The 1989 Per Jacobsson Lecture

On Promoting Successful Adjustment: Some Lessons from Ghana

J.L.S. Abbey

Economic Restructuring in New Zealand Since 1984

David Caygill

THE PER JACOBSSON FOUNDATION

Washington, D. C.
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Foreword

The 1989 Per Jacobsson Lecture was delivered on Sunday, September 24, 1989 at the Shoreham Hotel in Washington, D.C. The speakers were J.L.S. Abbey, Ghana's High Commissioner to the United Kingdom, and David Caygill, Minister of Finance and Minister of Revenue of New Zealand. The title of Mr. Abbey's speech was "On Promoting Successful Adjustment: Some Lessons from Ghana," while Mr. Caygill spoke on "Economic Restructuring in New Zealand Since 1984." Sir Jeremy Morse, Chairman of the Per Jacobsson Foundation, presided over the meeting.

The Per Jacobsson lectures are sponsored by the Per Jacobsson Foundation and are held annually. The Foundation was established in 1964 in honor of Per Jacobsson, the third Managing Director of the International Monetary Fund, to promote informed international discussion of current problems in the field of monetary affairs.

The Per Jacobsson lectures are published in English, French, and Spanish and are distributed by the Foundation free of charge. Through the courtesy of other institutions, other language versions are also issued from time to time. Further information may be obtained from the Secretary of the Foundation.

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Opening Remarks

Sir Jeremy Morse

A warm welcome from Jacques Polak and myself and the other directors and officers of the Per Jacobsson Foundation. This is the twenty-sixth of the Per Jacobsson lecture meetings, and the first one at this particular venue. Those of you who stay on for the reception afterwards perhaps could let us know whether you find this more convenient or more agreeable than the venue we normally use at the university.

Some of you were present at last year's meeting in Basle, where we had mainly a central banking audience. We had a panel of three speakers who, looking forward, dealt with the next twenty-five years of the international monetary system. That was at the twenty-fifth anniversary of these lectures. This year we come back to focus on the present, and we have two speakers. They both come from countries that have had really striking policies and achievements in the areas of adjustment and restructuring.

I will not say any more about the speakers because the program you have gives an ample account of their careers. I will ask Mr. Joseph Abbey to start by giving us his own perspective on the story of Ghana and what that tells us more generally.

On Promoting Successful Adjustment: Some Lessons from Ghana

J.L.S. Abbey*

Deep-rooted structural bottlenecks and sectoral imbalances have continued to constrain output levels in many developing country economies. In the face of rapidly growing populations, this has meant that for the vast majority of the people in these countries, poverty, which was widespread, has worsened. Thus, in Africa over the period 1980–87, per capita income, already low at the beginning of the decade, declined by 2.7 percent per annum. A similar phenomenon has occurred in Latin America. At the same time, all too often, attempts to ameliorate the situation have foundered in inappropriate economic policies, measures and actions with accompanying high indebtedness, severe payments imbalances, and rampant hyperinflation.

A record number of arrangements with the International Monetary Fund have already broken down. An increasing number of countries are in arrears both with the Fund and the World Bank. Faced with the engulfing crisis, the Managing Director of the Fund has given a clear and unequivocal commitment to a new adjustment strategy, as has the President of the World Bank.

Steps have also been initiated to promote adjustment with a human face so as to enhance the sustainability of programs and to protect the most vulnerable from damaging adverse effects. These are all welcome initiatives on which a successful response to the acute crisis facing so many countries can be developed. Clearly, additional external financing on easier terms will be needed. At the same time, it is imperative that the design of adjustment programs be improved both in their economic and political economy aspects.

In my remarks I shall dwell primarily on the issues of program design, drawing on the experience of Ghana, which clearly demonstrates

*I wish to thank the Fiscal Affairs Department of the Fund for the support provided me during my tenure as a visiting scholar over the past six weeks, while preparing this lecture.

that for the strategy to be effective some very radical changes will have to take place in the thinking and formulation of adjustment programs by the Bretton Woods institutions. New commitments and imaginative efforts will also be required of the adjusting countries and of the international community. In particular, it will be essential to restore a fruitful dialogue between the adjusting countries and the Bretton Woods institutions, which, out of the frustrations born of widespread program failures in recent years, has degenerated into mutual recriminations in many cases. I shall propose some measures to deal with this problem as well.

THE DESIGN OF ADJUSTMENT PROGRAMS

Introduction

Traditionally, Fund-supported adjustment programs focused on stabilization and specifically on the balance of payments. Because of the short-run orientation, problems of growth could be neglected. However, the persistence and deep-rooted character of the balance of payments problems of many developing countries, which frequently necessitated several successive stand-by arrangements, led to a growing awareness that the standard approach to financial programming could be disruptive of growth.

About ten years ago, in a statement on "Surveillance Over Exchange Rate Policies," issued by the Fund at about the same time as the "Guidelines on Conditionality," there was recognition of the need of member countries to promote growth. However, in a recent staff study there was admission of "the increasing relevance to extending the basic financial programming model to incorporate the economic variables and relationships that are crucial for meeting growth objectives."[1] It was also pointed out that: "To do so, however, is a formidable task, and studies aimed at doing so have only *begun* to suggest ways in which the financial programming framework might be extended" (emphasis added). As it turned out, some of the models which flowed out of these studies were found to have a "fatal defect," namely, in the failure to recognize that stabilization measures could strongly and adversely impact on output.

