper, diamonds, gold) across several SAR borders, often undertaken by the same global mining conglomerates, it is particularly important that mining legislation and taxation be regionally harmonised (AfDB, 1993) and that tax codes are evenly enforced. This is equally true when it comes to the frenetic race that every country in the region is now in, often at IFI urging, to attract foreign investment (portfolio and direct) through, *inter alia*, fiscal incentives when other conditions for attracting the entry of such investment – infrastructure, capital markets, administrative capacity and business support services – are distinctly unequal. Experience in other developing regions (including East Asia) suggests that inappropriate or thoughtless fiscal competition to achieve specific and limited objectives in attracting FDI usually attracts the wrong kind of FDI and is likely to leave the region as a whole worse off while leaving no member country significantly better off.

In SAR virtually all countries confront a major shift in sources of revenue away from taxes on trade to taxes on other transactions which may be more difficult to calculate and collect. What national SAPs have

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achieved to a limited extent in SAR is expenditure-reduction with the singular aim of reducing an unsustainable deficit. What they have not yet achieved are (i) sufficient expenditure switching in desirable directions to make adjustment more palatable and effective; (ii) increases in revenues from other sources of taxation and from improved compliance and collection; (iii) adjusting governments and IFIs making the right choices in balancing the mix of revenue-raising, expenditure-reducing and expenditure-switching measures (World Bank, 1994a); (iv) resolving conflicts in the revenue enhancing advice offered by the IFIs at the national level in terms of overall fiscal policy (usually by the IMF) vs. sector-specific advice given to promote sector adjustment and growth (usually by WBG); and (v) effective approaches to intersectoral prioritisation to achieve efficient public investment programme rationalisation especially in expenditure-constrained environments which usually result in sharpened political competition for conflicting expenditure priorities.

These five areas of relative failure may have a negative impact on both medium-term adjustment and long-run development even when the desired deficit reduction is achieved in the short-run through just expenditure cuts. Attempting to enhance revenues by increasing marginal rates and tax burdens on a narrow taxable base may have exactly the opposite incentive effects to those intended by a SAP. Similarly, prescribing savage expenditure reduction in countries where the supply of public goods and service is already below an acceptable level can impair long-run development prospects.

Perhaps the saddest example in SAR (and throughout Africa) is that a decade of adjustment focused excessively on expenditure reduction, and not enough on revenue raising and expenditure switching until much later in the game, has probably resulted in compromising the lives of yet another generation of young Africans. Savage across-the-board public expenditure cuts were countenanced in the face of misdirected government priorities in health, education, food subsidies and social safety nets at a time when population growth, the spread of chronic contagious diseases and the onslaught of AIDS have increased the problems which governments confronted. The net result has been a deterioration in the quality of human capital available to tackle future challenges of growth in SAR when its adjusting economies require precisely the opposite.

Whether a regional approach would necessarily help in tackling these five problem areas better than a national approach to adjustment is an interesting but open question which needs further contemplation. What is clear is that these problem areas need to be addressed and any approach which progresses matters is worth trying. What a regional approach might achieve is to give SADC a much more powerful collective voice in con-

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structive dialogue with its IFI and donor interlocutors than any individual SAR country could possibly have on its own. Moreover, a sharing of regional experiences with these problems may point to ways of resolving them and might induce greater harmonisation on the fiscal policy front as commonalties and mutual interests become clearer.

2. Monetary Policy

The proposition that monetary policy is perhaps an area of adjustment in which a regional approach might yield significant benefits and facilitate swifter adjustment is intuitively more acceptable than when the same argument is attempted on *prima facie* grounds for fiscal policy. But as the European Exchange Rate Mechanism's experience between 1992-95 suggests, intuitive judgements cannot always be taken for granted. The conditions under which regional monetary policies are beneficial to participants need to be clearly appreciated – whether coordinated informally by tracking a regional anchor and undertaking whatever macrofinancial policy adjustments are necessary to maintain equilibrium with it, or through formal arrangements involving reciprocal obligations. Equally, the commitments and obligations which member nations need to make for such arrangements to work properly need to be honoured in the keeping and not the breach.

A cursory look within SAR suggests that members of MMA appear to have fared better in managing their monetary parameters than their other SADC neighbours between 1980-95. SACU members have suffered from less ravaging inflation, less volatile and large swings in real interest rates and have had more stable exchange rates. Though two SACU members (Lesotho and Namibia) suffered from excessive *internal* account imbalances, the other three did not. In all SACU countries and Mauritius, *external* account imbalances have been lower than in other SADC countries between 1985-94. Consequently they did not have to make such large and painful eventual adjustments to restore balance.

The catch, however, is that SACU-MMA are not arrangements among economic equals but among countries which are highly unequal. SACU-MMA have been sustained so far by strong political motives on the part of South Africa, rather than by considerations of economic efficiency alone. It is clear that the *raison d'être* for the continuation and inevitable renegotiation of these arrangements will need to be based on economic rather than political rationales. They will also need to be based on an understanding of the real costs and benefits to the members rather than empty public posturing on the basis of visible (but misleading) budgetary costs and other superficial effects.

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Some of the consequences of SACU and MMA being underpinned and controlled largely by South Africa are sufficiently unattractive for Botswana (whose international reserves are now larger than South Africa's) to exclude itself from the MMA and for Namibia to contemplate the same possibility. To some South Africans, of course, that asymmetry suggests that Botswana is being opportunistic in benefiting from SACU but not doing enough to share the burdens of MMA. More pertinently, however, South Africa may be entering a difficult and prolonged phase of its own adjustment (much as Germany did with unification in 1992) which could threaten to destabilise, if not rupture the MMA if South Africa chooses to pursue unilateral adjustment policies detrimental to its partners.

Before going into the pros and cons of a plurilateral regional vs. national approach to achieving and maintaining monetary stability in SAR, it is useful to review recent experience with the monetary characteristics of SADC members and efforts at achieving monetary stabilisation in the region (see Annex Tables 12-13).

As alluded to earlier, the core SACU countries have experienced relative monetary stability although domestic credit creation and monetary expansion in Lesotho, Namibia and Swaziland reached disturbing levels but with Lesotho having corrected itself by the mid-1990s. In all three countries, monetary expansion, though moderate by the standards of the non-SACU members of SADC (Mauritius of course being excepted), has been larger than it should have been, particularly in 1993-94. In South Africa, the anchor economy of SACU (and increasingly of SADC), domestic credit creation averaged 11% annually between 1990-94, money supply (M2) growth averaged 11.6% and inflation declined from 15% to under 9%. These parameters have been kept under reasonable control with a regime of positive real interest rates applying to deposits and lending throughout 1985-94. In Botswana, there was significant contraction of net domestic credit creation between 1985-94, accounted for entirely by the government sector reflecting its comfortable fiscal surplus position throughout that period. Money supply growth, however, exploded in the late 1980s reaching over 46% in 1989 but has since moderated to an average of just over 10% between 1990-94 while inflation has remained in a 8-16% band over the last decade. Real (lending) interest rates in Botswana which were around +3% in the mid 1980s, turned negative between 1989-92 but reverted to being positive again in 1993-94. Reflecting the controlled monetary stance of South Africa and Botswana, the real effective exchange rates of the rand and pula remained relatively stable between 1985-94 while the nominal effective rates reflected a gradual depreciation in line with inflation differentials between the rand/pula on the one hand and the US dollar on the other.

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In the non-SACU members of SADC, the monetary picture has been more mixed. There is no reliable annual information available for Angola; a war economy which has been out of control for a considerable period of time. Several partial attempts at reducing inflation and stabilising the exchange rate since 1987 have failed because government has been unable to apply sufficient fiscal and monetary restraint. Inflation was over 500% in 1992, 1800% in 1993 and, though reduced to 900% by mid-1994, it escalated again to a rate of 58% per month toward the end of the year. The kwanza was in a free fall in the parallel market during 1993 and though the ratio of the parallel market rate to the official exchange rate was reduced from 16:1 at the end of 1993 to 3:1, by mid-1994 it started rising again. Officially controlled interest rates have remained highly negative in real terms. When Angola does undertake an IFI-supported SAP, the assertion of monetary control will be among the most difficult objectives to achieve.

In the other SADC countries, Mauritius re-established stability in its monetary regime in the mid-1980s bringing M2 growth down from over 30% in 1985 to an average of around 15% between 1990-94 and inflation down from a peak of over 13% in 1990 to an average of 7% for 1992-94. The nominal exchange rate has been permitted to drift to reflect inflation differentials while keeping real effective exchange rates stable. The story is less encouraging in Malawi, Mozambique, Tanzania, Zambia and Zimbabwe where matters worsened progressively between 1985-91, took a turn for the better in Malawi and Tanzania in 1991-92, but reversed again in 1993-94. Monetary stability has thus remained elusive between 1990-94. Domestic credit (mainly to government) in these countries, has grown in the range of 27-68% annually between 1990-94. Over the same period M2 growth has been between 27-84% annually.

Although real interest rates have been maintained at generally positive levels in Malawi and Tanzania over most of this period (in the range of +5 to +10%) they have been highly negative in Mozambique and Zambia until 1994. In that year they turned positive with a vengeance in Zambia (+33%). Zimbabwe permitted real interest rates to remain negative for too long between 1989-1992 before liberalising rates and seeing them become positive in 1993-94. The absence of sufficient monetary discipline has resulted in these countries experiencing high levels of annual inflation (ranging from a low of 25% for Malawi to a high of 200% for Zambia) during 1990-94 as well as high instability in their nominal and real exchange rates.

This overall picture suggests that, other than in SACU and Mauritius, monetary policy in the rest of SADC has not yet been as effective as hoped. Monetary stability in the six other SADC countries remains elusive with major reversals occurring each time that the IFIs and governments have begun to believe that the corner has been turned. Would embracing these six countries progressively within multilaterally-backed regional arrangements – an extended MMA – provide the anchor they need to break the vicious cycle of deficit-monetisation-inflation-devaluation-deficit they seem locked into, and achieve greater monetary stability more swiftly than has been the case so far?

Perhaps the best single reason for believing that regional monetary arrangements in SADC might work is that a plurilateral framework, involving peer group pressure for exerting monetary discipline, might well serve to exercise greater restraint over the abuse of seigniorage powers than SAR's politically vulnerable national governments are capable of exercising under short-term domestic political pressure. It would be much more difficult for SADC governments to run large deficits and monetise them for short-term political expediency if the process of monetisation was restrained by plurilateral decision-making involving wider, long-term regional interests. But the economic characteristics, structures and monetary/fiscal parameters between SACU/Mauritius on the one hand and the other SADC-six (AMMTaZZ) on the other, appear at present to be too divergent to contemplate such arrangements being sufficiently robust and resilient to endure. Nevertheless, if regional arrangements were to be aimed at, various convergence criteria (i.e. monetary, inflation and fiscal targets) could be established which might induce individual countries to strive harder to meet these criteria and attain membership.

In this context, it used to be believed, axiomatically, that real/nominal convergence were essential *prerequisites* to the effective operation of common monetary arrangements; following from the view that the location of economic activity is subject to centripetal forces generated by the process of economic integration (Myrdal, 1957; Perroux, 1959). The neo-classical view is now inclined toward believing that, instead of being a prerequisite, convergence may actually be a *consequence* of closer economic and monetary integration for two reasons. *First,* free movements of goods and services, in an environment which is free of foreign exchange risk, will lead to eventual equalisation of factor prices, factor productivity and output per capita. *Second,* as there is no trade-off in the long run between inflation and unemployment, price stability can legitimately be pursued as an economic objective in its own right without raising the spectre of entrenched unemployment. Moreover, when regional arrangements hold out the promise of resulting in greater price and exchange/interest rate stability, they can improve the trade-off between inflation and unemployment in the short-run because of the positive effects of expectations on trade and investment. Such arguments support the logic that inflation

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convergence need not be a precondition for common monetary arrangements but will come about as a result of their existence and operation (Chipeta and Mkandawire, 1994).

The other arguments in favour of common monetary arrangements in SAR around a *rand zone*, gravitating eventually towards monetary union (though this need not be an objective of such arrangements at the outset) are that:

- they require credible commitments on the part of members to monetary, fiscal, exchange rate and price stability which might be difficult for them to meet unilaterally;
- potential savings can be derived from the pooling of international reserves;
- ensuing intra-regional exchange rate stability and interest rate convergence will reduce barriers to trade and investment caused by high exposure on the part of traders and investors to foreign exchange and interest rate risk in excessively volatile regional currencies and monetary regimes;
- there would be a general reduction in intra-regional transaction costs;
- freer intra-regional flows of investment capital and trade finance would be triggered and sustained, especially between SACU/Mauritius and AMMTaZZ, than would be the case if present circumstances persisted;
- significant capital and administrative cost savings would result from a common financial institutional and regulatory framework whose operations are more viable when applied over a larger market base;
- more rational, effective operation of monetary policy, and prudential supervision of banks and securities exchanges could be achieved at the regional vs. national level especially when the resources of several small economies are pooled to share in the advantages of a strong, independent central monetary authority, the core of which already exists in South Africa and Botswana;
- the re-establishment of monetary stability in AMMTaZZ, would restore lost public confidence in local currency as a store of value and result in both increased overall savings as well as an increase in the proportion of financial savings; and,
- the perennially increased needs for extraordinary levels of concessional aid from donors to finance the costs of fiscal and monetary instability in the region – which are exacerbated by unaffordable external debt service burdens in AMMTaZZ – could be substantially reduced, if aid was applied instead to backstopping regional monetary arrangements which had more efficient macroeconomic effects (AfDB, 1993).

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As with every economic tool or policy, common monetary arrangements (which have actually characterised SAR for much longer than unilateral ones albeit through a colonial history) are double-edged mechanisms; they are not costless. Issues arise with the distribution of seigniorage returns; the implied loss of sovereign flexibility in the use of the exchange rate as a tool for correcting external account imbalances, and for macroeconomic correction and adjustment; and the intra-regional developmental imbalances that can be perpetuated if not compensated for through appropriately designed regional policy and compensatory financing arrangements (Robson, 1993).

Moreover, many previous theoretical and empirical analyses have suggested that common monetary arrangements and optimal currency areas only work well when the following conditions are met: geographical contiguity of members; a high degree of intra-regional trade; free intra-regional factor mobility, particularly for capital and labour; wage-price flexibility; strong political will and technocratic cooperation to make regional arrangements work; gains from monetary integration are not asymmetrically captured by the more developed members;[8] there are checks-and-balances operating on the larger anchor economies to avoid passing on the costs of their macroeconomic miscalculations to their partners; reserves are adequate to backstop these arrangements under temporary balance-of-payments stress; there is relative openness in the economies of participating members vis-à-vis each other; participating economies are relatively diversified in their production structures so that exogenous shock effects are not overly concentrated; and participating members are committed to coordinating balanced fiscal policies with strict budget discipline.

Without going much further into the theoretical and empirical pros and cons of whether regional monetary arrangements might provide a superior option for achieving monetary stability in SAR (especially in the AMMTaZZ countries) and taking into full account the experience of the

8 On the issue of extant regional asymmetries in levels of development becoming embedded, recent analysis (Krugman, 1990 and 1991) suggests that under regional integration arrangements, the *centralisation* of economic activity is likely to be reinforced when returns from economies of scale are large and the location of manufacturing activity is relatively immobile, whereas *decentralisation* is likely to occur in a region where transport costs are more important as a proportion of final product cost. In SAR: (i) the returns from economies of scale are likely to be large; (ii) manufacturing activity can be quite mobile in response to sufficiently large differentials in tax-adjusted factor costs adjusted for factor productivity, but may be immobilised by gaps in the availability of infrastructural and business support services and in the availability of an appropriate and honest regulatory framework in which political and bureaucratic rent-seeking is minimal (in relative if not absolute terms); and (iii) transport costs constitute a very high proportion of final product costs.

MMA in SAR (AfDB, 1993) and of the CFA arrangements in Francophone West Africa (Honohan, 1991) there is a powerful intellectual case for the IFIs to rely more on *regional* rather than national approaches to monetary stabilisation in SAR. It is a case which neither the WBG nor the IMF have given sufficient thought to, perhaps because of the obvious impracticality of doing so under political and economic conditions in SAR which were quite different to what they are now. The current constitution of SADC offers more benign and more efficient (although by no means as yet problem free or entirely practicable) options for regional monetary cooperation as a means to the stabilisation end and thereafter to the maintenance of monetary balance in the region on a sustained basis.[9]

3. *Exchange Rate Policy*

Related closely to the question of whether common monetary arrangements might facilitate monetary stabilisation throughout SAR is that of whether greater exchange rate stability can be achieved and maintained (intra- and extra-regionally) as an integral part of such arrangements. Before that question can be answered, it is necessary to ask what the experience of SADC countries has been with exchange rate policy and exchange rate management regimes. Has exchange rate stability in the context of competitiveness and greater openness been achieved over the last decade? Have exchange rate adjustments resulted in anticipated current account adjustments and rectified resource imbalances in SAR? Clear-cut answers to these questions are difficult to come up with although the evidence suggests that exchange rate adjustments by themselves have not achieved the desired effects, especially in the non-SACU economies of SADC. This despite the fact that the size of exchange rate adjustments in all of these countries, other than Mauritius, has been quite large and, in the case of three countries, excessively so mainly because devaluation-inflation spirals went out of control.