In light of the immiserization of so many countries over the intervening years, the inadequate progress to date is most lamentable.

[1]*Theoretical Aspects of the Design of Fund-Supported Adjustment Programs: A Study by the Research Department of the International Monetary Fund*, IMF Occasional Paper, No. 55 (Washington, September 1987), p. 27.

The Standard Approach

The starting point for the typical financial programming exercise is that output is either already at full employment or is constrained at lower levels by structural bottlenecks and sectoral imbalances. Consequently, output is exogenously determined and adjustment in absorption impacts primarily on prices and the balance of payments. The composition of production, including exports, even in the short run is assumed to be highly responsive to relative price changes. Among other things this strong elasticity optimism implies that imports are not complements in production and moreover can quickly be replaced by domestic substitutes under appropriate pricing policies. Any output not domestically absorbed is quickly exported. Under these conditions cutbacks in real domestic expenditure need not affect the real value of output. Payments imbalances therefore are the consequences of the attempt by the country to "live beyond its means" as represented by the excess of real domestic expenditure over real income. The elimination of such imbalances requires the use of appropriate demand management policy measures (possibly) with a depreciation of the real exchange rate.

Limitations of the Framework

There are several criticisms that can be made of this basic financial programming framework. The most important, in the context of the economies of developing countries, is that the strong elasticity optimism is unrealistic and unwarranted. Imports, at least in the early years of the adjustment process, are as much complementary to domestic production as they are substitutes for domestic output. Domestic produce is not as quickly transformed into exports or import-competing goods, for reasons of domestic supply bottlenecks and the high incidence of external protection on typical developing country exports. The result is that the compression of real domestic expenditure could induce a recession that cannot readily be compensated for through depreciation of the real exchange rate. On the contrary, if exports are not sufficiently responsive, a depreciation would aggravate the recession. Thus, the domestic price level would be raised, which reduces domestic purchasing power. Furthermore, the leakage from domestic purchasing power would be increased owing to the higher valuation in domestic currency terms of imports insofar as they are price inelastic, while increases in the amount of imports from catering to pent-up demand as a result of any associated liberalization would add to the leakage. The reduced demand for domestic production could be so curtailed that a severe recession, if not depression, ensues.

A growth-oriented adjustment program must aim at raising efficiency levels, promoting exports and their diversification and import-competing activities, as well as increasing domestic savings and investment rates. This means that the effects of adjustment policies on these critical determinants of output growth must be ascertained. A common "fatal defect" in attempts to incorporate the growth objective into what are essentially stabilization programs is to make these determinants of growth constant and unaffected by the stabilization measures. But you cannot simply add the growth option to the financial program. For example, if the economy is initially shocked into a severe recession by the stabilization program, the flow of savings and investment required to initiate the growth process will not be forthcoming, particularly from the private sector. Which investor will expand his operations if capacity utilization collapses, and how can those with depressed incomes save more? Furthermore, the inevitable recession-induced deterioration in the fiscal balance erodes the support that the budget can provide.

The central issue is how to bring about the desirable situation that avoids excessive recession or inflation in the short run, while paving the way for sustained growth. Some recommend a strategy that involves the application of controls and other forms of government intervention. I believe, however, that it is through the restoration of market forces, but undertaken in carefully phased stages and not abruptly as in many programs, that the needed enhanced substitution effects and supply responses would result. In short, while undue elasticity optimism could lead to disastrous prescriptions, the package of measures should include some that increasingly make such optimism warranted and recourse to intensified controls should generally be avoided. Nevertheless, it must be stressed that these structural adjustment measures should be introduced with great deliberation and be combined with a judicious stabilization as I shall subsequently illustrate generally occurred in Ghana.

The Political Economy of Adjustment Costs

Adjustment, which among other things requires bringing domestic absorption and income into an appropriate relationship, will exact costs. A reasonable approximation of the primary cost of adjustment, in terms of domestically produced goods and services, is the excess of the initial real absorption over real income. It is a measure of the loss in current and future well-being of bringing the country to "live within its means." Alternatively, it is a measure of the debt to be incurred, in terms of domestic output, in order to postpone adjustment.

However, in addition to this primary cost of adjustment, there may be secondary costs as well. These would be incurred if structural distortions and rigidities—downward inflexibility of real factor prices, immobility of factors of production, or low elasticities of substitution and supply in the tradables sector—make "elasticity optimism" unrealistic. In such a situation output and employment cannot be maintained at their initial, preadjustment levels. A measure of the secondary costs is the *decline* in domestic output that may result.

Evidently, successful adjustment requires that appropriate measures should be taken to remove the structural rigidities whose presence is responsible for the secondary costs of adjustment. In other words, while unwarranted elasticity optimism leads to inappropriate policy prescriptions and pace of the adjustment process, leaving unchanged the structural rigidities—the primary causes of payments imbalances—condemns the economy to a stop-and-go process. Availability of external finance then gives the impression of progress, while cessation of external inflows could mean a severe recession.

In general, such rigidities cannot be removed in the short run. Consequently, in the critical initial months following the launching of an adjustment program, great caution has to be exercised to keep the secondary costs within bounds. Adjustment programs that have an inherent tendency to assume away these secondary costs can, therefore, have grave consequences, especially if compensatory external financing to cushion the adverse effects of a program design flaw are not available. The political arrangements that may have been made for distributing the burden of adjustment may then prove totally inadequate and the program aborts.

Issues of political economy are complex and there is an inevitable tendency for economists steeped in the Western tradition to separate economic analysis from the political economy aspects concerning how the adjustment burden is to be distributed. Such a separation may be appropriate in a sovereign state, where the economist simply presents options for the politician to choose. However, a common complaint has been that Fund programs and the associated conditionality do not sufficiently recognize the political costs of adjustment. Aside from underestimating these costs, there is no assessment of whether the measures recommended will result in their acceptance by the broad majority of the population. If the majority perceive the program to involve an unfair distribution of the burden of adjustment, the program will not be sustainable. Furthermore, the social tensions that result are likely to be aggravated if the program also impoverishes the most vulnerable.

The recent initiatives of the Managing Director of the Fund to sensitize his staff to these issues of political economy are most laudable and should be encouraged. In particular, I support his objective of bringing the political costs out into the open so that governments in turn do not conveniently use the Fund as a scapegoat. Ultimate responsibility rests with the governments, but they should be given every assistance in their time of travail to ensure that the program gets off the ground and succeeds.

But taking the political economy aspects into account will have an impact on the design of adjustment programs. Thus, as I will demonstrate from Ghanaian experience, governments may initially have to intervene in the form of a mandatory incomes policy or to temper the pace of liberalization so as not to be seen to give an excessive relative advantage to a privileged few. Over time, a well-designed and assiduously implemented program will prove beneficial and increasingly command broader support, but vigilance will continue to be needed to retain perceptions that the program is fair, while specific actions will be needed to cushion the costs of adjustment on some of those who are most affected.

GHANA: THE EXPERIENCE

Throughout the 1970s, the Ghanaian economy stagnated, exhibiting negative growth rates in real per capita income. The low point was reached in 1983. Since then real output has expanded by about 40 percent; real per capita income by more than 20 percent; the inflation rate, while still bothersome, has been dramatically reduced; the balance of payments is in surplus and the initial large stock of external arrears has been virtually eliminated. The net domestic public debt has been almost eliminated. In this and other ways we have begun to repay our debt to future generations.

How was this success achieved? At the outset I should add that there was no sustained fortuitous improvement in the terms of trade. Nor have we been the beneficiaries of excessive external financing. In fact, in net terms, the inflow since 1983 has been about US$1.5 billion. This is about one third of the total exports that have taken place since then, or about 5 percent of gross domestic product (GDP).

To answer the question we have to look to the strategy of adjustment that was pursued in the context of three successive stand-by arrangements with the Fund, which have now been succeeded by an enhanced structural adjustment facility arrangement, and the support provided by the various adjustment loans from the World Bank.

In 1983, we confronted a severe drought-induced shock on aggregate supply, inflation of well over 100 percent per annum, the need to accommodate one million Ghanaians who were being repatriated from Nigeria, and a catastrophic situation with regard to the balance of payments. The initial emphasis of the program was on stabilization and on correcting the exchange rate, which was highly overvalued. Inflation had to be curbed so as to ensure that the relative price adjustments would stick and to eliminate an extremely regressive tax on the poor. Accordingly, a very tight policy of demand management was pursued, one that was consistent with the severe contraction in supply as a result of the extreme drought, and combined with a huge, corrective exchange rate devaluation. However, we were also conscious of the need to ensure that we did not engage in overkill. Consequently, the injection of domestic and external credit into the economy was carefully monitored to keep domestic absorption at an appropriate level, taking account of the effect of the exchange rate adjustments. In the initial years, domestic credit expansion was substantially larger, but as foreign capital inflows picked up, domestic credit expansion has been reduced.

We were very conscious of the presence of widespread domestic price and wage distortions and rigidities and the limitations on our exports. Accordingly, we could not simply allow absorption to decline in the hope that the shock would be absorbed by price-wage reductions and an increase in exports. Given the rigidities, the outcome would have been to contract domestic production. At the same time, we were very concerned over the speed with which the external sector was liberalized and also the real exchange rate depreciated. In particular, since exports could not be rapidly expanded and net foreign capital inflows were limited, the pace of import liberalization was deliberately restrained. This was done to keep the leakage from the already restrained absorption into imports within bounds so that there would be adequate demand for domestic production. As a result of our actions we were able to avoid excessive contraction but, nevertheless, to dramatically reduce inflation.

While recognizing the need to liberalize and to decontrol prices so as to restore the beneficial workings of the price mechanism, there was always a concern that the economy not be destabilized through excessive price fluctuations as a result of decontrol and that the political economy fallout be manageable. Consequently, we were quite deliberate in not overloading the stabilization phase with too many structural adjustment measures. We also resisted urgings that we float the exchange rate until we became convinced that excess demand for foreign exchange had attenuated. Sometimes anomalies can result from institutional tinkering. An example of this is when we abandoned administered interest rates, which had become positive in real terms, and liberalized only to watch interest rates plummet. Instead, much of our initial emphasis was placed on providing a setting that would facilitate *real* responses to the relative price adjustments. Some limited investments were undertaken to overcome critical infrastructural bottlenecks, such as the broken-down railway system that prevented exports from reaching the ports; improvements in power generating facilities; and acquisition of road transport equipment and spares.