That said, it is particularly difficult in any of these countries to isolate

9 In that context it is worth mentioning three independent efforts undertaken in the 1990s arguing the case for closer regional monetary cooperation for achieving adjustment and growth objectives in SAR which the IFIs need to take cognizance of (i) the African Development Bank's analysis, particularly in the Finance Chapter of its 1993 report on *Economic Integration in Southern Africa;* (ii) the former PTA's (now COMESA) 1990 study on its proposed *Monetary Harmonisation Programme;* and (iii) a recent paper produced under the aegis of the African Economic Research Consortium (AERC) on *Monetary Harmonisation in Southern Africa* (Chipeta and Mkanadawire, 1994). Using the substantially larger intellectually resources available to the IFIs, these initiatives need to be built on and developed into operationally viable concepts.

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the effect of the exchange rate adjustment alone in restoring current account balance or in achieving a switching from imports to domestic goods in the case of tradables. The macroeconomic programming model for guiding adjustment treats the real exchange rate (RER) as a key variable in restoring equilibrium when there is a large current account deficit or resource imbalance. If – under the econometric models used to calculate required adjustments in different targets, prices and parameters – the fiscal and monetary measures required to restore internal and external balance show an unsustainably large and persistent current account deficit at the prevailing exchange rate, then a large real exchange rate devaluation is prescribed. This is generally brought about by a large initial *nominal* devaluation, accompanied by tight fiscal policy, to control the inflationary effects of the exchange rate adjustment thus transforming a nominal devaluation into a real one. If, in the short run, devaluation triggers destabilising impulses on the capital account, tighter monetary policy is brought into play to mitigate the consequences and restore external balance.

African countries in general and SAR countries in particular have had reservations from the outset about the impact of devaluations on the subsequent controllability of their unusually fragile economies whose structures are rigid and unresponsive. Except for Tanzania (1990) they have been unable to articulate their fears and concerns in cogent terms using the jargon that IFIs comprehend. They were intellectually overwhelmed by the IFIs when it came to arguments in negotiating adjustment conditionality on exchange rate adjustments. The two recent reports from the World Bank on adjustment experience in Africa (1994a and 1995a) are disturbingly vague and obscure in their assessment of whether exchange rate adjustment in Africa has worked or not, conveying a general sense of discomfort about outcomes but not advancing sufficiently clear or cogent explanations or alternatives. The IMF, with its usual aura of intellectual and operational infallibility of course suffers from no such inhibitions (Schadler et al., 1993) claiming considerable success for exchange rate adjustments but on the basis of evidence that is open to debate. The following paragraphs attempt to discuss in much simpler terms whether the experience of countries in SAR confirms theory.

Over the 1988-95 period, the level of domestic currency depreciation has been least in Botswana and Mauritius, the two strong economies of SAR, although Botswana was affected by importing South African inflation with the pula being dragged by a faster depreciating rand. Over the eight-year period, the Botswana pula has depreciated in nominal terms against the US dollar by 30% and the Mauritian rupee by 18%, while both currencies have appreciated against the rand. Both countries have attempted to pursue policies of maintaining a relatively stable trade-weighted real effec-

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tive exchange rate (REER) and have generally succeeded in doing so with few hiccups. In terms of stability, the MMA regime has performed next best, with South Africa's rand – which underpins the Namibian dollar, Lesotho loti, and Swazi lilangeni at unit parity – depreciating over the 1988-95 period by 34% against the US dollar and to a lesser extent against the pula and Mauritian rupee.

Nominal devaluations in the AMMTaZZ economies have been much greater, falling into two categories. The depreciation of the Angolan, Zambian and Mozambican currencies have approximated Latin American levels of the 1980s with the kwanza and Zambian kwacha depreciating by over 99% against the US dollar and the metical by 91%. The level of annual inflation has made it difficult in these countries to attempt any fine-tuning of the REER to retain competitiveness – whatever that term means in these particular countries. Nonetheless, available indices suggest that Zambia has had some success in stabilising its REER although the impact of that achievement on its current account remains difficult to fathom. Mozambique has been less successful and despite large devaluations has seen its REER appreciate and Angola even more so, although any attempt to measure the REER in that country, leave alone stabilise it, may border (under present conditions) on the absurd. Moreover, officially set rates in Angola mean very little in practice since most transactions outside of government accounts are settled at parallel market rates.

In the second category are the less drastic but nonetheless large nominal devaluations of Malawi's kwacha, the Tanzanian shilling and the Zimbabwe dollar, against the US dollar which have approximated 83%, 79% and 77% respectively. In these countries there have been attempts to stabilise or actually depreciate the REER with continued nominal devaluations, but the inevitable lags in the timeliness of devaluations has resulted in REERs appreciating in Tanzania and Zimbabwe and stabilising in Malawi. Thus the countries of SAR fall into bands as indicated in Table 3.

Table 3 Exchange Rate Adjustment, Inflation and Actual Adjustment in SAR

Devaluation vs. US dollar (1988-95)		**Inflation Countries**	**Adjustment Range**
A. 20% <<	Mauritius	10%<<	Internal and External
B. 30-40%	The SACU Five (BLNSAS)	12%-15%	External
C. 75-85%	Malawi, Tanzania, Zimbabwe (MTZ)	25%-35%	Neither Satisfactory
D. >> 90%	Angola, Mozambique, Zambia (AMZ)	75%-1,000+%	Out of Control

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The overall impact of exchange rate adjustments in the four categories mentioned in Table 3 tends to mirror the size of the devaluations which have occurred. Of the SADC economies Mauritius has adjusted best while depreciating the least.[10] At present it has the fewest problems of inflation, monetary and fiscal control, trade regime liberalisation and savings/investment. Its internal and external accounts are in sustainable balance. The SACU-5 have adjusted less well with higher inflation and mixed experiences with fiscal deficits although all have reasonable monetary control. They have been more successful in stabilising their external accounts than their internal accounts. Their adjustment problems however may continue for some time as South Africa undertakes its own adjustments and begins to liberalise its trade and exchange regime with the hiccups that can be expected as a result of a more fractious and less predictable system of political governance.

Malawi, Tanzania and Zimbabwe face more difficult problems with exerting fiscal and monetary discipline, and have significantly higher levels of inflation than the SACU countries (25-35% vs. 12-15%). Yet they appear to be veering towards internal account stabilisation despite several reversals, while external account stabilisation remains problematic. The AMZ countries are the worst off by far. Their devaluation-induced inflationary spirals remain out of control and internal and external account stabilisation are remote prospects.

Most SAR countries continue to be heavily dependent on commodity exports for which they are price takers (except perhaps for gold and diamonds) and whose volumes are entirely dependent on world market demand-supply conditions. From the evidence available it would be difficult to assert, for any SADC country other than Mauritius, that the conduct of exchange rate policy has made a material difference to improved export performance or diversification or to improving fundamentally the resource imbalance. It would be equally difficult to establish, in most of these countries, the extent to which import demand was influenced by exchange rate policy and the large relative price changes which successive exchange rate adjustments resulted in. The absolute constraint of import finance availability – which (except in SACU countries and Mauritius) was alleviated mainly, if not only, by concessional aid flows – makes it difficult to estimate the domestic demand-reducing effects of depreciation in the chronically aid-dependent SADC economies. Moreover, with liberalisation, long-repressed demand for consumption imports was unleashed

10 The IMF and World Bank might argue conversely (and perversely) that Mauritius has had to devalue the least because it adjusted the fastest; but this argument confuses the question of cause and effect.

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resulting in an unanticipated surge of consumption imports (instead of capital goods and intermediates) being financed which did not have any lasting growth-inducing effects (Martin and Mistry, 1996).

In those countries (Lesotho, Malawi, Mozambique, Tanzania and Zambia) where donor-disbursed concessional flows provide the largest source of free foreign exchange the concept of a *market-determined* exchange rate is, to say the least, a bit odd. The market for foreign exchange can be severely destabilised by inadvertent or deliberate slowdowns or acceleration of fast disbursing loans and grants resulting in parallel market signalling which can throw monetary and exchange rate policy (and by linkage) even fiscal policy completely off course. Consequently, outside of SACU and Mauritius, what frequent and significant devaluations in previously fixed or quasi-fixed exchange regimes in SAR – with economies whose imports are largely price inelastic and whose domestic supply side capacity is weak or non-existent – appear to have achieved is the following:

- significant increases in the interest component of primary budgetary deficits in domestic currency (often covered by parallel increases in the quantum of external grants) as a result of the need to meet inflated debt service obligations to preferred creditors even as other debt remains unserviced;
- enlargement of the fiscal deficit as a result of more local currency being required by government to finance essential survival imports (again often covered by donor-provided import-support grants);
- a general cost-push rise in domestic price levels triggered by each devaluation adding to inflationary pressures because of the incapacity of SAR economies other than South Africa and Zimbabwe to benefit from switching effects;
- an environment in which, even as public investment is being sharply compressed, volatile exchange and interest rates, accompanied by frequent monetary squeezes, eliminate any incentive for long-term investment on the part of the domestic or foreign private sector because of increased risk and exacerbated uncertainty; and
- diminishing any incentive for long-term financial savings in domestic currency holdings or in domestically denominated financial instruments, except on a speculative basis, to capture arbitrage opportunities arising from inevitable temporary policy twists or failures.

These five effects have increased the intensity and volatility of the devaluation-inflation cycle and created a chronic degree of aid dependency in the non-SACU economies of SADC with extraordinary assistance rising to unsustainable levels (e.g. $100 per capita in the case of Zambia), yet with no clear strategy in sight for an exit from the debt-aid trap. Somewhat disconcertingly, SAP prescriptions contain no remedies for weaning these economies off their absolute dependence on external assistance within the next decade without running the risk of destabilising them completely yet again. Instead, they attempt to justify requests for continually higher levels of extraordinary grant financing from donors on the grounds that adjustment is taking longer than earlier anticipated.

Moreover, a careful look at changes in the volume, value and structure of exports and imports in SADC countries over the last decade of adjustment, does not suggest that exchange rate adjustments have worked their magic in any of the countries (Martin and Mistry, 1996, forthcoming) except perhaps in Mauritius which has undertaken the least amount of it while keeping its other policies in balance. Indeed, if improvements in export and import growth and diversification were to be correlated with the relative sizes of real exchange rate adjustments undertaken by SAR countries, the exercise would probably end with inconclusive results, if not a statistically significant inverse correlation. But such an exercise would be intellectually suspect since the structure of SAR exports is not particularly affected by the relative exchange rate, nor is the demand for imports affected by an increase in their domestic price, at least not at these low, rock bottom levels of demand for the AMMTaZZ countries.

Other policies and physical phenomena (not least drought, weather, war, and movements in the terms of trade) play a much more powerful role in influencing external account outcomes – suggesting that the IFIs' obsession with exchange rate adjustments in SAR may have been excessive and misplaced. That large initial nominal devaluations were required is unarguable. That the IFIs expected such nominal devaluations to be accompanied by the kind of fiscal and monetary restraints which would contain inflation was naïve beyond belief. That they predicated their prescriptions on the ability of weak and ineffectual institutions and governments to hold the line on domestic pressures after these large devaluations was mildly absurd. What was needed were large nominal devaluations immediately succeeded by credible arrangements (backstopped by sufficient financing and early action on debt and debt service reduction) to *stabilise* the devalued exchange rate – nominal and real – permitting enough time for stability to be achieved without igniting an inflationary spiral. Instead, initial devaluations were not bolstered by credible arrangements nor by sufficient external financing, forcing large and repeated adjustments tuned to over-exaggerated price signals emitted by parallel market premia; when it was widely accepted that these markets were highly imperfect and ultra-sensitive to expectations about exchange rate movements which neither the IFIs nor governments fully understood. In that sense, an overdone preoccupation with theoretical purism may have obscured the need to consider more pragmatic options to achieve external account improvement in a con-

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text of growth, with lower rather than heightened risk for investors and savers.

More evidence needs to be marshalled to convince the IFIs that continuous devaluations are probably not the right policy response to adjustment failure or stickiness in SAR. The time may well have come to contemplate the possibility of stabilising (though not necessarily fixing rigidly as in the case of the CFA) exchange rates for a reasonable period of time to reduce risk and uncertainty, and to create a more benign climate for trade and long-term investment. Moreover, it may also be an opportune time to pause and reflect on the effect that exchange rate turbulence in SADC, outside of SACU and Mauritius, is having on closer regional integration, especially in terms of investment and trade.

These effects have been carefully considered in the AfDB's Report (1993) on integration in SAR leading to suggestions for a regional exchange rate stabilisation mechanism (REXSTAB). That study has recommended expanding payments and settlement arrangements based around the South African rand in SAR, coupled with regional exchange rate stabilisation arrangements between the rand and other regional currencies. By extending the embrace of a rand-zone throughout SADC, the foreign exchange constraint to adjustment and development could be relieved far more effectively than has been achieved so far by IMF/WBG prescribed SAPs. Neither the IMF nor WBG have taken up seriously the idea of extended *regional monetary arrangements* in SADC perhaps because political conditions in the region until 1994 precluded any prospect of such arrangements being put in place in the non-SACU countries. Those conditions have now changed radically and the idea needs to be revived and operationalised.

REXSTAB is conceptually equivalent to extending MMA cover to non-SACU countries on a progressive basis, but with the support of external underwriting arrangements (multilaterally funded) similar to those which operate under the relatively successful, if excessively rigid, CFA franc arrangement. Such an arrangement might have accomplished more by way of closer integration and more effective adjustment in SAR than the painful and unsatisfactory sequential devaluations which have been resorted to repeatedly under SAPs; often leading to devaluation-induced inflation spirals which have proven difficult to control and reverse. These have had unanticipated and unintended consequences not the least of which have been (i) rapid de-industrialisation; (ii) absence of domestic switching effects which exchange rate corrections should produce; and (iii) ever-increasing reliance on scarce concessional aid flows to keep these economies afloat, especially in the absence of satisfactory debt and debt service reduction arrangements – in particular for multilateral debt.

It needs to be emphasised, however, that this argument is predicated on two critical assumptions (i) that the present and future governments of the new South Africa can *always* be relied on to pursue prudent and sound macroeconomic and structural policies which are of benefit to itself and the region, and (ii) that REXSTAB will be prudently governed by an independent plurilateral monetary authority. Sufficient international safeguards need to be put in place to ensure that default by South Africa in this respect can be either swiftly corrected or that its neighbours can be insulated from the effects of such default. Should that caveat not apply, the argument would of course be invalidated.

In making its suggestion the AfDB observed that further analytical work needed to be done to examine the feasibility of REXSTAB and define its institutional and operational contours after intra-SADC consultations had been held among the region's ministries of finance and central banks. In the meantime, Malawi and Mozambique have already indicated their desire to join the MMA on various occasions precisely in order to re-establish exchange rate and monetary stability. It is a matter of some urgency that this proposal, which has been on the table for nearly three years, now be taken up by the IFIs and SADC governments as a concrete regional step. Extending MMA and establishing REXSTAB would facilitate adjustment in a manner likely to be more efficacious than attempts with continued unilateral exchange rate adjustments. Such attempts have been tried since 1980 but have failed to deliver the goods for most countries in the region. It is time to consider an alternative approach with regional dimensions which would further the prospects for successful adjustment and closer integration simultaneously.

4. *Labour and Wage Policy*

In theory and rhetoric SAPs usually call for removing rigidities and distortions which impede the efficient functioning of factor markets, often alluding specifically to rigidities and distortions in formal labour markets. But this particular aspect of macroeconomic adjustment does not feature as strongly in the conditionality of IFI-supported SAPs as do aspects concerning fiscal, monetary, exchange and trade policies. Perhaps that is because labour-related conditionality is too politically charged; or because it involves trade unions – institutions which the IFIs do not have the same comparative advantage in dealing with as they do with central banks and ministries of finance – or even perhaps because it has profound societal implications which the IFIs cannot cope with.

It is not that IFIs are oblivious of the problems that SAPs create in terms of widespread dislocations and displacements of labour in Africa and SAR. They usually side-step these with references to the experiences of adjusting countries in Asia and Latin America – in which post-adjustment employment generation and export effects have been undeniably impressive – without mentioning that those conditions often do not apply in Africa. In Africa, human capital is still largely undeveloped, traditions of entrepreneurship are not particularly deep or wide, indigenous, non-African entrepreneurs are distrusted and often vilified as exploitative, and a sufficiently broad-based private sector has yet to develop.

Major difficulties will be faced by African countries and firms attempting to force competitive entry into world markets for manufactured and service exports already dominated by other developing countries and by economies in transition, especially when Africa lacks the competitive business support services or infrastructure. In IFI reports, it is usually argued that adjustment has resulted in benign effects in unleashing markets, unlocking entrepreneurship, and – relying on private small and medium enterprise – generating labour-intensive opportunities. But these hypothetical palliatives, even if they worked in practice, would be woefully inadequate when the IFIs advocate public retrenchment at a pace much too rapid for adjusting African economies to absorb without running the risk of counterproductive social and political resistance-often within the structures and institutions of government itself. These real world problems are usually dealt with by the IFIs at the level of vague generalisations rather than through imaginative and concrete labour absorption measures and conditionalities.

Neither of the World Bank's two recent reports evaluating adjustment experience in Africa (1994a and 1995a) are particularly illuminating on how its SAPs and SECALs have fared with the liberalisation of labour markets (apart from attempting to persuade a few governments to remove restrictions on hiring and firing) or wage policies.[11] They have, however,

11 The 1995 World Development Report of the World Bank entitled *Workers in an Integrating World*, alludes to the African problem of labour absorption and labour market adjustment observing that (i) There are about 70 million workers in sub-Saharan Africa struggling with adjustment (p. 99); (ii) Labour does tend to suffer during the initial period of adjustment and possibly more than capital ... because capital can flee but labour cannot (p. 104); (iii) Adjustment can pay off for labour despite temporary declines in employment and real wages as the experience of adjusting African countries during the 1990s demonstrates (p. 104); (iv) Although data on wage and employment trends in Africa are scarce, evidence on two adjusting countries – Ghana and Tanzania – reveals that both employment and wage performance improved following structural reform (p. 104). However, the picture the World Bank presents is misleading. Various independent commentators (e.g. Mosley et al., 1995) have debunked convincingly the methodology and statistical analysis that leads the Bank to assert that adjustment is working in Africa. The differences in performance which the Bank points to between strong-adjusting and weak-adjusting African countries is statistically insignificant. Moreover, the two examples the Bank quotes are subject to qualification. Ghana has had reversals causing it to lose its lustre as a paragon of adjustment success, and it is much too early to trumpet success in Tanzania, especially on the employment front.