As the stabilization efforts bore fruit, and the most critical infrastructural bottlenecks eased, attention was then directed to sustaining growth. Given the limited external resources, it was essential to mobilize domestic resources. We had to rely on budgetary savings as our principal source of funds, knowing that after the ravages suffered by the household sector it could be a long time before they could generate additional savings. A critical element was therefore the fundamental tax reform that was undertaken with help from the Fiscal Affairs Department of the Fund, as a result of which the tax ratio has been raised by some 10 percentage points of GDP. Our strategy for mobilizing resources was dynamic, tailored to the emerging surpluses generated by the structural measures and geared to political economy considerations. As more domestic resources were mobilized, it became possible to substantially improve the real level of civil service salaries, which had fallen to unacceptably low levels and seriously compromised the efficiency of the civil administration.

In a way, it was fortunate for the acceptability of the initial program in 1983 that there was a severe drought so that the program did not get unduly blamed for the suffering that occurred. To ensure that the program would be supported by the majority of the population, a mandatory incomes policy for the whole economy was instituted. Furthermore, acts of conspicuous consumption were discouraged, relying largely on moral suasion, but backed if necessary by sanctions. While some prices were decontrolled, profiteering was carefully guarded against and the liberalization of the external sector was rigidly controlled. Austerity, in a context of drought, generated severe social tensions and I can assure you that if articles of conspicuous consumption such as luxury cars had then been allowed in, the program would not have survived.

The tax reform strategy helped renew the perception that the burden of adjustment was being fairly distributed. Although tax rates in general and the tax burden on lower income classes was reduced, the taxation of the rich was more vigorously pursued. Profits, which have been favorably affected by the structural reforms, have also been more effectively taxed.

We have assiduously pursued a strategy of eliminating subsidies, which we have combined with providing assistance to those specifically disadvantaged by the structural adjustment measures. Thus, a special efficiency fund, which now amounts to about 1 percent of GDP, was established in the budget to pay for the redeployment, including retooling and other costs of settling redundant civil servants. With international donor support, a Program of Action to Mitigate the Social Costs of Adjustment (PAMSCAD) has been launched to enlarge the productive opportunities of some of the more disadvantaged, while attending to basic social needs.

Last but not least, a critical element that facilitated the success of the adjustment program was the very close and fruitful, even if at times acrimonious, dialogue that was established with successive missions. The Fund missions in particular demonstrated a remarkable degree of continuity until recently, which facilitated the process of analysis and acquisition of key insights. On the side of government, reliance on a core economic team since the inception of the economic recovery program helped develop a comprehensive integrative and filtering capability. Assailed as we were by suggestions of a more or less conditional nature on a wide array of program aspects by the myriad different missions from multilateral and bilateral institutions, it was essential to establish a coherent ordering, failing which the recovery process would have aborted.

SOME LESSONS

There are lessons to be drawn for the design of adjustment programs, for the conduct of business by the multilateral institutions, for the international community, and for the adjusting country.

Lessons for the Design of Adjustment Programs

Our experience clearly demonstrates the importance of operating within a more comprehensive model of the stabilization and adjustment process. Stabilization may be essential at the outset so as to provide an appropriate setting for the deliberate restructuring of the economy and restoration of market forces. Inflation must be stamped out, but this should be done in such a way that excessive recession is not the outcome. Particular care has to be exercised to ensure that the growth assumptions of the program will in fact materialize. It is important to begin the process of relative price changes, and large adjustments may be needed. The emphasis should be on making appropriate key relative price changes stick rather than on techniques for bringing about the change. For example, is an interbank floating exchange rate system or a market-based flexible interest rate system the important requirement or is it an appropriate *level* of the real exchange rate or interest rate? Lacking the needed indirect instruments of control, the outcome all too often of such *experiments* is violent price fluctuations, which destabilize the economy and greatly add to the risks and uncertainties of managing the finances and making appropriate political arrangements to ensure sustainability.

The macroeconomic effects of the relative price changes should be carefully assessed and, in particular, their adverse stabilization implications. Elasticity optimism should be avoided. Indeed, it may be better to exhibit elasticity pessimism so as to be motivated to initiate measures to avoid adverse destabilization effects while going through with the relative price adjustments. Thus, because of the weak distorted nature of the economies, a real exchange rate depreciation could have pronounced J-curve effects, which could be contractionary; a move to positive real interest rates may do little to stimulate savings, but could so raise the cost of finance as to seriously destabilize productive activities; price decontrol may do little to stimulate production but have major consequences for consumers. Such effects should be recognized and contingency plans should be drawn to prevent their getting out of hand.

Adequate domestic resources have to be mobilized so as to finance the needed restructuring and rehabilitation outlays and to initiate growth. This places a very high premium on undertaking sufficiently early the necessary fiscal reforms that will result in improved budgetary savings. A comprehensive tax reform is typically needed, as also an overhaul of the system of expenditure program formulation, monitoring, and controls.

Once the program is off the ground, many actions will be needed. Therefore, it is critically important to develop a framework of analysis that will facilitate taking the right policies at the appropriate time. Such a framework will encompass both the stabilization-oriented work of the Fund and the developmental concerns of the World Bank in a harmonious manner.

It is a pity that we do not live in a neoclassical world, where the price system functions perfectly and where a full array of intertemporal markets are present, and where transactors are blessed with rational expectations to validate the standard models currently presented. But then the adjustment problem would also have been rendered trivial. In the actual world that we inhabit, more realistic frameworks should be developed that allow for distortions, rigidities, limited markets, and imperfect understanding of the environment.

The design of the adjustment program should accommodate political economy considerations. The measures should be formulated in such a way that the burden of adjustment of the program is perceived to be fair. At the same time, assistance should be given to the most vulnerable so that social tensions are kept in check. This may require compromises and trade-offs. What is the point of a program that attempts to generate a very large fiscal turnaround by reducing average civil service wages to subsistence levels or below, and then collapses because the civil servants go on strike or become corruptible? Is the alternative to cut back on vitally needed social services or should we, perhaps, abandon development programs whose payoff is in the long run? Perhaps the sought-after fiscal turnaround should be more modest, but more realistic, with a slower pace of liberalization.

Lessons for the Bretton Woods Institutions

The work of the Bretton Woods institutions and their respective subcomponents has to be effectively coordinated. Extension of the adjustment exercise beyond traditional macroeconomic stabilization has progressively encompassed a range of subject matters. While specialization of function is desirable because of the economies of scale, it can become excessive and impose major demands on coordination. Some progress has been made through the collaborative inputs of both institutions and the country authorities in the preparation of policy framework papers in the context of structural adjustment facility and enhanced structural adjustment facility programs. Concern with poverty alleviation can be expected to lead to some form of involvement in these exercises by various multilateral institutions with related mandates, further raising a need for effective coordination.

How is such coordination to be achieved? In the absence of a clear arbiter, such a situation is likely to entail lengthy discourses, detrimental to a speedy adjustment process. The typical approach to such problems at the national level—namely, endowing a Planning Commission with predominant voice in the policy deliberations process—would be unworkable in the multilateral context, without taking the undesirable step of creating another bureaucracy. Perhaps what is needed is a reinforced specification of precedence among the multilaterals. Ideally, the country should exercise the required integrative and interpretative function, the scope for which I shall subsequently examine.

Recognition of the coordination problem between the multilaterals should not mask the coordination problems within the institutions themselves. There is a natural tendency for each unit to promote its own mandate. Thus, the agriculture unit would press for an increase in producer prices, the exchange rate unit for a depreciation of the exchange rate and so on. It is vitally important for the success of the program that these disparate contributions be effectively melded into a meaningful harmonious whole and not be simply an agglomeration of all the different parts.

The missions sent out into the field should be properly staffed and maintain a long degree of continuity. From our experience in Ghana, I can assure you that our economies, although underdeveloped, are not simple. Moreover, being fragile they need to be studied very carefully before experiments are undertaken with them. The staff should be fully cognizant of the distorted realities of such economies and be technically equipped to undertake the expert analysis needed, whether it be for adjusting our financial, fiscal, or exchange rate systems. Above all, they have to resist the temptation of viewing everything through their industrial country glasses.

Much work remains to be done in the theory and design of effective bureaucracies so that good program designs will result.

Lessons for the Country

If the adjustment process is to be sustainable, the authorities of the country concerned must play a central role throughout all the various stages—conception, negotiations, design of the specific package of measures, and implementation. Indeed, successful implementation requires that the authorities regard the program as their own and not an external imposition in exchange for urgently needed financial resources. It requires total commitment to mobilize the necessary public support to see the program through the difficult early period as well as for survival through any unexpected adverse exogenous shocks. Commitment in turn requires that the program is realistic and holds out a reasonable promise that its successful implementation will result in the country growing out of its problems.

There are trade-offs between the goals of society. Resources are limited. Critical decisions will have to be taken and measures undertaken which impact differently on different groups in the society. There are the issues concerning poverty alleviation and the environment. Others concern the sharing of the burden between the present and future generations. All or most of these are matters of national sovereignty and politics which can only be decided by the authorities of the country concerned.

CONCLUSION

The experience of developing countries that have undertaken adjustment programs supported by the Bretton Woods institutions clearly leaves much to be desired. This has been especially evident in the present decade as external conditions significantly worsened. Several reasons may be given for this. It is, however, clear that the deep-rooted and structural origins of the problems require a fundamental reappraisal and rethinking of the design and policy prescriptions of adjustment programs.

A succession of stabilization programs is not an adequate substitute for a medium-term adjustment program. The structural bottlenecks, sectoral imbalances, and price distortions that constrain output, often far below the potential of the economy, and how these interact with various macroeconomic instruments raise complex issues of analysis. Furthermore, time is required to eliminate these constraints, and to make the economy more resilient to exogenous shocks as well as productive resources even more responsive to relative price changes. The short-term orientation of stabilization programs and their exclusive focus on the balance of payments objective make it difficult to adequately deal with these issues. They also tend to lead to policy prescriptions which in their undue optimism about relative price effects often imply that recession and rising unemployment are the price to be paid for achieving program objectives. This is not a price to be exacted carelessly from any economy, least of all from one with widespread poverty.

With appropriate changes in the design of adjustment programs (there are indications already available in the literature to guide such changes and in the interim the art can more than make up for the defects of the science); with adequate capital inflows from the international community (and this can be quite modest in net terms); and with effective coordination of the activities of all the institutions involved together with the requisite resolve and commitment to successful implementation of the program by the country, this heavy price in lost output and at times in human life itself, need not be necessary.