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invoked the usual theoretical implications that labour market and wage policy rigidities might have in increasing production costs, reducing productivity, stifling investment, inhibiting formal-sector job creation, and protecting workers in the formal sector to the detriment of those unemployed. The IMF's Occasional Paper on *Economic Adjustment in Low-Income Countries* (Schadler et al., 1993) does not discuss labour market policies except in referring *en passant* to token gestures for retrenched workers as part of a side-discussion on the social dimensions of adjustment.

The World Bank's 1994 report suggests that its experience with labour market reform in Africa is limited to three countries in the CFA zone and in other countries to the limited issue of compensating retrenched workers in state-owned enterprises. It goes on to note that:

> 'There has been little systematic study of labour market regulations in Africa or of their impact on economic activity, so it is difficult to evaluate the costs of various restrictions and the benefits of reforms. Most of the barriers are believed to be more of an implicit tax than an absolute barrier. Firms usually find ways – sometimes costly – of getting around the regulations.' *(Adjustment in Africa*, World Bank, 1994, pp. 92-93)

This reflects scant regard for the interplay between other macroeconomic reforms and their impact on a critical factor market, suggesting that the only factor market the IFIs are interested in transforming is the market for money and capital. That is a glaring omission given the challenge that labour markets in Africa pose to the adjustment process, especially in view of Africa's disconcerting demography, its rate of unbridled population growth, its relative lack of resources to focus on rapid and broadly based human capital development, and its incapacity to absorb the about-to-be-retrenched, leave alone new additions to the active labour force.

These factors are already creating significant social pressures translated into higher crime rates, widespread lawlessness, a counter-culture of dispossession, and other pernicious social effects with potentially explosive political repercussions for the medium term. Such trends do not bode well at a time when African economies are being severely tested by attempted transitions toward more genuine forms of democracy which are all too vulnerable to demagogic capture. IFI-generated literature therefore does not provide an acceptable basis on which to judge what has happened with regard to labour market and wage policy at the *national* level in SAR nor to compare that with what might be possible if labour markets and their reforms were approached with *regional* dimensions in view. The AfDB's report on integration in SAR (1993) on the other hand is more informative and useful in indicating the need for a regional labour strategy.

In 1995, SAR had an economically active population of about 42 million of which South Africa accounted for a third, Angola, Mozambique and Tanzania, for another third, and the other eight SADC countries for the remainder. This pool will increase by about 15% by 2000 and by a further 32% between 2001-2010. Most employment (and unemployment) in SAR is a national phenomenon. But formal labour markets in SAR – especially in the mining sectors of all SADC economies, highly-skilled professional services (in education, health, law, accounting etc.), in transport and infrastructure, in the tourism industry, the information technology, business support services and financial services sectors, and more generally in high-level management positions across the private sector – have a significant regional dimension. The only SADC economies which are not as yet integrated within a discernible regional manpower pool are the more geographically distant countries of Mauritius (which imports labour from Madagascar and Sri Lanka, and it is beginning to attract high-level professional manpower from South Africa, Zimbabwe, Europe and India) and Tanzania, which is more linked to labour markets in East Africa (particularly Kenya) than in SADC.

Cross-border flows of labour across SAR have been shaped mainly by (i) former policies favouring a tradition of migrant labour in the South African, Namibian and Botswanan mining and industrial sectors; (ii) widely varying per capita income levels across the region, with accompanying (iii) wide compensation differentials for the same types of jobs which encourage legal and illegal (informal sector) migration from low-income economies (such as Lesotho, Malawi, Mozambique, Swaziland and Zambia) to the high-income economies (mainly South Africa and to a lesser extent Botswana) with Zimbabwe on the cusp – attracting manpower from lower-income economies (Malawi, Mozambique and Zambia) and exporting its own to higher-income neighbours (South Africa and Botswana); and (iv) a network of family ties which straddle much of the region.

Regional labour flows, especially of well-qualified high-level manpower (HLM), have been accentuated between 1988-95 by large outward flows of non-African HLM from South Africa to Europe, North America and Australia, and to Botswana. This has created a regional *backdraft* effect, i.e. inducing into South Africa flows of trained manpower from neighbouring countries (especially in the health and education sectors). The result is a serious regional brain drain from the lower-income economies (especially Malawi, Zambia and Zimbabwe) to South Africa and Botswana. Its negative effects on neighbouring countries is being exaggerated by two other factors (i) increasing indigenisation of the South African civil service at national and provincial levels, which is attracting trained Africans from the education and health sectors into government and creating a vacuum which is being filled by inward cross-border flows of HLM; and (ii) increasing resistance to absorption of cross-border flows of unskilled and semi-skilled labour (i.e. low-level manpower – LLM) which is being encouraged to repatriate to countries of origin as South Africa attempts to absorb its own large pool of such labour in productive employment. Regional labour flows are connected with outward and inward flows of remittances which are of critical importance to economies such as Lesotho and Mozambique, and to a lesser extent to economies like Malawi and Zambia, in balancing their external accounts.

Apart from the large number of microeconomic issues which need to be addressed in regional and national labour markets in SAR, there is a major *wage policy* issue emerging in SAR. While inevitably having to be tackled at national level, it has widespread regional implications which must be taken into account. The large pool of surplus LLM in South Africa and SAR, coupled with a large deficit in HLM, would suggest the need for downward pressures on real (productivity adjusted) wage rates to clear the labour market for LLM and relatively high LLM vs. HLM compensation differentials.

Yet real wage rate distortions, with their roots in the apartheid regime's labour policies entrenched by union-supported rigidities set by the mining sector, have driven real wage rates for LLM in South Africa to uncompetitive levels which (i) cannot possibly clear national or regional labour markets and (ii) render South African industry generally uncompetitive by international standards (or compel it to become artificially capital-intensive). They also create incentives for inward labour flows (legal and illegal) of LLM which are now administratively impossible for South Africa to curb or control simply because the administrative machinery to enforce draconian entry-barriers or forced repatriation/deportation programmes has been dismantled. It would be much too costly to reassemble and would probably be subverted by rent-seeking behaviour even if it was.

Consequently a major policy twist has developed in regional real wages through the 1987-95 period in SADC. As a result of unending adjustment and devaluation, real wages have fallen sharply in virtually all the SADC economies outside of SACU where they have risen sharply. Thus, in continental SAR, the gap between real wages in the SACU economies and the other countries, which was already large, has widened considerably over the last decade and has been particularly problematic in the HLM labour market exacerbating brain drain effects.

As the AfDB report (1993) emphasises, the brain drain phenomenon has important policy implications for adjusting countries in SAR. Whereas

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migrant LLM and HLM and recipient countries may benefit, supplying countries bear the cost of wasted public investment in human capital, reduced quality of public services and a loss of HLM manpower critically needed for their adjustment to be successful. Supplying countries of course benefit from remittances which these HLM outflows generate, but it is questionable whether the benefits (captured largely by private households) are sufficient to offset the costs (borne mainly by the fiscus). Regional real wage differentials then create pressures within national markets to raise wages of HLM thus widening internal wage differentials and reversing the pressure for budgetary savings.

Regional wage twists, as well as supply-demand conditions in national labour markets, have created a serious conflict of interest situation between South Africa and its SADC neighbours. It is clearly in the interests of South Africa to curb inflows of migrant LLM and perhaps even to attempt repatriating the surplus which is now resident, while encouraging the HLM inflows from the rest of SADC which it needs. Neighbouring governments have exactly the opposite interest – i.e. to discourage HLM outflows while encouraging LLM exports. Against these conflicts of interest, South Africa has an obvious stake in promoting economic development and growth throughout SADC to (i) create growing markets for its own output and (ii) prevent the spillover effects of their economic and social dislocations being imported into South Africa. All of this points to a need for a region-wide perspective.

When the potential exists for powerful and disruptive conflicts of interest – on perhaps the most politically sensitive and explosive of issues – among countries in a regional community, the rationale for freeing markets in labour, along with concomitant freeing of markets for goods, services and capital (to avoid other more damaging twists from emerging when one market is freed and others are not) becomes a compelling one. The pay-offs from doing so for all the economies of SADC are obviously high although, as with any adjustment, temporary dislocations and political repercussions are inevitable. Freeing goods and services markets in the region must be accompanied by freeing capital flows within SADC. Otherwise current account imbalances between countries in the region cannot be counterbalanced by compensating capital account transactions (which are privately induced rather than publicly negotiated). If left to the market, free capital account flows would be directed by differentials in relative costs, relative differences in factor productivity and other competitive factors. Obviously some public investment must be directed towards reducing these differentials, but free cross-border capital movements will certainly contribute to a moderation of factor price pressures (in particular wage rates for LLM).

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The South African region at present faces an extraordinary opportunity for doing something more positive about employment generation by combining public and private sector investment initiatives with IFI and donor support. Opportunities for large scale employment generation in SAR can be found in sectors such as construction, infrastructure development, and the expansion of services (especially in transport, finance and tourism) rather than in agriculture, mining and manufacturing. Construction and services provide more typical entry points for upwardly mobile indigenous entrepreneurial start-ups and as a training ground for LLM than do other sectors. Growth in the construction sector also has a backward multiplier effect in requiring increases in the output of domestic basic industries (cement, steel, glass, aluminium, building materials, fabricated structures etc.) which need reviving in SAR.

Happily, as it happens, the region now confronts the challenge of massive land-mine clearance, and country-wide reconstruction and rehabilitation efforts in Angola and Mozambique with the equally daunting task of providing low-cost housing and infrastructure provision on an accelerated basis to the hitherto dispossessed majority in South Africa. These three areas alone – quite apart from similar opportunities which exist, but on a smaller scale, in other SADC countries – provide considerable opportunity for SAR governments, regional and foreign construction firms, donor governments and IFIs to work together in formulating market-friendly strategies which would achieve simultaneously the objectives of increasing LLM incomes, creating demand in low-income groups, alleviating poverty, generating employment, inducing output growth and regional regeneration. Leaving such opportunities for the market alone to develop would be both naïve and short-sighted.

A more holistic cooperative approach to LLM absorption, supported by the proper regional and national adjustment policies, needs to be accompanied by a deliberate, integral strategy for increasing rapidly the supply of indigenous HLM within the region. In an environment where all SAR governments are under pressures to reduce public expenditures that objective can best be achieved by pooling available regional resources (institutional and financial) for human capital development and maximising the efficiency/effectiveness of their use, rather than by pursuing more costly, and probably ineffectual, alternatives for doing so through initiatives confined to national economies.

Labour market and wage policy adjustment in all their various dimensions therefore need to be urgently considered with a regional perspective on the part of SADC governments, the donor community and the IFIs. With its broad but useful analysis of regional labour markets and regional wage policy issues, the AfDB has taken a lead in raising key questions

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which need urgent answering – through the development and re-orientation of regional institutions focusing on labour markets as well as the accompanying adjustments that are required in the structure of SAPs designed for SAR economies.

5. *Trade Policy*

In Africa and the adjusting economies of SAR the impact of SAPs has perhaps been most visible in the area of trade and exchange regime reform. The policies pursued under SAPs have considerably reduced foreign exchange rationing and accompanying import scarcity premia – enabled mainly by expanded donor financing for import support. Progress thus far with trade liberalisation has reversed the distortionary policy excesses of the 1980s but, viewed in a long perspective, has simply restored most adjusting SAR economies to the position they enjoyed before they were overwhelmed by unsustainable imbalances in their external accounts. Moreover, the sustainability of their trade regime reforms is dependent almost entirely on the continuation of extraordinary levels of concessional aid flows.

Sufficient structural adjustment and production structure transformation has not yet taken place in the poorer SADC countries for their own commodity (and other) export earnings to finance simultaneously (i) the minimum levels of imports they require and (ii) their debt service obligations to preferred creditors even after foregoing debt service to other creditors. This is particularly true for Lesotho, Malawi, Mozambique, Tanzania and Zambia and may become increasingly true of Angola in the latter half of the 1990s and beyond, despite its large earnings from oil exports (which account for nearly half of its GNP). Their experience is in line with the World Bank's observation (1990) that poorer and less diversified economies – which face a discouraging combination of institutional weaknesses, relatively undeveloped production structures, and impediments to factor mobility – usually react very slowly to changes in the real exchange rate and tariff structure rationalisation.

The other six more developed and higher-income SADC economies (Botswana, Mauritius, Namibia, South Africa, Swaziland and Zimbabwe) have either achieved, or are capable of achieving, external account balance more easily from commodity exports and services income. The wealthier six of course account for a much larger amount (nearly four-fifths) of the region's total trade than the poorer six, suggesting that the region's external account imbalance taken as a whole can be corrected more easily than might be the case with external balances in the six poorer countries (see Annex Tables 17-18).

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The current external tariffs of countries in SAR range from 20-65% with much lower tariffs applied to intermediates and capital goods. A COMESA-induced round of tariff cuts was scheduled for 1995 but, given the desultory performance of implementing previously negotiated tariff cuts in PTA, expectations that the latest round will be implemented quickly would be unrealistic. More significant than tariff inhibitions on intra-SADC trade are non-tariff barriers which include acute foreign exchange shortages throughout the region (except for Botswana and Mauritius); lack of intra-regional currency convertibility outside of SACU and Mauritius; import licensing; lack of trade finance and letter-of-credit facilities; lack of country creditworthiness, which heightens credit and transfer risks; high internal transport costs; border controls characterised by rent-seeking behaviour; adjustment pressures inconducive to expanding intra-regional trade; the dominance of inefficient parastatals in production and marketing activities throughout the region; and an absence of adequate product/market information for supply sources within the region. The dependency of so many SADC countries on aid-funded import support has also reduced opportunities for intra-regional trade by diverting procurement to tied, extra-regional (i.e. donor) sources of import supply even when regional sources would have been more efficient and economical. Moreover, a long legacy of apartheid and sanctions was hardly conducive to the development of properly structured trading arrangements within the region.

Much of the trade liberalisation which took place till 1992 in SAR addressed the progressive withdrawal of import controls through foreign exchange rationing. It did not fully address trade restrictions imposed by tariff and non-tariff barriers such as quantitative restrictions through import licensing. Since then import regimes in SAR have been liberalised further with open general licensing, significant tariff rationalisation with accompanying tariff reduction (before 1993, tariff reduction in SAR through successive PTA rounds of tariff cuts occurred more in rhetoric than reality) and further movement in the direction of current accounts becoming progressively more open. However, imports are still restrained in most SAR economies by tariffs which are high by international standards (in developed economies) but not by developing country standards.

The general picture is one of more happening on the import liberalisation front than on the export promotion and diversification front in SAR. Though the disincentive to exports posed by overvalued currencies has now been largely eliminated in much of the region (except in Angola and Mozambique) exports are still restrained by reduced but residual export licensing; export taxes; inefficient parastatals which continue to monopolise principal export production and marketing; and state-run agricul-

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tural export commodity marketing boards (which are not being phased out quickly enough). The type and sequencing of different types of trade reforms which have been undertaken in Africa and SAR are well documented (World Bank, 1994a, 1995a) and need not be recounted here.

Although attention has been paid in most SAPs to increasing non-traditional exports, not much has been achieved in practice, despite measures such as: duty drawback schemes for imports used in exports; special export-processing zones; relaxation of foreign investment codes and specific government incentives (as well as regulatory streamlining) for non-traditional exporters. Manufactured exports from SAR have not yet diversified or increased sufficiently in response to structural adjustment measures in the same way that they have in Latin America and South Asia (e.g. India's export performance since 1992 has been dramatic with export diversification and growth averaging 25% annually between 1992-95).

This outcome suggests that, outside of South Africa and Zimbabwe, African production structures may still have a long way to go in adjusting properly to the measures taken so far and becoming globally competitive. It is possible that African economies may lack the basic essentials of more established private-enterprise cultures elsewhere. In other regions, these entrepreneurial cultures, even though repressed for a long time, are responding swiftly to the opportunities created by liberalisation and taking advantage of competitiveness created by overdue changes in relative big prices. In Africa they are not.

Outside of SACU, recorded imports are an unreliable guide to actual imports in the non-SACU economies of SAR, as are customs revenue data which are frequently misleading. The same applies to recorded exports. Monetary, fiscal and exchange rate changes have had a dramatic impact on relative prices (in domestic currency) of imports and exports in the adjusting countries and less so in the six middle-income countries of the region. They have made most manufacturing parastatals uncompetitive and subjected them to increased competition from imports. Many have simply become unviable. In the private sector the de-industrialisation impact has been more mixed since many private firms without privileged access to import purchases at overvalued exchange rates had already adjusted to parallel market import prices or gone out of business.

The principal difference between trade reform prescriptions under SAPs in each Southern African country vs. a *regional* trade-focused approach, is that the former aim mainly at achieving unilateral competitiveness vis-à-vis the rest of the world while the latter attempt a two-stage process of achieving regional competitiveness first and having the region as a whole becoming globally competitive later. The 1989 *(Crisis to Growth)* World Bank report acknowledged forcefully the role that regional integration in Africa

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could play in achieving competitiveness through a regional approach which would buy time for *learning effects* to occur. But subsequent IMF/WBG publications (and indeed the contents of SAPs in SAR themselves) seem to take a more purist (trade theoretic) view. They express considerable scepticism about extending customs unions and common external tariffs seeing them as soft options which vitiate the adjustment message rather than reinforcing it. The AfDB (1993) on the other hand throws itself squarely behind the regional integration trade approach, taking a pragmatic rather than a theoretical approach.