In all of this, the role of the adjusting country is perhaps the most critical. The Ghanaian experience suggests that a strong and technically competent team that enjoys the full confidence of the political authorities is necessary. Such a team should not only be able to articulate the concerns of the authorities and help in building the required consensus behind the program, it should also be in a position to take advantage of the experiences of other countries that have undertaken adjustment programs, as well as share its experiences with others. It is in furtherance of these objectives that I strongly urge support for an Institute that could be set up on an interim basis for promoting growth-oriented adjustment.

Such an Institute would consist of a relatively small staff drawn from academics, and officials seconded by the Bretton Woods institutions and governments, and possessed with a strong developing country orientation. The proposed Institute, if appropriately constituted, could play a most useful role in helping countries work out solutions in a low-key and supportive manner that would promote their adjustment consistent with the goals of the Bretton Woods institutions. Such an Institute would differ from other institutes in that its focus would be on providing policy-oriented technical support rather than being primarily concerned with research or training functions. The Institute would work on bridging the gap between the adjusting countries and the Bretton Woods institutions, thus making their relations less adversarial. I can envisage a role for the Institute in providing important technical support to adjusting countries in developing their adjustment options.

Another important role for such an Institute would be to bring home to the Bretton Woods institutions themselves some of the concerns of the adjusting countries and to assist in the development of viable adjustment strategies.

Clearly, since the Institute would promote the adjustment process under the umbrella of the Bretton Woods institutions, it will need to be supported by them. At the same time, it will need to maintain an arms length relationship so as to be credible to the adjusting countries. This is obviously a proposal that can benefit from further elaboration, but it should be considered as a matter of urgency if the heightened tensions are to be reduced and successful adjustment promoted. I, therefore, call upon the Managing Director of the Fund and the President of the World Bank to initiate steps for the early establishment of the Institute for Growth-Oriented Adjustment.

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SIR JEREMY MORSE: Thank you very much, Dr. Abbey. Now I ask Mr. David Caygill to give us the second half of the lecture.

Economic Restructuring in New Zealand Since 1984

David Caygill

It's a pleasure and an honor to be invited to take part in the Per Jacobsson lecture.

I'm sure the topic is one of which Per Jacobsson would have approved, given his concern to use the lessons of history as guidance for the future. While New Zealand is only part way through the adjustment process to sustainable economic growth, I think we may have learned some useful lessons for other countries contemplating reform. These lessons have been both technical and political.

My background as a politician naturally leads me to emphasize issues such as policy credibility, the formation of expectations, and the sequencing and management of reform. I'm pleased to see that issues such as credibility and the political economy of reform have increasingly been recognized by academic economists and multilateral institutions as crucial to the success or failure of economic liberalization. This is a field where progress will only be made if theory is tested against experience.

It seems that economic stabilization and liberalization programs normally develop from some kind of "crisis." Let me briefly outline New Zealand's crisis leading up to 1984 that involved some special factors and others common to other countries.

New Zealand is a small island nation of three million people that is crucially dependent on trade. Exports currently account for approximately 20 percent of gross domestic product (GDP), although that proportion has in the past been higher. While agriculture provides a strong, and currently growing, share of export receipts, our economy is diversified in comparison with the 1950s. At that time New Zealanders enjoyed the third highest standard of living in the world. Since then our position steadily deteriorated to the point where New Zealand was eighteenth among OECD (Organization for Economic Cooperation and Development) member countries in terms of GDP per capita by the early 1980s. Our productivity record over the previous two decades had been the worst in the OECD.

We had been living beyond our means for a number of years. The stock of public debt—and especially external debt—had been growing rapidly.

New Zealand's problems were long term and not simply a result of the deterioration in our trading environment in the 1970s.

However, Britain's entry into the European Community and the rapid change in oil prices both severely affected our trading position. Sporadic attempts were made to correct the emerging imbalances in the New Zealand economy during the mid-to-late 1970s, but these were followed by policy reversals.

By the early 1980s New Zealand had combined the ingredients of a macroeconomic crisis, namely unsustainable expansionary macroeconomic policies, with a host of policy-induced distortions in the working of the domestic price mechanism. Such policies culminated in a wage and price freeze in June 1982, interest rate controls, and growing direct assistance to agriculture and industry.

New Zealand added a third ingredient that was to contribute to the emerging crisis—state-guaranteed or state-funded investment in major projects. These were mainly energy related and contributed more to debt than to national income. During this period the overall trend in the economy was of increasing unemployment, internal and external deficits, and high inflation (aside from the period 1982–84 when all wages, prices, rents, dividends, and interest rates were frozen). New Zealand did experience significant growth during part of the early 1980s but it was not sustainable.

The crisis peaked just prior to the 1984 election, when a large capital outflow occurred, driven by expectations of a currency devaluation. Within four days of taking office, in my case as Associate Minister of Finance, we removed interest rate controls and devalued the New Zealand dollar by 20 percent.

Since that time New Zealand has undergone an extensive, and orthodox, program of economic reform. This has seen significant progress in macroeconomic stabilization, and a shift from being one of the most regulated, protected, and distorted economies within the OECD to one of the most liberal in a number of respects. During this period of adjustment we have valued our ongoing dialogue with the International Monetary Fund and the interest shown by the World Bank.

Some would see some of the policies we have introduced as surprising for an ostensibly socialist Government. Indeed, that perception may have made the task of establishing policy credibility somewhat more difficult. But is winding back a politically created set of property rights that benefited certain privileged groups at the expense of the general populace really surprising for such a Government? Particularly when it offers the greatest hope of improving real incomes in society?

A commitment to price stability and debt reduction are both, in my view, consistent with equity objectives. Both inflation and persistent deficits redistribute wealth in undesirable and capricious ways. While adjustment has involved costs, there has been widespread support for the Government's continued program of restructuring to ensure that the New Zealand economy remains internationally competitive. Pressure group politics has been substantially replaced by acceptance of a medium-term policy focus and the evenhanded removal of assistance. The shortcomings of past attempts at demand management and unsustainable expansions, coinciding with our three-year election cycle, are now widely acknowledged.

THE FRAMEWORK FOR REFORM

The framework that underpinned the economic strategy that we adopted in 1984 involved three main elements:

- a medium-term approach to economic policy with the emphasis on consistency and credibility;
- an orthodox medium-term financial and monetary strategy aimed at achieving a winding back of the fiscal deficit and the rate of inflation; and
- the removal of sectoral assistance and distortions in the tax system, and regulatory reform to ensure that resources flow into areas that maximize national benefit and that market participants have an incentive to improve productivity and innovate.

SEQUENCING AND PACE OF REFORM

The task was then one of establishing an appropriate pace and sequence for reform. It is in this area that those approving of the overall direction of reform have questioned New Zealand's approach. For example, in June this year *The Economist* ("The Kiwi and the Koala," June 24, 1989, pp. 15–16) stated:

> If New Zealand has made a mistake, it was not the zeal with which it liberalised, but the order in which it did so. With hindsight the short-term pains of restructuring would have been smaller if the government had tackled the least responsive market (ie, the labour market) first, and the most responsive (the financial markets) last.

Now, I'm not going to claim that we got it all right, particularly with hindsight. But isn't the absence of countries that have successfully followed such a sequence grounds for doubt about its superiority?

I think a crucial difference between so-called ideal adjustment sequences and those we adopted was the overwhelming need we saw to establish credibility and signal clearly medium-term intentions, to allow expectations to adjust. Such considerations complicate the usual analysis of optimal reform paths. These theoretical analyses are often based on implausible models of the behavior of the state and its citizens. For example, removal of "distortions," from which particular sectoral groups have benefited, will inevitably result in the pain experienced by such groups being both more immediate and more vocally expressed than the benefits.

In my view an argument against gradualism, *or* of holding off from the reform of particular sectors until others have been tackled, is that vested interests, given time, may combine to force a policy reversal. This is especially so at the early stages of reform before credibility to carry through a plan has been established. The other extreme of simultaneous liberalization of all markets, even if desirable, is simply not feasible. Many issues are complex, no individual can be aware of them all at the outset, and the institutional reforms required take time to implement. Perhaps this supports initial reform focused on those policies that can be implemented quickly and where expectations can be expected to adjust quickly, such as the financial sector.

A related issue is the role of preannounced policy targets. These provide a means of clearly signaling policy intentions and, if credible, changing expectations. However, they may not be effective in the early stages of reform due to expectations of policy reversal. In addition, they will be more credible if backed by institutional arrangements supportive of their achievement. In New Zealand I have set the targets of achieving a financial deficit of 1 percent of GDP in 1989/90, followed by a financial surplus in 1990/91. In addition, a target inflation rate of 0 to 2 percent has been set for achievement by December 1992. Hopefully, the political commitment involved in such targets raises their credibility and accordingly the expectation that they will be achieved.

NEW ZEALAND'S EXPERIENCE

Immediate Steps

Details of New Zealand's economic policy reforms can be found in publications such as the recent OECD *Economic Survey* of New Zealand. I would like to focus attention on particular reforms to illustrate some of the points I have made, and where our experience may be of particular interest to others.

Following the devaluation in July 1984 the Government announced a range of policies, including fully funding the budget deficit by market operations, to help restore monetary credibility.

The scope and direction of the proposed reform was first indicated clearly when the then Minister of Finance, Roger Douglas, presented the incoming Government's first budget in November 1984. It provided for significant fiscal consolidation and the removal of distortions, both to be achieved through the rationalization of industry and agricultural assistance and increases in the price of state-provided utility services to reflect the cost of supply. Assistance to farming was to be rapidly phased out, including concessional lending. Assistance was provided to families on low incomes, and tax reforms such as a fringe benefits tax were introduced. In addition, it was announced that a comprehensive goods and services tax would be introduced in 1986, together with other taxation reform. The removal of agricultural assistance, in what is substantially an agricultural economy, clearly signaled the Government's commitment to reform. It also made New Zealand's calls for the removal of agricultural assistance and protection policies in other countries more credible. An interesting outcome was that the farming representatives, rather than calling for a return of government assistance, saw it as in their interest to press for the reform of other sheltered sectors such as Central Government, manufacturing, and the waterfront industry.