Before South Africa joined SADC in 1994, regional trade analysis invariably emphasised the lack of complementarity in member economies and the very low volumes of intra-regional trade that occurred as evidence that there was little to be gained by a regional approach. At that time most trade between (non-SACU) SADCC members and South Africa was clandestine and unrecorded. As observed earlier, with South Africa in the frame, the trade picture within SADC changes dramatically (Maasdorp, 1992; see also Annex Tables 4-7). Although the non-SACU economies in SADC do not trade much with each other (intra-SADC trade excluding South Africa was less than 5% of the total trade of SADC countries), they do trade with Zimbabwe, and in much more significant amounts with South Africa, especially when parallel market trade is factored in.

The trade figures appear dramatically different when one looks at that portion of trade which excludes (i) the region's principal mineral and cash crop commodity exports, which are all directed at world markets although some, e.g. tropical beverages, do go to South Africa; (ii) Angola's oil exports; and (iii) the region's imports of crude oil. The picture is reinforced when one considers the destination of South Africa's manufactured exports, nearly a third of which are directed primarily at SACU, SADC and other African markets (AfDB, 1993). Trade by SADC countries with South Africa has increased from under 17% of their total trade in 1970 to over 23% in 1984 and possibly an estimated 35% in 1994.

On the other hand, of South Africa's total trade, SACU accounted for 10% in 1990 and an estimated 12% in 1994 whereas the rest of SADC accounted for less than 3% in 1990 and perhaps not much more than 5-7% in 1994. These percentages do not take account of the large parallel market trade which occurs within SADC. With the entry of Mauritius into SADC and the dawn of a new political era in April 1994, this proportion (especially if trade in invisibles is included) might be expected to rise significantly.

The AfDB's analysis (1993) of extant intra-regional trade and future trade potential (see especially, Vol. 2, pp. 3-90), demonstrated clearly that there was considerable scope for expanding intra-SADC trade within a

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context of *trade creation and expansion* and minimising *trade diversion*. This could be achieved by (i) shifting some of South Africa's commodity imports from the rest of the world (RoW) to imports from efficient producers within the region; (ii) reciprocally shifting some of the region's imports of manufactures and intermediates from RoW to South Africa, Zimbabwe and Mauritius to the extent possible without trade diversionary effects; and (iii) expanding intra-regional trade in services and invisibles (especially financial, tourism and transport services).

None of these shifts can be induced by fiat but they can be encouraged by market forces acting on better information and new trade linkages. Finally, given the topography and natural resource base of SAR, and as the Lesotho Highlands Water Project symbolises, considerable further potential exists for (iv) significant expansion of intra-regional trade in utilities (electricity, water and telecommunications) which are tradable regionally but not internationally. Such trade would help to balance current account asymmetries since, for these goods, South Africa would be the principal buyer while its regional cohorts to the north would be the main sellers.

Regional trade expansion would be encouraged and made more sustainable if the existing current account imbalances between South Africa and Zimbabwe on the one hand, and the rest of SADC on the other, were counterbalanced by free flows of investment capital in the opposite direction. The potential for converting a hub-and-spoke regional trade nexus in SADC, with South Africa at the centre, into a richer weave involving enhanced trade between all the countries of the region is considerable.

This would be especially true if factor markets were freed, enabling capable firms located in the region to spread their diversified mining, production, commercial farming, infrastructural and financial service capabilities across the region in search of the most favourable environment (taking into account total factor productivity) and locating closer to major consuming markets. That is even more likely to happen if the regional macroeconomic environment is structured so as to reduce exchange, payments, settlements/transfer and credit risks. Greater cost efficiencies are also likely to result under such an approach (Riddell, 1990, 1993; Meier and Steel, 1989; AfDB, 1993; World Bank, 1989).

A regional approach to trade policy – though perhaps theoretically second best – is more practicable, achievable and in the interests of SAR as a whole as well as in the growth and diversification interests of individual member economies. Moreover, since the present SAP trade-regime adjustment paradigm has failed to deliver the goods in SAR, especially in encouraging the rapid diversification and growth of exports, the case is strong for attempting a different approach, along the lines specifically suggested by the AfDB (1993).

6. *Industrial Sector Policy*

Apart from the focus on macroeconomic reforms in its SAPs, the WBG (more than the IMF) extends its adjustment reach into key sectors of African economies with sectoral adjustment programmes (SECAPs) aimed at supporting meso- and micro-policy adjustments to induce sectoral output growth and diversification. These SECAPs have been confined mainly to the industrial, agricultural and energy sectors in which changes in the big prices are likely to make the most difference. Surprisingly, SECAPs have not been focused on transport or other infrastructural sectors (such as telecommunications) except in the context of parastatal rationalisation, restructuring and privatisation.

Also, beyond the financial services sector, in which major adjustment efforts have been supported through specifically designed FINSECALs, no serious efforts have been made to achieve equally important adjustments in key revenue generating and export earning sectors such as tourism and construction; although much attention has been given to sectors such as health and education. But, even in these social sectors, emphasis has been placed on project and sector loans involving improved prioritisation and expenditure-switching rather than on sectoral policy adjustment as such. The conditionality of several SAPs have also often contained requirements for policy reform in the industrial, agricultural and energy sectors. This sub-section focuses on industry while the ones that follow focus on agriculture and energy.

The characteristics of the industrial and manufacturing sectors in SAR are discussed in considerable detail in the AfDB's 1993 report and will not be repeated here. Industry is dominated largely by mining in the region, although the mining sector does not feature prominently in the economies of Lesotho, Malawi, Mauritius and Tanzania.

Mining

Mineral output far exceeds manufacturing output for most of the other economies in SAR and mineral exports are much larger than manufactured exports. There is considerable scope for greater efficiency through rationalisation of mining activity in the region with the possibility of welfare gains being captured by individual countries and by the region at large. In the case of Zambia, the success of its overall adjustment effort depends largely on how effectively its mammoth mining company (ZCCM) which monopolises copper production is eventually transformed – a problem which has eluded a solution for the last thirty years! IFI-supported SAPs in SAR have been concerned with the mining sector primarily in Zambia

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because the interplay between copper production and the rest of the economy has introduced the greatest number of distortions and policy twists in the economy at large. Given the importance and complementarity of mineral production across most of SAR, and its geostrategic importance to the rest of the world, it would be remiss to avoid focusing on the key regional issues which the mining sector raises and to suggest the benefits of a regional instead of nationally focused approach to making the obvious policy adjustments required in that industrial sub-sector.

National adjustment policies for the mining sector across SAR are broadly similar and preoccupied with the same issues: encouraging further exploration; attracting the investment interest of regional and international mining conglomerates; increasing the extent of domestic mineral beneficiation value-added throughout the region, with the concomitant reduction of the region's raw ore exports; the exploitation of further forward integration in mining-related manufacturing, e.g. the development of a regional jewellery manufacturing industry which, surprisingly, does not exist to any significant extent; and phasing out the role of parastatals in dominating mineral production in SADC countries outside of SACU with a concomitant increase in private sector involvement/investment.

The key questions of regional importance concern the structure of ownership and its excessive concentration among six inter-related and collusive South African mining conglomerates whose complex cross-shareholding structures are opaque and appear threatening to SAR governments; competition and regulation in the mining sector in SAR; the introduction of new and improved mining technology for exploration, mineral production and beneficiation; the role of the state vis-à-vis mining conglomerates with massive resources and countervailing power in maximising overall economic (and not simply private financial) gains from the exploitation of the region's mineral resources; further regional cooperation in mineral marketing arrangements; the issue of regional migrant workers in mines across the region; and the real wage policy distortions caused by wage price setting by the mining sector. None of these problems has been adequately addressed by the IFIs or the international community on a region-wide basis as key issues for adjustment despite their critical importance for the future of most SAR economies.

The future development of the mining sector in SAR is dependent on constraints and parameters which have major regional dimensions and can be best tackled at the regional level. Apart from SADC as a whole being affected by terms of trade shocks transmitted through the volatility of mineral prices and global demand fluctuations, these include an inadequate regional network of surface transport infrastructure outside of South

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Africa; obstacles imposed by the close involvement of the public bureaucracy and endemic corruption associated with mineral rights and mineral production; vulnerability to frequent regional droughts which have an immediate impact on power and water availability for the mining sector.

These factors combine to discourage rational regional exploration and reserves accretion activities; slow down extraction of proven reserves in ways that do not capture fully the opportunities offered by occasionally favourable price movements; and discourage large-scale long-term private investment in downstream beneficiation and forward integration. They also result in cross-border spillover effects with constraints on mining production in one country influencing patterns of production in its contiguous neighbours.

Post-1994 political and economic developments in SAR raise the question of whether the time has come to consider harmonising (or even eventually replacing) disparate nationally based mining codes, legislation, regulatory practices and mining investment incentive structures within a regionally consistent framework. The AfDB (1993) study has examined this issue in depth and concluded that, while having obvious benefits in attracting rational inward flows of foreign investment in the SAR mining sector, there are major risks involved in moving too fast and prematurely on this front given (i) the uncertainties of present political dispensations and the nascence of regional cohesion in a SADC framework which now includes South Africa; and (ii) differences in the types of minerals produced, mineral potential, the extent to which factors outside the mining sector constrain exploration, production and development, and in the scale of mining operations across different SAR countries.

The AfDB argues for gradual movement towards a regional mining regime and regulatory framework as more experience is gained and after structural changes have occurred which would make the development and management of such a framework more politically acceptable and economically efficient. The AfDB does suggest immediate regional actions aimed at developing the capacity for research and development, and information and technology sharing, through a regional mining technology centre and regional mining commission.

In short, the analysis undertaken by the AfDB strongly suggests the advantages of (i) capturing significantly higher economic gains by adopting a regional perspective to the future development of the region's mineral resources, and (ii) exploiting more effectively the linkages between the SAR's mining potential and the development of a connected downstream manufacturing base by adopting a regional approach. It needs to be incorporated into the debate on structural adjustment in the region and taken up more effectively by the IFIs.

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Manufacturing

Total manufacturing value added in SAR in 1994 was over $33 billion with South Africa accounting for 82% of that amount. Manufactured exports of the region were about $8 billion with South Africa, Mauritius and Zimbabwe accounting for 95% of those. Nowhere are the development disparities among SADC economies reflected more starkly than in their manufacturing sectors. South Africa, Zimbabwe and Mauritius are relatively highly industrialised, as (but to a much lesser extent) is Zambia. Of these four only Mauritius has achieved a degree of sector-specific international competitiveness while South Africa dominates overwhelmingly in being the region's industrial engine and principal exporter of manufactures to the rest of the region. Angola, Mozambique and Tanzania have antiquated industrial sectors in a state of severe disrepair and in need of major overhaul. The smaller SACU economies (BLNS) and Malawi characteristically have small consumer-oriented industries (food processing and brewing) dominated by local product processing.

Industrial development in the region outside of the PWV-Harare corridor is constrained by geography, high transport costs, the minuscule size of most national markets and a chronic shortage of the appropriate skills and technology. SAR (including South Africa) is severely handicapped by a deficit of human capital specialised in engineering, science, business support skills and the vocationally honed technician/artisan skills needed for industrial widening and deepening commensurate with the needs of the region.

Outside Mauritius, industrial and manufacturing growth in SAR has been (and continues to be) dominated by protected import-substituting production for national domestic markets behind high tariff walls and a range of non-tariff barriers. It has been dependent on relatively weak and stagnant domestic demand with duplicative production structures built up in every SAR economy concentrating mainly on foodstuffs, clothing and textiles.

The industrial sector has been the focus of SAPs and SECALs in Africa and SAR (specifically in Malawi, Tanzania, Zimbabwe, and indirectly, Zambia) perhaps because industrialisation has invariably been viewed as being synonymous with development. However, attempts to promote industrialisation efforts (especially the inefficient, highly-protected import-substituting, parastatal-dominated kind) have been a major cause of resource misuse and dissipation, of burgeoning fiscal deficits, and of the overall internal macroeconomic imbalances which African countries experienced through the 1980s and early 1990s.

Industrial sector policy reform under SECAPs was aimed at being achieved largely through macroeconomic policy changes. Monetary, fiscal, trade and exchange rate reforms were intended to improve competitiveness in tradables. Industries producing tradable goods, and capable of responding to these changes, were supposed to have benefited. But the examples of firms doing so in SAR and Africa were few. By and large the combination of macroeconomic reforms in SAR generally worked toward making most parastatals (which dominate industry) unviable. Cuts in public expenditure affected industrial parastatals in two ways: they resulted in a sharp, sudden fall in domestic demand for their products, and in an absence of financing for new capital investment and for covering operating losses. Accompanying monetary squeezes usually resulted in severe constraints on working capital, which reduced capacity utilisation and added to plant inefficiency. Loss of privileged access to cheap foreign exchange (because of exchange rate reform) and increasing competition from imports (because of trade liberalisation), at the same time, also affected industrial parastatals in SAR adversely compounding their operating problems and pushing many of them over the brink before they had any time to restructure or adjust.

Surprisingly, most industrial sector adjustment loans (ISECALs) which were supposed to focus on industrial sector issues and sub-sectoral restructuring, actually focused on prescribing reforms in trade policy (Jayarajah and Branson, 1995). The aim of nationally focused ISECALs in SAR was to (i) remove biases against manufactured exports by removing export taxes, introducing duty-drawbacks on imported inputs, providing export subsidies, and creating special export processing zones; (ii) introduce efficiency-inducing competition mainly through import liberalisation rather than by expanding domestic competition; and (iii) increase responsiveness to changes in real relative prices and to the removal of other distortions (such as non-tariff barriers and quota restrictions) on the part of domestic manufacturers that trade and exchange regime adjustment is supposed to achieve.

In contrast to their preoccupation with trade policy reforms, ISECALs paid scant attention to other policy distortions which fostered sectoral inefficiency such as: price controls and wage rigidities, excessively onerous and irrelevant regulatory requirements, industrial licensing to control capacity expansion and competition, distorted pricing of publicly produced non-tradable inputs, restrictions on entry and exit, and restrictions on foreign direct investment (Jayarajah and Branson, 1995). Left unattended, these types of policy distortions continued to (i) constrain the efficiency with which resources were allocated when relative prices changed – thus inhibiting domestic efficiency and structural adjustment gains from materialising and limiting the gains that did accrue to increases in consumer welfare from expanded choice with the increased availability of imports; (ii) exacerbate the domestic costs of adjustment caused by higher domestic price levels; (iii) perpetuate resource misallocation throughout the industrial sector with knock-on effects for the economy at large; and (iv) deprive adjusting economies of benefiting from external sources of technology upgrading and improved production, quality control and industrial management techniques.

Judging the performance of intended reforms in the industrial sector by their visible results in SAR leads to disheartening conclusions (see Annex Table 19). Theoretically, success should be gauged in terms of ensuing productivity growth rates, the efficiency of intra-sectoral and intersectoral resource allocation, exploiting dynamic comparative advantage more fully, and shaping an efficient, competitive industrial sector (and its component sub-sectors) commensurate with the size and structure of the overall economy. Apart from the problem of poor data availability, which precludes definitive judgements from being made, existing evidence suggests that ISECALs in SAR have not achieved these intended objectives to any discernible degree.

Looking at crude figures of growth in industrial and manufacturing value added, or at the growth and diversification in manufacturing output and exports, or at the extent of internal restructuring and sub-sectoral balancing which has taken place so far, it is difficult to claim any obvious success with industrial sector reforms at the national level in SAR. What is visible in Malawi, Tanzania and Zambia is stagnation in industrial/manufacturing output and exports, relatively little diversification and a considerable amount of dislocation and de-industrialisation without the resultant emergence of a new, more dynamic and efficient industrial sector in adjusting SAR countries anywhere in the offing. The question is whether these signs reflect sectors, which are at the low point of the adjustment cycle, about to spring back with renewed dynamism and vigour, or whether the signs indicate progressive, and not easily reversible, de-industrialisation.

There are clearly some signs of promise in Zimbabwe which has a relatively efficient, resilient and robust manufacturing sector. In Zimbabwe, private manufacturing investment is rising, foreign direct investment is interested in expanding, manufactured exports showed strong growth (except when affected by power shortages caused by the 1992 drought), and some overdue restructuring and modernisation is taking place in the privately owned part of the industrial sector. Even so, much remains to be done in restructuring the parastatals which dominate the industrial sector.

Moreover, as mentioned earlier in the paper, the industrial sectors of other SADC economies are in for another adjustment shock when industry in South Africa undergoes the sectoral changes (in addition to the macroeconomic changes) which are necessary for that economy to achieve inter-

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national competitiveness; an objective to which the present South African government is apparently committed but not fully aware of the transitional costs involved nor of the political repercussions which may ensue, especially in terms of labour union resistance.

Part of the reason for an absence of the right supply response in the industrial sectors of individual SAR economies is that while public enterprise activity in the industrial sector is winding down – more as a result of fiscal constraints than a deep seated conviction about the inherent efficiency of such enterprises – there is little visible sign of new and more efficient investment and restructuring being undertaken by the private sector in SAR outside of South Africa, Zimbabwe and Mauritius. In these, and even more so in the other, SADC economies excessive reliance on the market alone for allocating resources efficiently is likely to be misplaced. Market-determined allocation of resources in the industrial sector at the national level may prove sub-optimal because of (i) inadequately functioning product and factor markets at that level; and (ii) chronic deficits in essential public goods in the form of adequate infrastructure and other essential frameworks to support industrial enterprise (legal and regulatory frameworks and properly functioning legal, accounting and other business support services).

Also, in the industrial sector, non-appropriable *dynamic* gains arise from learning effects, tapping a wider pool of HLM skills than is available in small national markets; technology sharing and development; and experience with exporting activities (Mistry, 1995). In such circumstances market allocation of resources in a static efficiency framework can and does lead to sub-optimal long run allocation of resources. With these caveats in mind, and given its characteristics and size, it is increasingly clear that manufacturing industry in SADC will have to develop with *regional* considerations in mind if it is to achieve five critical objectives: (i) maximising output growth; (ii) raising manufacturing value added through increased beneficiation of the region's mineral and agricultural products; (iii) diversifying and increasing manufacturing exports; (iv) increasing labour intensity in the manufacturing sector; and (v) increasing efficiency and total factor productivity to levels which permit regional and international competitiveness to be achieved in that order.

That nationally oriented SAPs and industrial SECALs do not incorporate regional dimensions in their design is a serious shortcoming in need of urgent rectification. The World Bank (1989), explicitly acknowledges the importance of sub-regional markets in Africa as stepping stones to achieving international competitiveness and in the development of viable intermediate and capital goods industries. Yet its SAPs and ISECALs fail to address that fundamental issue in an operationally meaningful manner.

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The major problem with the *laissez faire* SAP paradigm for the industrial sector in SAR is that, for the reasons provided above, it will result in manufacturing concentration being entrenched in the industrially endowed economies with the risk of progressive de-industrialisation in the others. The existence of considerable excess capacity in the same low-technology, consumer-goods industries across SAR will compel governments pursuing trade liberalisation policies to make unpalatable choices from three options: (a) allowing firms which are unable to compete regionally to shut down; (b) scrapping plans to restructure, privatise and rehabilitate temporarily moribund enterprises; or (c) revert to protective trade regimes with high tariff walls because of their inability to face the immediate political repercussions of doing otherwise (AfDB, 1993). For that reason an approach to industrialisation in SAR, whether national or regional, which ignores these difficulties at the national level, will be politically and economically unsustainable and will create problematic intra-regional conflicts which will be difficult to resolve.

To exit from the *cul de sac* that national industrialisation strategies and adjustment programmes have led to in SAR, some form of regional industrial policy, accompanied by appropriate compensatory offsets, or industrial relocation subsidies, may be essential in the initial stages of re-industrialisation to achieve a more pragmatic, if theoretically inferior, regional industrial balance. An immediate extension of the SACU framework to embrace all of SADC may seem tempting, superficially, as a quick-fix; but it would lead to emphasising the very problems that the BLNS countries face with their own industrialisation in the face of overwhelming South African advantage.

Too quick an opening of the region to the full force of industrial competition from South Africa could frustrate the industrialisation aspirations of other SADC economies and even delay necessary adjustment in South Africa itself. Intra-regional opening of national industrial sectors may therefore need to incorporate a system of two-tiered preferences (a higher initial barrier to imports from the rest of the world and a lower barrier to those from South Africa with both barriers being lowered progressively and automatically in a pre-announced time-bound manner) which give industries in all SADC economies time to adjust before completely free intra-regional trade can be achieved behind a moderate common external tariff.

To achieve progress along these lines the AfDB (1993) suggests two options for further study by SADC governments before their opting for either:

(1) *A delayed free market option* which involves lowering national tariff and non-tariff barriers and progressively within a framework of mutual

regional reductions, giving affected industries enough time to adjust to market discipline and become competitive, or to close down. Such a time-bound option would allow for cross-regional rationalisation and restructuring to occur through mergers, acquisitions, divestitures, privatisations and closures.

(2) *A regional integration option* which would combine the delayed free-market approach with incentives to effect more orderly rationalisation of industrial structures on a regional basis, guided mainly by efficiency criteria but sensitive to the need for regional equity and balance.

These options are discussed at length in the AfDB's study (1993, Volume 2, pp. 239-318) which takes a different view to regional industrialisation from the IFIs – as reflected in their SAPs and SECALs – and will not be elaborated upon further here.

7. *Agriculture Sector Policy*

Agriculture accounts for 35% of Africa's GDP, 40% of its exports and 70% of its total employment.[12] But, African farmers have been burdened with disincentives in the form of the highest effective rates of (explicit and implicit) agricultural taxation in the world[13] leading to falling agricultural output. It is hardly surprising then that agriculture was targeted for sectoral adjustment and policy reform. In SAR, such reforms were attempted through WBG-financed SAPs in all adjusting countries and through specific ASECALs in Malawi, Mozambique, Tanzania and Zambia. They were aimed primarily at reducing the overall tax burdens on farmers, raising agricultural production and encouraging crop diversification by: improving real producer prices; removing the implicit taxation burden of an overval-

12 The equivalent proportions for SAR as a whole are quite different, with agriculture accounting for under 10% of regional GDP, 20% of SAR exports and about 50% of total employment. However, these figures are distorted by the mining economies of South Africa and Botswana (where agriculture accounts for less than 5% of GDP but still accounts for over 50% of total employment) and the industrial economy of Mauritius (where agriculture accounts for less than 10% of GDP but about 30% of employment). Excluding those economies, the ratios of agricultural production and employment of the other nine SADC countries approximate the averages for Africa as a whole, with the share of agriculture in GDP ranging from a low of 13% for Angola (for unusual and specific reasons involving war and the relatively large size of its oil production and refining sector) to a high of 61% for Mozambique and Tanzania.

13 The explicit tax burdens were manifested in the form of producer-price controls, export taxes, and high input prices and taxes. Implicit taxes resulted from overvalued exchange rates, inefficiencies in state marketing boards, and high levels of domestic industrial protection which raised consumer prices on farm inputs and wage goods with input subsidies going only a small distance towards offsetting them (World Bank, 1994a).

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ued exchange rate for export crops; lowering explicit export taxes; reducing marketing costs and improving domestic marketing arrangements, especially for export crops; improving the efficiency of input and credit distribution; while removing input (e.g. fertiliser and water) subsidies for fiscal reasons in ways that would still leave farmers with higher net incomes taking into account the effect of all the other measures.

Just as ISECALs focused more on *trade policy* reforms than on meso-policies affecting the industrial sector, most ASECALs attempted to focus on *fiscal and exchange rate policies* rather than on meso- and micro-policies affecting the agricultural sector as such. In Tanzania, the ASECAL actually attempted to substitute for a SAL (Jayarajah and Branson, 1995) when negotiations for a SAP failed. In such instances it became difficult to distinguish between the macro-reform objectives of SAPs and the specific sectoral reform objectives of ASECAPs. This usually resulted in fiscal reforms being emphasised in a way that was unbalanced; often leading to conflicts between prescriptions at the macro and meso levels (Jayarajah and Branson, 1995), especially when it came to the budgetary effects of reductions in export taxes, or conversely when reductions in fertiliser subsidies were programmed at a rate which was sectorally (and politically) unachievable.

In promoting agricultural exports from adjusting countries, IMF/WBG-SAPs and WBG-ASECALs have been criticised for indulging in fallacies of aggregation by compelling neighbouring countries in Africa to expand export production of the same crops to their singular and collective detriment (e.g. cocoa from Ghana and Côte d'Ivoire, coffee and tea from Kenya, Tanzania, Uganda, Malawi, Madagascar and Zimbabwe, tobacco from Malawi and Zimbabwe, sisal and cashews from Tanzania and Mozambique, etc.). Such compulsions[14] exercised simultaneously in Latin America, the Caribbean and Asia as well as in Africa, often resulted in expanded supplies of tropical beverages and other export crops on world markets at a time when world demand for these crops was stagnant or

14 IFI-induced emphasis on increasing traditional (agricultural and mineral) exports in Africa and elsewhere has much to do with (i) their implicit bias towards maximising external debt servicing capacity on the part of adjusting countries (resulting in the immediate benefits of adjustment being exported rather than internalised) as it has with (ii) growing convictions among IFIs and the donor community (which have rapidly turned into yet another new neoclassical ideology) about the need to make developing economies more open and capable of earning their own way in a world – i.e. financing their import needs from export earnings rather than from over-reliance on aid or external borrowings – in which the market paradigm has taken almost universal hold. The consequence of such emphasis has often been the opposite of what was intended, at least in terms of short-run effects as the early debacles with first-generation adjustment programmes of 1982-85 vintage have clearly suggested.

declining. The result has been increased volatily and a declining trend in the world prices of these commodities, relieved or reversed temporarily only by occasional crop failures in particular countries (e.g. coffee frosts in Brazil).

This problem – clearly one with major regional implications in SADC given the commonality of agricultural output in its member countries – has become familiar in the literature as the *adding up problem.* In some cases it is serious (World Bank, 1994a; Schiff, 1994; Akiyama and Larson, 1994). It is particularly acute for countries with large world market shares in particular commodities. In theory, the remedies are export diversification and, paradoxically, the imposition of export taxes (which are aimed at eliminating high-cost producers from the market thus lowering relatively cost-efficient output to levels that markets can sustain without major price effects), although such taxes have been problematic in Africa with the WBG generally arguing for their reduction and elimination. In practice, these remedies are not easy to implement.

Though there can be little disagreement that the reform of policies applying to agriculture in Africa and SAR was long overdue, actual experience with agricultural reform has been mixed if not disappointing (Jayarajah and Branson, 1995). In SAR, droughts between 1985-1995 dampened the output response of the agricultural sector for food crops, export crops and other domestically produced agricultural products (especially in 1992-93; see Annex Table 20). Another problem was that between 1985-94 world prices for some of SAR's agricultural exports fell, making it difficult to improve real prices for producers even with large exchange rate adjustments, export tax reduction, reduced marketing costs and the easing of credit and input constraints. Although most adjusting SAR countries reduced the overall tax burden on agriculture they did not, except for Malawi, manage to reduce both implicit and explicit taxation at the same time. Where massive devaluations (Tanzania and Zambia) reduced implicit taxation, part of the domestic price gain was recaptured by the fiscus through export taxes.

Unsubsidised fertiliser prices are much higher in SAR countries than elsewhere because of small procurement lots, inefficient parastatal marketing and distribution with substantial leakages, and very high shipping, handling and domestic transport costs. For that reason, and to encourage greater use of fertilisers, subsidies have traditionally been very high and had become a major drain on the fiscus, being a government hand-out with considerable political appeal. Efforts with fertiliser subsidy reduction (politically very unpopular) have proven slow and only partially successful. Some countries believe that removing subsidies would discourage fertiliser use and cause yields to drop. For a variety of reasons, mainly political, most

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countries in SADC still maintain these subsidies, albeit at a lower level than before SAPs were implemented. In Tanzania, subsidies have been reduced from 80% of the farmgate price in 1989 to 40% in 1993 without any evidence that fertiliser use has fallen. Malawi's target of eliminating the fertiliser subsidy (30% of farmgate price) by 1989 was initially successful but was aborted when kwacha devaluation induced sudden, large price increases in transport and fertiliser import costs.

Maize production is a particularly critical region-wide problem in SAR. Although SADC has the potential to be in a large surplus position, it is actually in chronic maize deficit. Reforms to increase domestic maize production in SAR have focused on moving domestic producer prices closer to border prices; announcing attractive administered prices before planting commences; expediting payments to farmers; relaxing controls of maize movements across SAR borders; and restructuring or privatising maize marketing parastatals. Some of these reforms have taken hold and had a positive impact which has not been fully reflected in sustained output gains because of droughts. But it remains difficult to inject private entrepreneurship into maize marketing and, concomitantly, diminish the role of parastatal maize marketing companies into becoming buyers of last resort and holders of emergency grain buffer stocks. A *regional approach* to the issue of agricultural reforms affecting maize production would yield results far superior to measures being taken at the national level and has major structural implications for patterns of agricultural production in SAR.

Despite more than a decade of structural adjustments in agriculture at the national level, most SAR countries (other than South Africa) are still producing well below their agricultural potential with no clear indication that policy reforms have triggered decisive, sustainable increases in either agricultural output or exports. The weak supply and diversification response of the agricultural sector to adjustment measures is generally attributed to continuing macroeconomic imbalances and policy distortions leading to continuing agricultural pricing distortions; inefficient marketing arrangements which are not being corrected speedily enough; excessive vulnerability to weather patterns; sudden shifts in terms-of-trade; and the generally long lag with which agricultural output responds to policy reforms – raising the question of whether it is too early to judge the success of the reforms undertaken (Jaeger, 1992).

Agricultural market liberalisation will not, by itself, secure the sustained annual increases of annual agricultural output and exports that are required to achieve both food security and long-term external account viability. What SAPs and ASECALs in SAR have failed to address is a more fundamental structural issue concerning agricultural patterns of food production

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in SAR. This was brought to the fore by the AfDB's (1993) report and can only be addressed properly at the regional level. Anomalous though it is, SAR has agricultural production patterns which go against the grain of climatic logic. The largest amount of grain production in SAR takes place in areas which are agro-climatically unsuitable and economically inefficient. The large *real* costs of such production are being obscured by input subsidies (especially for water and electricity) being provided to wealthy non-African commercial and corporate farmers in South Africa to encourage maize production. These policies and patterns were established some time ago and entrenched by apartheid. They involve biases and subsidies which are neither fiscally affordable nor politically sustainable over the long term, especially as other fiscal and political priorities which have not received any weight before (largely because they involved expenditures on the majority native communities) begin to assert themselves under a new political nexus.

Food production in SADC countries (excluding South Africa) between 1965-95 has grown at an average of just over 1% annually in the face of a population growing at around 3.5% annually. By contrast, in South Africa, food production grew by 3-4% annually with exportable surpluses of food being available throughout the 1970s to the early 1990s (albeit at the expense of deliberate deprivation in the larger but dispossessed part of the domestic market). Since 1980, however, there has been a steady decline in the value of food crops produced by South Africa, compensated by increases in higher value output of horticultural, poultry and cattle production. With the progressive phasing out of subsidies for maize production and fertiliser inputs, cereal production in South Africa will decline further and its exportable surplus will diminish to the point of disappearing. By the turn of the century South Africa will probably become a net cereal importer dependent on either regional or (more expensive) extra-regional imports of grain.

For the region to achieve and retain food self-sufficiency, the production of maize and other cereals must shift from the irrigated, semi-arid areas of the South African *veldt* to higher potential rain-fed areas further north in Angola, Zambia, northern Zimbabwe, Malawi, northern Mozambique and southern Tanzania, where regular rainfall is higher (despite droughts) as is soil fertility and water retention capacity. Moreover, the ownership of land in the low rainfall of areas of South Africa and Zimbabwe (with pressures on cultivable land being exacerbated by animal herds and relentless population growth) is grossly skewed in favour of minority white and commercial farmers. The much larger numbers of poorer indigenous farmers (confined in South Africa largely to the former homelands) have been displaced to marginal and much smaller land areas –

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a pattern which cannot remain undisturbed as recent upheavals in Zimbabwe suggest.

On the other hand, to feed the region's burgeoning population, about 20 million hectares of new land will need to come under cultivation for maize alone (AfDB, 1993) – an increase of about 60% in the total amount of land presently under cultivation in SAR. Given limitations on cultivable land in South Africa, most of the increase in cereal production will need to come from cultivation of new land opened up in the northern part of the region and from substantially improved agricultural productivity (i.e. yields per hectare) if the region is to become food secure.

A regional rather than a national approach to this critical strategic challenge faced by SADC would permit the settlement of new land areas in a manner which reconciled meeting the food requirements of the region with the imperatives of addressing thorny and urgent land reform and redistribution problems in South Africa and Zimbabwe. At the same time, yields need to be improved, while aggregate output and agricultural exports with progressively higher value need to be increased. If long overdue land reform is to be achieved in SAR it must be managed in a way which does not compromise medium-term prospects for: achieving food security; expanding output to meet the needs of a growing population; increasing basic nutritional levels; and expanding agricultural exports from all SAR countries and not South Africa alone.

The expansion of production in the more northerly areas of SAR, where available arable land is barely being utilised, will require the prior provision of infrastructure (especially roads and water supply) with development plans being made for mixed settlement of small and large farms and for maintaining an environmentally appropriate ratio of farmland to woodland. Markets by themselves cannot possibly develop or clear the amount of land which needs to be transferred to address the size of the problem the region faces. Land transfers through markets will need to be augmented by regionally managed transfers of a reasonable size.

Regionally organised and financed infrastructure development in the new land areas, coupled with appropriately designed *land swap* arrangements are necessary to enable minority and large commercial farmers from South Africa and Zimbabwe (who are more regionally mobile and whose relocation would not necessitate major transmigration and resettlement programmes) to sell their existing holdings in these two countries and purchase more productive land further north. Zambia and Mozambique have already taken steps to attract commercial farmers from South Africa and Zimbabwe. The time is ripe for SADC to develop a *regional* land utilisation programme which would facilitate land reform while increasing food and export production. In the process, the skills of minority farmers in SAR

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will have to be redeployed since these constitute a scarce and precious regional asset which should not be dispensed with or treated lightly in an area short of food and human capital.

Establishing a regional land bureau might be contemplated to map out and monitor usable land reserves (without imbalancing the fragile ecology of these areas) in SAR countries; help to intermediate land swaps between countries at the first cut, and between private parties at the second; undertake development of infrastructure on new land; and facilitate a smooth transition from a politically and socially untenable land ownership regime to one which is more equitable, corrects previous injustices and absorbs the rural population in a productive manner. Such an institution might be complemented with a regional initiative which pulled together under one SADC umbrella the cooperative work being undertaken on agricultural research, extension services, and farmer training programmes aimed at raising agricultural productivity in the region as a whole.

The regional imperatives of cultivation are no more impelling than are the regional imperatives of forestry where there are equally strong arguments for regional aspects of policy reform and adjustment to be given more play, but to which IFI-supported SAPs and ASECALs have not paid much attention. There is recognised interdependence between the extent of tree cover and the incidence of rainfall in the region. Expanding cultivated land areas will have major implications on wildlife herd movement and on existing systems of agriculture. Moreover, demand for wood (much of which is presently being pre-empted to meet basic energy needs in rural areas) for industrial use to support the region's growth will continue to increase; a reasonable proportion of it will need to be regionally met. Equally, a regional perspective on fishery resources exploitation, especially where inland fish sources are concerned, is a *sine qua non* because the key sources are the natural and man-made lakes of the region which constitute several borders and in which the conservation of fish stocks are regional rather than national concerns.

Obviously, continuing adjustments in South Africa's agricultural sector, with reduction of subsidies and a shift in emphasis from commercial to small indigenous farmers, will have consequences for regional agriculture as a whole. The entry of South Africa into the regional agricultural equation could result in major benefits if regional receptivity to the skills, research knowledge and technology it has can be developed to capitalise on them. At the same time, South Africa's food security, which has been a goal attained at considerable national expense and high opportunity costs under a different political climate, will depend increasingly upon regional performance and initiative.

As the foregoing paragraphs have suggested, the main regional dimen-

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sions of agricultural transformation have till now been largely ignored in national SAPs and ASECALs (even where key regional issues such as maize are concerned). They are likely to become much more prominent as the rest of the decade unfolds and a different appreciation of interdependencies across countries in agriculture and the connected areas of natural resource management and efficient land utilisation, begins to permeate the thinking of SADC governments. Such a trend needs to be reinforced, rather than ignored or vitiated. Present national policy reform agendas focus too narrowly on *intra*-border adjustments and changes at a time when attention on managing issues of land and water in SAR should be shifting toward better understanding of *inter*-border adjustments and changes.

8. Energy Sector Policy

Africa and SAR are characterised by inadequate and unreliable supplies of power and energy which compromise their growth, development and adjustment prospects in pervasive ways. Excessive dependence on domestic fuelwood used by a rapidly growing population is leading to major problems with deforestation and denudation with its consequent implications for rainfall, cultivation and wildlife. At the same, time energy shortages at points of consumption and the unreliability of electricity supplies in most SAR countries are inhibiting industrialisation. Yet, neither Africa as a continent nor SAR as a region are short of natural resources, because the different forms of energy needed for targeted economic growth rates in SAR represent only a fraction of the known oil, gas, coal, hydro and geothermal resources available (World Bank, 1989). Moreover, increasing use of renewables (wind, solar, biomass and mini-hydro) – with the latest technologies in these sources of power-generation having improved far more than is generally appreciated – would stretch SAR's energy resources even further than has presently been estimated.

The gap between energy potential and energy reality in SAR is explained by (i) poor policies which have consistently underpriced energy sources and in particular electricity supply; (ii) an unequal distribution of energy resource endowments among individual countries which virtually disappear in their importance when a *regional* perspective is taken with SAR being an energy surplus region for almost all sources of energy, except perhaps woodfuel; especially if the hydro-potential of southern Zaïre bordering on Angola and Zambia is factored in; (iii) physical barriers which pose technological challenges, e.g. immense transmission distances for power and gas; (iv) fragmented and limited consumer market sizes which impose limits on the development of economic power supply; (iv)

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over-investment in duplicative facilities such as too many uneconomically sized electricity generating plants and too many oil refineries with countries determined to be self-sufficient and energy secure; (v) procurement of crude oil in uneconomically small quantities by individual countries; (vi) poorly planned energy infrastructure with imbalanced investment in generation and too little in distribution leading to low capacity utilisation and high maintenance costs; and (vi) growing environmental constraints to energy use which have regional implications.

More than 95% of Africa's coal deposits (of over 135 billion tonnes) are located in SAR (Botswana, Mozambique, South Africa, Swaziland Tanzania and Zimbabwe), although, apart from South Africa, these deposits are largely undeveloped for energy generation due to lack of capital, trained labour, negligible domestic market demand and very high transport and transmission costs and losses. Immense hydropotential (over 70 GW) in the region remains undeveloped because of the absence of proper regional grid connections or management, and the lack of cooperation across countries in trading electricity. The last unfortunate reality results in under 10% of electricity generated in SAR being traded across borders.

Apart from ESKOM in South Africa, national (parastatal) power utilities are much too small and cannot provide the economies of scale needed to develop viable hydro-projects of the kind that a regional market could easily support, or invest in the costly infrastructure needed for gas use. Yet, because they are public rather than private enterprises they have not been active in seeking ways of achieving market efficiency being more responsive to political signals rather than commercial imperatives. Power transmission losses are high because of both the inevitable resistance losses over long distances and extensive pilferage. Most of the utilities in SAR (outside Botswana, South Africa and Zimbabwe) are overstaffed and overindebted with large scale arrears and inadequate tariffs or revenues to finance ongoing operations, let alone regular maintenance and capital investment.

The urgency of energy sector reform in SAR has been acknowledged with SAPs for adjusting countries in the region incorporating conditionality on energy pricing, and on energy investment rationalisation and restructuring. But there have been no energy sectoral adjustment loans (ESECALs) in SAR as in other parts of Africa and the developing world. The emphasis on reforms in the energy sector through SAPs in different SADC countries have again been *nationally* focused based on their energy intensity; share of imported fuels in energy production; distortions in energy pricing; and the size of public investment in the energy sector. Despite what should have been the sobering impact of three oil shocks between 1973-85, the general picture in SAR in the mid-1980s was one of distorted price structures encouraging uneconomic fuel substitutions and poor utili-

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sation of capacity. Pricing policies – with prices well below long-run marginal resource costs – induced suboptimal development of domestic energy resources and subsidised uneconomic levels of energy consumption. Consumer price subsidies were unaffordable and enlarged the fiscal deficit. Moreover, skewed electricity tariff structures resulted in large supply-demand inefficiencies with the largest subsidies being transferred to the costliest consumers.

The reforms incorporated in SAPs were aimed at improving allocative efficiency and restructuring the energy sector so that its operating and investment costs would be met through internal cash generation based on cost-recovery based tariffs and revenues. Emphasis was placed on deregulation of the energy sector, enhanced scope for private sector ownership and participation, elimination of distortions in energy trading regimes, and in fiscal and financial incentives for energy production and consumption and, finally, on extricating governments from an ownership role and emphasising their role as system and market regulators. But, surprisingly, virtually no attention has been paid in SAPs to the arguments that the World Bank itself had made in 1989 on the critical importance of market enlargement and coordinated investment through regional cooperation.

The history of conflict in the region, with military action often being aimed at energy source targets, has made the goal of energy self-sufficiency a national obsession in SAR. Few governments seem able to accept that continuing with such a strategy in new (and, hopefully, very different) circumstances might result in energy *insecurity* because of the affordability constraint. As the region becomes a zone of peace, SADC countries should become more aware that security of supply at the national level may actually be enhanced, rather than diminished through regional cooperation in electricity generation and transmission.

Intra-regional exports from the northern SAR countries to South Africa after the turn of the present century, when South Africa's excess generating capacity will have been fully absorbed, would provide an important source of earnings for countries who are in chronic trade deficit with South Africa. In addition, a regionally connected power grid with open pooling, wheeling and trading arrangements across borders would reduce electricity costs in most national markets in SAR. It would improve supply reliability and frequency stability, reduce the incidence of frequent and long power outages, and reduce the need for high-pinning reserve requirements and costly investments in extra generating capacity to meet seasonal and peak loads. These savings would translate into large economic gains with SADC and AfDB estimating investment cost savings of $2.7 billion between 1995-2010, and the generation of over $800 million worth of annual trading in electricity by 2010.

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The AfDB report's analysis is convincing in making the argument that the energy sector in SAR needs to be structurally transformed taking a regional view with (i) early completion of the regional electricity grid; (ii) linking the SAR grid to southern Zaire; (iii) developing the hydropotential of the Inga river (44 GW) through regional investment involving a large role for the private sector; (iv) developing and institutionalising flexible intra-regional power pooling and system management arrangements; (v) agreeing on a satisfactory level of tariffs for cross-border power exports; along with (vi) suitable payments and settlements systems which minimise exchange and transfer risks in settling accounts for electricity traded between countries.

Clearly, the risks of monopolistic or monopsonistic behaviour on the part of the largest buyers and sellers of electricity in a regional context need to be guarded against through appropriate regional regulation. There are also technical and engineering risks involved in planning and managing the second-to-second operations of interconnected power systems in real time to avoid the costs and risks of inordinately costly systems crashes.

Outside of the electricity power sub-sector there are major opportunities in SADC for rationalising and redirecting crude oil and refined product flows involving Angolan oil more sensibly through the existing refineries in the region; developing gas fields for regional markets through private sector ownership and investment; and in finding ways of exploiting the region's coal resources for energy supply (AfDB, 1993).

9. *Financial Sector Policy*

The broader *real sector* adjustment problems faced by Africa and SAR are reflected in the poor condition of their *financial systems* whose health and capacity are profoundly affected by what happens in the real economy and vice-versa. To any casual observer Africa's financial systems appear patently dysfunctional in performing their main roles: adequate financial resource mobilisation to meet the investment and working capital needs of the real economy; efficient allocation of financial savings through effective intermediation; operating payments and settlement mechanisms which lubricate real sector transactions; offering holders of financial assets sufficient opportunity for portfolio risk diversification; and providing the financial services and credit facilities needed to facilitate trade and investment transactions across borders.

In SADC, South Africa has a financial system whose depth, diversity, sophistication and level of development probably exceeds the needs of its real economy. That has perhaps created a different type of real vs. financial sector imbalance which is exacerbated by its excessive risk aversion in

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dealing with the hitherto dispossessed part of South Africa's economy. Its SACU neighbours, to which the South African system extends (albeit not as prominently or effectively), are also reasonably well served, as is Mauritius whose financial system is not quite as sophisticated as South Africa's. But financial systems in the rest of SAR reflect the characteristics of those found elsewhere in Africa. The need for policy reform and adjustment in the financial sectors of Africa and SAR has therefore been as strong, and perhaps more urgent, than parallel reforms in the real sectors.

In the other SADC countries, financial systems (Zimbabwe's being the strongest, Angola/Mozambique the weakest, and Malawi, Tanzania and Zambia in the middle) are to varying degrees characterised by poor resource mobilisation capacity and effectiveness; high levels of credit risk and non-performing assets; egregious overmanning; poor technology and high intermediation costs; and an intrusive role of government in the ownership and direction of financial institutions. These factors have combined to exacerbate overall resource misallocation and misuse in real sectors dominated by parastatals. With government dominated as both borrowers and lenders, financial systems in Africa and SAR ceased playing any useful independent or impartial role in monitoring/disciplining the use of credit and financial resources in the economy.

What were supposed to be independent intermediation systems, effectively became payments, clearing and bookkeeping mechanisms for deteriorating fiscal systems. Central and commercial banks lent mainly to governments and state-owned enterprises resulting in the private sector being crowded out from credit. Excessive deficit monetisation over long periods retarded the growth of properly functioning interbank or money markets to equilibrate liquidity. Non-performing portfolios, high taxes, and excessive administrative costs steadily eroded bank profitability. Consequently, the integrity of Africa's and SAR's financial systems has degenerated over time becoming shallower and narrower, reflecting (and resulting in) low rates of financial savings, and a general lack of public confidence in financial institutions and domestic currency denominated financial assets.

With the successive financial shocks triggered by external payments crises and subsequent adjustment programmes resulting in monetary and exchange rate instability, the level of non-performing assets owned by many SAR financial systems increased to a point where systemic portfolio risk actually materialised and the financial sector became essentially insolvent (World Bank, 1994a). SAPs and FINSECALs in Africa and SAR began paying serious attention to these problems around 1989 and have aimed to achieve five broad objectives: reducing financial repression (in the classic McKinnon-Shaw sense); restoring solvency of the banking system; improving its incentive structure and operating environment; improving standards of financial practice; and upgrading the quality of institutional infrastructure supporting the financial system.

The specific measures taken to achieve these objectives have included (i) interest rate liberalisation involving shifts from negative controlled real rates to positive quasi-market determined rates along with the elimination of interest rate subsidies and reduction of excessively high statutory liquidity and reserve ratios; (ii) market determined allocation of credit to replace fiat-driven, subsidised credit; (iii) restructuring, recapitalisation and in some cases privatisation of public banks with more stringent rules on capital adequacy ratios and provisioning requirements; (iv) liquidating many insolvent non-bank financial institutions (including some development finance institutions); (v) introducing greater domestic and foreign competition in the banking sector by liberalising former entry barriers; (vi) encouraging development of incipient capital market institutions; (vii) strengthening regulatory capacity and prudential supervision in the banking system and over nascent capital market activity; (viii) reducing overmanning levels and introducing new technology to bring payments, settlements, accounting, auditing, control, and risk management systems in line with acceptable standards (using international benchmarks from other developing countries) on a phased basis; (ix) aiming at more general improvements in the quality of financial reporting practices and standards; and (x) improving the quality of legal standards and practices applicable to financial transactions and collateral realisation/asset recovery procedures.

Both the diagnostics and the prescriptions appear intelligent and exhaustive. So, what has the overall impact of financial sector adjustment in the non-SACU economies of SADC been so far? It has in generally been unimpressive and disappointing (World Bank, 1994a; Jayarajah and Branson, 1995). Some progress has been made with lessening the extent of financial repression with movement from highly negative, controlled real interest rates to positive rates, lower liquidity and reserve ratios, and some success in increasing private participation in banking systems (but with no clear evidence as yet that such participation has improved bank operating performance). Regrettably, many of SAR's financial systems continue to fund large deficits of governments and parastatals; the first round of bank recapitalisations and balance-sheet clean-up has been succeeded by a second round of new portfolio problems.

Financial sector reform has been complicated by the persistence of large fiscal deficits and sudden shift to high real interest rates and more realistic exchange rates. The combined effect of these adjustments has generally been to worsen bank portfolio quality problems and trigger systemic insolvency. A shift to high real interest rates impinges adversely on government and parastatal accounts in countries which have high levels of outstanding

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domestic debt (e.g. Zambia). Moreover, bank recapitalisations have been extremely expensive, imposing fiscal burdens of between 2-8% of GDP annually. In Tanzania the cost of a partial restructuring of the main state-owned commercial bank was estimated at 40% of GDP (World Bank, 1994a).

Collateral recovery rates on failed loans have been disappointingly low with liquidation costs absorbing a large proportion (30-65%) of the amounts recovered. Relatively little progress has been made with implementing the other measures listed above, or in having those measures which have been attempted yield visible results. Nor is there any persuasive evidence that financial sector adjustment efforts have resulted in increasing total or financial savings or in supporting increased productive private investment in SAR or Africa (World Bank, 1994a; see also Annex Table 16).

Experience with FINSECALs and SAP conditionality related to financial sector reforms in Africa and elsewhere suggests that:

- cause-effect relationships between financial reform instruments and fiscal/monetary targets are either not properly understood *ex ante* or not taken fully into account; e.g. when funds required for bank recapitalisation are so large as to rebound on fiscal targets and destabilise monetary aggregates; or when interest rate liberalisation and credit decontrol affect government finances and destabilise money demand/supply parameters;
- if macroeconomic stabilisation has not been achieved before financial sector liberalisation gets underway, the effects are usually counterproductive; e.g. when interest rates are liberalised *before* inflation rates and budget deficits are brought under control and before external capital flow volatility has been dampened, the result is usually an uncontrolled money spiral;
- financial sector liberalisation should follow, not precede real sector liberalisation because real sector adjustment usually takes place more slowly; e.g. when the big financial prices (interest and exchange rates) are liberalised before real sector prices have adjusted, significant misallocation of credit could result;
- institutional reform in the financial sector may need to precede price reform because weak and fragile institutional structures and operating systems can crack in the face of major financial price adjustments with their implications for portfolio performance;
- interest *structure* rationalisation and simplification should precede interest *rate* liberalisation; and
- banking sector adjustment and reform should be undertaken with performance being stabilised before adjustment is attempted with non-banks and capital markets.

With the desultory outcomes of attempts at financial sector reform in SAR, and with the benefit of learning from elsewhere, how would a *regional* approach to improving financial sector restructuring and functioning be superior to efforts confined largely to the national level? In answering this important question, the analysis of financial sector issues contained in the AfDB's 1993 report provides vital clues in observing that financial sector reform in individual SAR countries is likely to occur at a much slower pace if the institutional and financial resources of the *region* are not fully deployed in resolving the institutional, human and technological deficits which exist in each national system.

The strategy required by a regional approach to financial sector reform and development would be based on the central pillar of regional linkages being established through a process of financial institutional development, employing a flexible approach which emphasises the following four broad areas:

(a) Fostering an efficient and well-capitalised *commercial banking system* in each individual SAR economy which is inter-linked on a regional basis and operates under a common, rigorous regulatory and supervisory structure. Such a system would require the existing foreign banks in the region, the present strong South African banks, and the region's several strong central banks (in particular those of Botswana, South Africa, Mauritius and Zimbabwe) to play a much larger regional role by bolstering and supporting a market-driven process of new entry, acquisition, merger and restructuring of banks which is already underway. The model would employ a *universal banking* approach permitting banks to engage in term lending and capital market activities. It would be supported by a regional regulatory framework designed to suit multi-purpose banking. Such a framework would require establishing common or at least harmonised regional standards for bank regulation and supervision with respect to matters such as standardised bank documentation; asset and risk classification, provisioning, audit specifications, licensing and regulatory requirements, capital adequacy ratios, deposit insurance etc.

    A regional interbank market in SAR currencies and foreign exchange, and interbank payment clearing arrangements would go a long way toward strengthening commercial banking operations region-wide especially if common monetary arrangements could be expanded beyond the MMA. Moreover, encouraging the development of commercial banks with regional branch networks across SAR would add immeasurably to encouraging cross-border trade. There are advantages to IFIs and SAR governments involving South African banks more actively in the restructuring, recapitalisation and privatisation of

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public sector banks throughout SAR as a means of facilitating their entry into national markets with a nationally beneficial *quid pro quo* attached.

(b) The restructuring of crippled or insolvent *development finance institutions* (DFIs) which litter the landscape of SAR's financial sectors could be dealt with as part of a comprehensive regional financial reform package. DFIs could be restructured on a *regional* basis through acquisition, merger, rationalisation and recapitalisation. This could be achieved either within the DFI community with external assistance or by national public DFIs being offered for sale to regional or foreign commercial and investment banks for low-cost or no-cost buy-outs. The *quid pro quo* would be that the banks would clean out DFI portfolios and revive them within a time-bound frame or wind them up in an orderly fashion after having segregated their good portfolios from the bad. This approach could be extended by establishing a regional asset recovery and reconstruction fund accessible to all DFIs within the region which would enable dormant assets or those in receivership to be sold on a wider regional market with specific arrangements being made to deal with the recovery of assets of public enterprises in default to DFIs.

(c) Using the institutional and financial strength of *insurance* companies in Mauritius, South Africa, and Zimbabwe to develop a region-wide market for insurance open to private sector participation. Under a regional approach to developing a broadly based insurance industry, institutions would emerge which could manage risks better across a wider geographical market than have risks excessively (and artificially) concentrated in small national ones. SAR governments could collaborate to: re-introduce competition in their national insurance industries; develop a reinsurance capability at the regional level; and adopt regional regulation and supervision of insurance companies. The stronger insurance companies in the region could do much to stimulate competition, introduce new products, introduce improved actuarial and market pricing techniques, and transfer up-to-date technology by entering deregulated and open insurance markets in SAR countries beyond their own. Regional cross-investments and management entry by the major insurance companies in southern SAR could assist in the financial restructuring of public national insurance monopolies which are now being restructured and privatised in the non-SACU economies.

Extension of insurance markets and the revival of insurance industries in SAR economies could do much to facilitate the development of regional capital markets by creating a long-term institutional investor

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capability which presently does not exist outside of SACU and Mauritius. Such possibilities are capable of being translated into realities with increasing exchange rate convertibility and open current and capital accounts now emerging across the region.

(d) The establishment of a privately backed *regional stock exchange* operating from an offshore jurisdiction without exchange controls could help to link SAR economies with international capital markets and attracting foreign portfolios which have been conspicuously absent from countries in SAR other than South Africa, Zimbabwe and Mauritius. Such an exchange would be useful in linking SAR markets to capital-surplus markets in Asia which may be more interested in acquiring risk exposure in SAR than traditional markets in Europe and America. This initiative, whilst of lower priority to more urgent reforms in banking and insurance, is worth the support of SAR governments and the international community as a means to foster domestic capital market and stock exchange development, increase and diversify opportunities for mobilising foreign savings, and developing incipient international linkages between nascent markets in SAR and those elsewhere.

These four areas illustrate broadly how individual SAR countries would gain if they leveraged their own limited and overstretched financial and institutional resources, with the more substantial capabilities that the stronger financial systems of the region have to offer. To the extent that financial markets are freed, and entry barriers to regional and foreign investment in domestic financial sectors are lowered, much of what has been suggested is likely to happen anyway. But it will take place more slowly than the needs of the region require.

The national approaches which are taken by traditional SAPs and FINSECALs cannot possibly offer as much. Their orientation and focus needs to be changed to incorporate wider regional dimensions which may make their outcomes more fruitful and effective than they have been so far. For the pace of reform to be accelerated in a manner which is commensurate with the needs of financial systems across the region, concerted action is required within a consensually agreed framework for regional cooperation and financial linkage development, by SADC governments, the region's international interlocutors and economic disciplinarians, and by private sector institutions and agents from within the region and from outside SAR.

10. Rationalisation and Privatisation of State Enterprises

The core of the development crisis and adjustment problem of Africa

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and SAR resides largely in the malfunctioning of state-owned enterprises. These state enterprises which, in SAR, were created in abundance, predominated in virtually every sector of SADC economies in the post-independence era. They were built to get away from the ethos of the free-but-reserved market colonialism which was extractive in nature and did little for local development. Under the populist socialist theories of the day, parastatals were supposed to deploy resources, achieve rapid industrialisation, accelerate development and generate surpluses for the public good. By contrast, markets, private ownership and foreign investment were suspect. In pre-independence Africa, the larger private firms (especially the mining, construction, manufacturing and plantation conglomerates) were owned and operated largely by colonial metropolitan interests. Smaller (mainly trading and services) firms were owned and operated by non-Africans imported from other colonies to perform petty commercial functions. There was little evidence visible of indigenous African private entrepreneurship being in existence when independence was achieved.

In retrospect, African parastatals achieved largely the opposite of what they were intended to. Overmanned, overprotected, fiscally cushioned, financially undisciplined and open to rampant political interference, they became conduits for achieving political rather than commercial objectives. In the process, far from achieving the broader objectives of industrialisation and development, they turned into vehicles through which the private agenda of public officials and political leaders, rather than those of the commonweal or public good, were fulfilled. While absorbing the largest proportion of employment outside of the agricultural sector, parastatals laid claims to disproportionate amounts of fiscal resources for capital investment – very inefficiently used – and for covering operating losses which accounted for a significant proportion of national GDPs, representing a major drain on increasingly insolvent exchequers. Their operations resulted in distorting prices, markets, budgets and money virtually across the board, and introducing untenable rigidities in markets for tradable and untradable goods, services and production factors. This damning indictment of public enterprise performance in Africa is sweeping, but should not convey the impression that no parastatal in Africa can justify its existence. There are in fact many parastatals which can and do. But they are few and most of these are in South Africa and SACU. Even there, their performance is sub-optimal although not quite as draining of scarce national resources as elsewhere.

The adjustment conditionality relating to public sector reform usually focuses on both government and civil service reforms as well as parastatal reforms. In the first category, the objectives supported by specific measures are to (i) reduce the role and size of government as a whole and diminish

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its intervention capacity in the economy; (ii) reduce the number of goods and services which have been taken for granted as being public in nature and introduce greater private sector involvement and competition in the provision of such goods and services; (iii) shift the government away from direct involvement in productive activity and have it concentrate on core functions of governance and effective market regulation through the establishment and enforcement of rules which ensure competition; (iv) reduce overstaffing in government; (v) use the resource savings from civil service reduction to improve pay scales, working conditions and other incentives to attract and retain a better quality of civil servant; and (v) retrain/retool civil servants to perform at much higher levels of efficiency.

Where parastatal reform is concerned, the aims have been to (i) rationalise and reduce their number; (ii) close enterprises which are inherently uncompetitive and unviable and for which the costs of restructuring would exceed any benefit emanating over the discountable future; (iii) corporatise and commercialise the remaining state enterprises through radical restructuring, downsizing, cost-cutting and technology upgrading into operating efficiently and profitably through increased capacity utilisation and improvement of product/service output as well as its quality/cost; (v) financial restructuring; (vi) management and organisational revamping; (vii) weaning parastatals from dependence on government for subsidies and investment funds; and (viii) privatising as many of them as possible under domestic and foreign absorption constraints.

Though the need to proceed rapidly on all of these fronts has been obvious for some time, little progress is being made with public sector and parastatal reform in Africa (in sharp contrast to experience in Latin America, Eastern Europe and East Asia, but similar to experience in South Asia). Although there are signs that progress in 1994-95 has been more encouraging on this front than between 1989-93, no effective solution has been found to the plethora of problems which is constipating the process of public enterprise reform and inhibiting effective privatisation in SAR and, in the process, preventing the desired supply-side response to adjustment from taking place. Yet of all the sub-regions in Africa, SAR has the greatest potential for rapid movement on this front by using the *regional* capabilities that the stronger economies of SADC have. The capacity exists of meeting extant concerns of adjusting governments while retaining regional and domestic ownership. Opportunities can also be devised for putting in place arrangements to expand domestic ownership at a pace commensurate with the development of absorptive capacity in domestic capital markets, using interim trust fund arrangements for share ownership in privatised enterprises (Mistry and Griffith-Jones, 1992) involving public international investors. Some headway has already been made by South

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African and Zimbabwean firms acquiring former public enterprises in Tanzania, Zambia, Mozambique, and Zimbabwe in areas such as brewing, food processing and cigarette manufacturing sectors as well as in hotels and aquaculture.

But left to market forces alone, progress is likely to be much less rapid than is potentially possible through more systematically organised, concerted initiatives involving IFI-backing and long-term financing including organising pools of external portfolio equity. Almost on an industry-by-industry basis – and nowhere more so than in the financial services, power, transport services (especially air, road haulage and railways), water supply, telecommunications, construction, mining, manufacturing and tourism sectors – the management and institutional capacity exists within one SAR country or other (especially in South Africa, Zimbabwe, Mauritius and in some cases even Botswana) to do much more toward reform and privatisation of parastatals in the weaker SAR economies.

The required merchant and investment banking skills certainly exist within the region (although they appear absent at the national level in AMMTaZZ) as do capital market capacity (in Johannesburg, Harare, Gaborone and Port Louis), accounting, auditing and valuation skills, as well as the makings of an adequate legal framework and judicial capacity, to engineer and absorb privatisations in tandem with cross-regional shareholding arrangements in SAR on a larger, more ambitious scale than can possibly be envisaged if the restructuring focus is confined to domestic markets alone.

Such arrangements, based on a regional perspective, are a feature whose time has come. It is difficult to see a rational, efficient network of utilities, transport services, and supporting financial services developing in the region if the opportunities offered by present privatisation programmes in the non-SACU countries of the region are not seized sensibly to the mutual advantage of all. Private cross-holdings of entities in these sectors would permit much more rational and efficient investment programmes to be undertaken without reliance on government budgets, and much more efficient management and operation of their facilities and services on a region-wide basis (within corporate structures that would allow for much faster development of the HLM resources needed).

Moreover, market enlargement under effectively evolving regional integration agreements coupled with freer movements of capital and labour across borders, would permit the regional market to function much more efficiently than confined and fragmented national markets in facilitating the rationalisation and restructuring of manufacturing capacity across the region in a wide range of industries. As already emphasised, the financial engineering, accounting, legal and technical knowledge and expertise required to design and structure the large number of potential privatisation transactions involved exists within the region, probably at a higher level of sophistication than within the IFIs themselves. It is under-utilised and can be much more effectively used for regional benefit.

Until 1994 it would have been euphoric and prematurely wishful to contemplate such possibilities. But thanks to the remarkable transformation that has taken place in SAR since April 1994 that is no longer the case. It would therefore be a dereliction on the part of the IFIs, the international donor community and the AfDB, if their third-generation adjustment programmes for 1996-2000 did not incorporate in their design architecture a *regional approach* to achieving public sector reform-cum-privatisation objectives in SAR, using the formidable private sector skills and capital market resources that SADC (with South Africa in its membership) now embraces.

V Conclusion

It may suffice to conclude with the reiterated observation that the paper has attempted to demonstrate, based on available empirical evidence and analysis of literature, that a strong case can be made for thinking more carefully about the regional dimensions of the usual structural adjustment prescriptions, and ensuring that reform prescriptions at a national level are consistent with a wider regional perspective. Whether the paper has been sufficiently convincing is for the reader to judge; an attempt has been made to strengthen its arguments by focusing on linkages between adjustment and integration in ten distinct yet inter-related areas of policy reform.

Unfortunately, the paper has not dealt with other important dimensions of adjustment which have regional repercussions such as the *social* dimensions of adjustment, nor has it dealt with the crucial links between adjustment and integration in key sectors such as transport, telecommunications, tourism, water, ecology, health and education. All of these sectors are, arguably, as important to consider as subjects for adjustment in the case of SAR as the three specific sectors which have been analysed. The other areas have been touched on in AfDB's study (1993); but time and knowledge limitations have precluded this paper from examining them. Instead this paper has been confined deliberately to those areas of policy, and to those sectors, in which the WBG has evaluated adjustment experience in Africa and elsewhere in a systematic, organised fashion, so as to have an intellectual peg, with supporting evidence, for this paper to hang its arguments upon.

In its discourse, the paper has drawn attention to the absence of system-

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atic, rigorous thinking by the IFIs about mutually reinforcing linkages between RIAs and SAPs. Virtually no attempt has been made to operationalise the essence of such linkages into adjustment action and conditionality. A close look at what adjustment conditionality aims at, and what it actually achieves, shows not just a large gap between expectations and outcomes, but also a lack of concern for the effects of domestic adjustments on neighbouring countries.

Precisely what stabilisation and adjustment problems one diagnoses, how one arrives at the right prescriptions about controlling and liberalising economies, what range of policy instruments one uses, and in what order one deploys them, are critical determinants of the good or harm that a country risks doing to itself or to its neighbours. For the prescribers of SAPs this has, till now, been a costless process except in terms of lost reputation. But for adjusting countries in Africa the costs have been very heavy. They have been at an intellectual and negotiating disadvantage in determining (except by default) the nature, pace and sequence of the adjustments foisted on them. Indeed, belated concerns about the *ownership* of such programmes implies precisely that unfortunate reality.

When after ten or more years, guaranteed prescriptions have failed to effect the promised cure, African countries have been left with a legacy comprising unserviceable burdens of unproductive multilateral debt and chronic overdependence on the largesse of donors, which is of course heavily politically conditioned. Donors on the other hand are left with the embarrassment of explaining to their constituencies for aid why the tax resources provided have been wasted in such large amounts for so long. As is the case with any patient immobilised for quite as long, recovery in Africa is likely to be much longer, slower and more painful than anyone would wish.

In making the case for the regional dimensions of structural adjustment to be taken into account in a more rigorous fashion, the paper has alluded to specific problems and has made suggestions in key policy areas which, taken together, could constitute a skeletal outline for the contents of a regional adjustment programme for SADC should the occasion ever arise to implement such a programme, and should the membership of SADC ever decide to contemplate the possibility. That, at present appears unlikely. It may be far more likely, and perhaps more desirable, that the members of SADC take on board the problems outlined and the suggestions made in each area of policy, as a possible agenda they might pursue and develop but, preferably avoiding the involvement of external agents in the kind of relationship between an adjusting country and IFIs that typically develops under a SAP.

The agenda could be used as an *aide memoire* by individual countries, as

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they formulate their own adjustment efforts at the national level, to ensure that they are heading in a direction which is compatible with their (and their partners') regional interests and not inimical to it. Some of the problems identified and ideas suggested in highlighting the regional dimensions of adjustment, and suggesting the incorporation of regional features in the design of adjustment, are recapitulated in telegraphic form below.

Fiscal Policy
- Revenue dependency on regional trade and invisibles transactions.
- Fiscal implications of intra-regional remittance-flow dependencies.
- Regional fiscal spillover effects from regional tax arbitrage opportunities.
- Revenue losses from intra-regional parallel market trade.
- Deficit spillover effects of region-wide droughts and measures to combat them.
- Savings in public investment from regional approach to infrastructure.
- Recurrent budget savings from joint operations in transport and utilities.
- Positive fiscal benefits from regionally agreed reductions in military expenditures.
- Fiscal savings from tax harmonisation and joint revenue administration.
- Fiscal savings from reducing arbitrage opportunities in mining taxation regimes.
- Avoidance of counterproductive regional fiscal competition to attract FDI.

Monetary Policy
- The value of peer group pressure in exerting monetary discipline under MMAs.
- Benefits vs. costs of extending the rand zone throughout SADC.
- Reduction of intra-regional financial risks and transaction costs with MMAs.
- Savings realised through cooperative monetary arrangements.
- Savings/leverage effects of reserves pooling.
- Effects of MMAs on forcing greater fiscal and exchange rate discipline.
- Opportunities for regulatory savings and improved enforcement.
- Better prudential supervision of financial systems.

Exchange Rate Policy
- Benefits of stabilising exchange rates after a long period of excess instability.
- Effects of exchange rate instability/inconvertibility on inhibiting regional trade.

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- Regional Exchange Rate Stabilisation Fund (REXSTAB) to support MMA.

Labour and Wage Policies

- Policy twist in regional labour markets: HLM competition vs. LLM displacement.
- SAR labour market problems/anomalies best dealt with in regional context.
- Cross-border labour flows and corresponding remittance effects.
- Intra-regional conflicts of interest with attracting HLM while repelling LLM.
- Brain drain effects of existing wage/labour policies on poorer SAR economies.
- Freeing labour and capital markets to unwind regional wage twist.
- Regional approaches to mass employment creation (Angola, Mozambique etc.).

Trade Policies

- Actual and potential intra-SADC trade much larger than usual figures suggest.
- Two-step approach to achieving competitiveness: region first; world later.
- Regionally coordinated rounds of tariff and non-tariff barrier reductions which deal with intra-regional and extra-regional liberalisation simultaneously; ensuring that extra-regional barriers are not so high as to vitiate reforms aimed at intra-regional efficiency-enhancing initiatives.
- Improvement of regional market sourcing opportunities to encourage trade-substitution effects in favour of intra-regional trade without incurring trade diverting inefficiencies and risks.
- Buying time for regional adjustment through learning effects.
- Two-tier regional protection structure to avoid immediate South African domination (and swamping effects) of regional production of manufactures through initial dumping at the expense of de-industrialisation elsewhere in SAR.
- Offsetting intra-regional current account imbalances with offsetting market-driven investment capital flows in reverse directions.
- Increasing intra-regional trade in invisibles, i.e. water, electricity, transport, tourism and financial services through market driven as well as government promoted efforts.
- Gradual extension of SACU to rest of SADC under modified arrangements.

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Industrial Sector Policies

- Importance of regional adjustment in mining and manufacturing.
- SAP approach to adjustment will reinforce the de-industrialisation already occurring in most SAR countries other than South Africa, Zimbabwe, Mauritius.
- Regional adjustment approach to industrialisation may be theoretically second best but is pragmatically first best.
- Delayed free market regional integration option for industrial adjustment in SADC would be preferable to implied SAP/ISECAL option of exposing very weak domestic industries to pressures of international competition too swiftly.
- Temporary protection of SADC industries from South Africa, Zimbabwe and Mauritius with lower barriers than from the rest of the world, allowing sufficient time for catch-up to occur in other SADC economies.

Agricultural Sector Policies

- Regional approach to structural shift in cereal production areas from southern (irrigated) to more agro-climatically efficient northern (rain-fed) areas in SAR.
- Regionally coordinated approach to agricultural subsidy withdrawal which encourage market forces across the region to bring about changes in production frontiers and agricultural output/export diversification programmes.
- Regional adjustment to future demand patterns for food in SAR, with the prospect of South Africa turning from a grain exporter to importer after 2001.
- Regionally coordinated development of agricultural infrastructure, especially for water, rural roads, communications and power.
- Combining land reform imperatives in southern SAR with food security imperatives of region by opening up arable lands in northern SAR through regionally organised land swaps.
- Regional integration of efforts in agricultural research, animal and plant disease control, agricultural marketing in world markets, training and extension.

Energy Sector Policies

- Regionally coordinated changes in energy pricing policy to enable cost-efficiency benefits of regional power generation and transmission to be realised; such an approach would enable projects to be developed which could not be justified or conceived under fragmented national market limitations.

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- Regional welfare benefits and reduction of public investment budget pressures of capital investment savings, and a concomitant shift in investment burdens from the public to the private sector, which could be realised from coordinated investment in economically sized power projects for regional markets.
- Greater security and stability of electricity supply from regional approach.
- Significant reductions in annual operating costs from regional power system management.
- Trading benefits from expanding exchanges of electricity across SAR borders enabling other SADC economies to increase their earnings from invisibles exports to South Africa and partly offsetting the intra-regional current account imbalance.
- Regional grid completion (priority) and establishment of intra-regional electricity pooling and trading arrangements with accompanying arrangements for swift intra-regional payments in settlement of power trading accounts.
- Regional grid link to southern Zaïre Inga river hydropower generating site.
- Regional cooperation on refinery capacity and output mix rationalisation to optimise production and transport cost efficiencies for refined oil products.
- Regional approaches to development of regional coal and gas potential for energy use and energy exports rather than for raw ore exports and wasted gas.

Financial Sector Policies
- Linked with regional monetary arrangements, a regional approach to financial sector stabilisation, institutional rationalisation, rehabilitation and development in SAR would be more efficient than SAP/FINSECAP approaches limited to national markets with limited internal financial and institutional capabilities.
- Need to develop capable regional commercial banking network which is financially strong, institutionally competent, technologically up-to-date, and capable of providing services to expand cross-border trade and investment.
- Regional approach to restructuring and recapitalising national development finance institutions in SADC within a more holistic framework would be more efficient and cost-effective than attempting to resolve their insolvency and illiquidity at the national level.
- Regional approach offers opportunity of developing healthier, more competitive and efficient insurance and long-term institutional savings

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industries in SAR's national markets than would be possible through a purely national approach; a healthier insurance industry would promote the development of capital markets faster than financial systems in which such industries are weak.

- Regional approach is essential to the cost-efficient development of non-banking capital markets for equity, bonds, other financial instruments and foreign exchange.
- Regional multi-market stock exchange initiative.
- Regional approach to financial system regulation (banking and capital markets) would promote visible savings in regulatory costs, avoid regulatory capture risks and produce a number of invisible benefits which would favour the maintenance of prudential supervision and the minimisation of systemic risk; it would prevent the risk of a domino effect of financial system risk materialising in one country having consequential spillover implications for its neighbours.

Public Sector Reform and Privatisation Policies

- Regional approach to public sector reform and privatisation would enable individual countries to access a much wider pool of institutional, financial, knowledge and human resources than can possibly be mustered in any national context to overcome the problems presently being faced with parastatal reform and privatisation efforts across SAR.
- Synchronicity of concurrent reform and privatisation initiatives across SAR provides a unique opportunity for *intra-regional cross-holding* patterns to be developed in the region's utilities and transport companies (i.e. electricity, water supply and river basin management, telecommunications, airlines, airports, railways, road haulage, shipping) as well as in publicly owned financial institutions and tourism facilities.
- Taken advantage of properly, intra-regional cross-holdings would permit, through acquisition and merger, stronger regional institutions to emerge in all of these areas enabling the region to capture economies of scale and operating efficiency benefits.
- Cross-holding opportunities could be availed of even prior to privatisation or public flotation to make the resultant restructured regional companies more attractive to domestic, regional and international investors.
- Such a regional approach would enable SAR governments to derive far more value from divestiture and asset sales over time than under the less efficient national approaches presently under consideration.
- Regional approaches to privatisation in manufacturing and mining would also yield more efficient outcomes than national approaches in matters such as privatisation pricing and regional market absorptive capacity.

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- International trust fund arrangements (to safeguard national interests, most domestic markets in SAR have developed the absorptive capacity to enable widespread public shareholding of privatised corporations) could be devised to go hand-in-hand with regional approach to public sector reform and privatisation.

Regional integration and structural adjustment are both vital to improving the economic, political and social prospects of the region. The imperatives of neither can be escaped. But each can be pursued inefficiently or efficiently. There is more than enough *prima facie* evidence to suggest that a *regional* approach (whether it involves simple cooperation, or progresses to closer coordination, harmonisation or integration) to the economic challenges SAR confronts – including perhaps most immediately and importantly the challenge of successful structural adjustment – is likely to yield greater pay-offs than national approaches which have been tried and not yet yielded very much.

It is perhaps time for the region's governments and the international community to be bolder and more imaginative in the vision they have for the future of the region and in the commitment they have to making it happen. Such a vision cannot avoid incorporating the regional dimensions of structural adjustment in the thinking of the region's political leaders, technocrats, economists, policymakers, market-makers and of everyone at large. The IFIs and the donor community need to go beyond encouraging words about regional integration into operational actions that make its requisites a part and parcel of the adjustment paradigm for SAR and for Africa. Sadly, as a consequence of the economic unravelling of Africa which has taken place over the last three decades – and it has to be honestly admitted that adjustment experimentation has played its part in that discouraging process at least over the last decade – most Africans have lost hope that the future will be better than the present or the past.

For Africa to progress, hope must be restored through delivery and action rather than slogans and rhetoric. A regional approach to adjustment and development in SAR offers an alternative which is not inimical to adjustment but may enhance its outcomes. For that reason alone, more work needs to be done to explore further, and more rigorously, some of the points that have been made qualitatively and impressionistically above.

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Annex 1 Broad Policies, Objectives and Specific Adjustment Measures

A. Macroeconomic Policies

Broad Policies/Objectives	*Sub-policies/Specific Measures*
1. Fiscal Policy	*Reform of tax structure: direct vs. indirect*
Reduce fiscal deficit	*Revenue raising and administrative measures*
Enhance revenue efficiency	*Expenditure reform:*
Enhance expenditure effectiveness	• *Subsidies*
Focus govt role on "enabling conditions"	• *Recurrent expenditures*
Reduce role of government	• *Size of civil service*
	• *Social priorities*
Provide affordable social safety nets	• *Human capital priorities*
	Public investment reform: • *Sectoral priorities*
Reduce state ownership of enterprise	*Sovereign debt management policies*
	Budget process reform and enhancement.
2. Monetary Policy	*Monetary targeting/direct controls*
Control money supply	*Reduction of seigniorage/open market ops.*
Align money demand with growth	*Interest rate policy as basis for allocation*
Control inflation	*Elimination of directed credit policies*
Positive real interest rates	*Sovereign debt service relief/reduction*
	Financial programming model approach.
3. Exchange Rate Policy	*Initial large devaluation*
Establish right level of X-rate	*Elimination of fixed official X-rates*
Eliminate black market premia	*Crawling peg/dirty float/full float*
Maintain exchange rate equilibrium	*Reserves policy/forex open mkt intervention*
Stability of real effective X-rate	*Competitive exchange rate policy*
Induce switching effects	*Early liberalisation of current account*
Reduce current account deficit	*Gradual liberalisation of capital account*
Encourage capital inflows	*Progressive forex market development.*
4. Labour and Wage Policies	*Revamp rigid labour laws*
Establish/restore competitiveness	*Eliminate govt monopoly over hiring/firing*
Reduce labour market distortions/rigidities	*Remove restrictions on collective lay-offs*
Reduce excess costs of formal employment	*Encourage collective bargaining at "firm" level.*
Relate wages to "firm" viability	*Eliminate indexation of wages*
Eliminate govt over-employment	*Remove govt intervention in setting wages.*
Increase formal employment	
	Tariff revision/reduction to lower protection
5. Trade Regime Reform	*Lower or remove various non-tariff barriers/qrs*
Increase/diversity exports (vol./value added)	• *eliminate forex rationing measures*
Improve trade competitiveness (price/quality)	• *eliminate import/export licensing measures*
Reduce imports (in relative not absolute terms)	*Improve customs efficiency/administration*
Increase domestic value-added of trade	*Specific import liberalisation measures/policies*
Shift inv. from inefficient to efficient prodn	*Specific export promotion measures/policies.*

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B. Real Sector Adjustment Policies

Broad Policies/Objectives	*Sub-policies/Specific Measures*
6. Industrial Sector Policy	
Eliminate import substitution bias	*Reducing industrial protection (product/sectors)*
Increase/diversify manufactured exports	*Subsidies/duty drawbacks/epzs/ecgis*
Increase industrial value-added	*Capacity-utilisation and investment measures*
Reduce state ownership of enterprises	*SOE restructuring and privatisation*
Reduce SOE losses	*Cost-recovery+profit pricing by SOEs*
Lower entry barriers to new firms	*Reducing/eliminating government licensing*
Eliminate monopolies	*Lower entry barriers to pvt and foreign firms*
Induce competition	*Changes in regulatory law, policy and practice*
Exploit comparative advantage	*Reducing cross industry disparity in protection*
Improve industrial relations	*Removing govt intervention in labour relations*
Improve allocation/investment efficiency	*Greater reliance on price signals/exit barriers*
Upgrade technology	*Investment/accelerated depreciation allowances*
Increase/diversify industrial investment	*Measures to encourage pvt investment/FDI*
Attract foreign direct investment	*Removing restrictions on foreign firms*
Productivity growth	*Removing biases which distort factor utilisation*
Increase industrial employment	*Promoting SMEs through special measures.*
7. Agricultural Sector Policy	
Food security	*Producer incentives and price liberalisation*
Increase in agricultural output	*Improve producer yields/returns, commercial farms*
Diversify product range	*Input cost reduction, financing extension, incentives*
Increase agricultural exports	*Finance high priority imports/market access*
	Reduce export taxes on agricultural commodities
Improve agricultural investment efficiency	*Increase responsiveness to market price signals*
Induce financial self-sufficiency in sector	*Reduce producer/consumer and input subsidies*
Improve marketing of agricultural products	*Open agricultural marketing to private traders*
Improve distribution of inputs	*Open up input distribution to private sector*
Better dispersion/utilisation of agr. credit	*Depoliticise credit provision/improve channels*
Upgrade agricultural technology	*Improve research; open sector to FDI*
Increase domestic processing and v.a.	*Remove price distortions; expand financing*
Develop agro-industries	*Phase out price controls; reduce import input tariffs*
Increase productivity of smallholders	*Land tenure, credit, better input distbn, lower costs*
Expand agr. infrastructure investment	*Cost recovery pricing for irrigation, power, etc.*
Avoid/reverse natural resource degradation	*Environmental consciousness; financing.*
8. Energy Sector Policy	
Reduce price distortions/economic pricing	*Energy price reform policies (centrepiece)*
Effective economic substitution of fuel	*Effective market pricing of all energy sources*
sources	*Rationalisation, restructuring, load management*
Increase capacity utilisation of plants	*Privatisation, FDI, cost-recovery, no subsidies*
Reduce burden on public budget	*Policies to assure sustainability; env. accounting*
Accommodate environmental realities	*Institutional reform, financing, pvt sector entry*
Supply-side adjustment	*Economic marginal cost pricing for customers*
Conservation and sound demand	*Improved technology, investment, network security*
management	*Privatisation; independent regulatory framework*
Reduce wastage and losses	*Rational tariff structures with proper regulation*
Deregulation with improved regulation	*Greater supplier competition at all levels of system.*

C. Financial Sector Reforms

Broad Policies/Objectives	*Sub-policies/Specific Measures*
9. Financial Sector Policy	
Reduce financial repression/ - real rates	*Abandon directed credit; rely on + real int. rates* *Rationalise/liberalise interest rate structure* *Rely on system-wide benchmark guiding rate.*
Improve resource mobilisation and allocation	*Rely on interest rate signalling* *Reduce high statutory liquidity/reserve rqmts* *Eliminate priority sector lending at subsidy rates.*
Increase domestic savings and investment	*Real positive interest rates to attract deposits* *Reduce high implicit taxation on financial savings* *Induce term transformation toward LT instruments.*
Mobilise private foreign savings efficiently	*Positive short and long-term premia on returns*
Lower credit losses and credit risk	*Risk asset classification/monitoring & provisioning*
Lower intermediation costs	*Reduce overstaffing, overbranching, loan loss risk*
Reduce govt/political intervention in finance	*Reduce state-ownership of financial institutions*
Eliminate crowding out of pvt. sector	*Avoid deficit monetisation; reduce public deficit.*
Widen and deepen financial markets	*Strengthen exchange-based trading for equity/debt* *Reduce tax bias against equity/in favour of debt* *Develop markets for government bills and notes* *Emphasis on development of LT bond markets* *Reduce implicit bias for over-gearing of fin. firms* *Reduce risk of systemic insolvency* *Develop exchange market regulatory infrastructure.*
Restore public confidence in financial system	*Privatise; foreign bank entry; avert bank failure*
Reduce/reverse capital flight	*Offer premium forex risk adjusted local returns*
Secure capital adequacy of the banking system	*Restructure BS; enforce capital adequacy ratios.*
Improve profitability of banks	*Close down unprofitable banks; rely on mkt. forces* *Reduce bias towards disintermediation.*
Reduce bank overstaffing and over-branching	*Change labour legislation, back lay-offs, technology*
Extend capital markets/long-term institutions	*Ensure steep positive yield curve*
Restore viability of DFIs	*Rationalise, close, merge and restructure DFIs*
Improve financial institutional infrastructure	*Strengthen central banks, SECs and fraud detection.*
Improve financial supervision & regulation	*Improving Prudential Regulation standards* *Improve quality of manpower and probity.*
Improve auditing and accounting practices	*Encourage entry of foreign accounting firms.*
Enforce property/collateral exercise rights	*Establish fast-track judicial recourse for fin. trans.* *Establish separate recovery agencies.*
Increase competition in financial services	*Remove entry and exit barriers to financial firms*

From: Regionalism and the Global Economy: The Case of Africa
FONDAD, The Hague, 1996, www.fondad.org

D. Public Sector Rationalisation and Reform

Broad Policies/Objectives	*Sub-policies/Specific Measures*
10. Policies for the Public Sector and Privatisation	
Reduce public ownership and no. of SOEs	*Divestiture/privatisation of SOEs*
Corporatise residual SOEs	*Introducing market pricing discipline in SOEs*
Introduce competition in SOE operations	*Removing entry/exit barriers to pvt firms*
Reduce SOE monopolies	*Effective independent regulation and competition*
Improve productivity, efficiency, profits	*Restructuring, recapitalising, widening ownership.*
Improve information on SOEs	*External assistance with accounting/auditing*
Reduce size of Civil Service	*Retrenchment, early retirement, out-placement*
Agency contracting out functions	*Privatisation of service functions; MBOs/EBOs*
Improve service quality	*Public standards, accountability, enforcement*
Good Governance	*Administrative efficiency/productivity.*
Establish privatisation sequence	*Analysis of SOE characteristics and buyers*
Identify future owners	*Analysis of options for sale; broad divestiture*
Price SOEs properly for sale	*Valuation approaches; collateral benefits*
Ensure effective post-sale regulation	*Regulatory framework for PSOEs.*

E. Social Policies to Reinforce Reform

Broad/Policies/Objectives	*Sub-policies/Specific Measures*
11. Policies to mitigate the Social Impact of Adjustment	
Minimise secondary income loss for poor	*Expenditure switching to favour poorest groups*
Minimise negative impact on urban poor	*Targeted expenditure/food subsidy programmes*
Minimise losses in human capital formation	*Protect/target health and education expenditures*
Minimise net loss of employment	*Focus on increasing productive pvt investment.*
Social safety-nets/social security	*Restructuring of public social expenditure*
Avoid urban dislocation	*Compensation policies for retrenched SOE labour*
Induce labour flexibility in LI groups	*Retraining and resettlement programmes*
Enhance LI employment	*Targeted construction and public works programmes.*

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