Floating the Currency

Two weeks after the budget, controls on foreign exchange transactions were removed. Four months later we floated the kiwi (New Zealand dollar). Such sequencing provided a credible commitment to sound economic management and allowed a deepening of the foreign exchange market before the float. Immediately prior to the float, ratio requirements obliging institutions to invest in government securities were abolished.

The float worked smoothly with margins between buying and selling rates rapidly falling to levels characteristic of much larger economies. In addition, on a monthly basis, the New Zealand dollar proved to be reasonably stable.

It is interesting to recall the arguments that led to the decision to adopt a floating exchange rate, especially in view of the commonly heard argument that exchange controls should be maintained during the early stages of liberalization.

The arguments in favor of a float relied heavily on a comparative institutional framework; do bureaucrats and politicians possess better information and have superior incentives to make sound decisions about the price of foreign exchange than market participants? Further, were there sound grounds for suppressing the nominal exchange rate as a channel of adjustment during the period of major change? Our experience of large discrete changes in the previously "fixed" exchange rate led us to question the effectiveness of a political adjustment process. The alternative to the price mechanism for foreign exchange would have, and has in the past, involved politicians in difficult tradeoffs between competing vested interests.

One concern expressed about floating exchange rates during disinflation is so-called exchange rate overshooting. This might occur where the exchange rate appreciated above its supposed long-run equilibrium due to different speeds with which financial and goods markets clear. Looking at this issue from the comparative institutional approach I doubt that the problem is clear cut. Judgments about the long-run equilibrium exchange rate during periods of rapid adjustment would be extremely difficult. To the extent that assessments can be made, people making investments will have a strong incentive to anticipate future outcomes rather than base decisions on the current exchange rate. For example, when the kiwi appreciated sharply against the Australian dollar during 1988 most exporters remained committed to the market. An additional point is that it is not clear that a real exchange rate appreciation followed by depreciation, involving an expansion and then a contraction of the nontraded goods sector, is a less efficient adjustment process than possible alternatives. Maintaining a fixed exchange rate during this time would have thrown much of the adjustment pressure onto interest rates.

Experience in New Zealand, and more spectacularly in Australia, has shown that the foreign exchange market performs an additional role: exchange rate reactions provide an immediate feedback on perceptions of economic management. Perhaps surprisingly, that can have advantages for a politician to the extent that exposing oneself to such a discipline can itself increase the credibility of policy, and enable real gains to be achieved more readily. A final argument for a clean float, which New Zealand has maintained since 1985, is that the alternatives usually end up costing taxpayers money, as has been the experience of central banks the world over. A floating rate neatly privatizes the gains and losses from speculation.

Labor Market

Another area where the sequencing of reform in New Zealand has been questioned is the labor market. Frequently these questions overlook the significant degree of reform that has occurred, particularly in the public sector. Further, the removal of import protection and liberalization of domestic product and services markets has imposed important disciplines on labor market participants and provided an incentive for a move to more flexible arrangements within the scope of current legislation. Ultimately, attitudes matter at least as much as the legal framework and can be expected to respond to the opportunities and disciplines provided by a more flexible economy.

Early on in the process of reform the Government withdrew from direct involvement in wage negotiations and removed compulsory arbitration. In 1987 the Labour Relations Act was passed that allowed for decentralized bargaining, and in 1988 public sector employees were placed on a comparable basis to those in the private sector. This latter step has been important for getting the Government's finances under control. It has enabled cash limits to be placed on expenditure, whereas in the past a centrally determined public sector wage increase would automatically have been compensated.

Other reforms that are likely to influence labor market outcomes are the removal of import quotas and licensing for most industries in 1988 and the bilateral removal of tariffs with Australia by 1990. More recently, a number of reforms aimed at increasing the efficiency of the port and shipping industries have been introduced.

State Sector Reform

In the state sector, which constitutes around 40 percent of GDP, we have implemented wide-ranging reforms.

Government trading activities have been reformed with the establishment of the state-owned enterprises (SOE) policy. This clarified the objectives of commercial activities in the public sector and gave managers more freedom to manage. It increased the accountability of state-owned enterprises for their financial performance, which is assessed in relation to private sector norms. State-owned enterprises cover a range of activities including electricity generation, telecommunications, coal mining, forestry, postal services, and air traffic control.

A number of state enterprises have been, or are to be, privatized. In each case this was preceded by the removal of any regulatory privileges or statutory monopoly that they enjoyed. Some of the more far-reaching regulatory reforms include the removal of restrictions on foreign ownership of airlines operating domestically and the virtually complete deregulation of telecommunications from April 1, 1989.

Reform of the noncommercial core public sector has been an ongoing process until this year. These reforms are the most fundamental to financial management practices in New Zealand's history and are in large part unprecedented anywhere in the world.

New systems of financial management distinguish between the Government's ownership interests in state agencies and the "purchase" of specified outputs. There will be a progressive shift to accrual accounting for public sector agencies. Input controls will be relaxed in favor of increased accountability for meeting agreed objectives.

The important area of the institutional framework governing monetary policy has also been subject to change. Recently introduced legislation is designed to make the Reserve Bank (our central bank) more autonomous and at the same time more accountable. The Bank will be given a single primary objective of price stability. The Governor of the Bank will enter into a five-year contract with me for a target track of how to get there, with the Governor's performance assessed against the outcome. The design and implementation of monetary policy to achieve that track will be his responsibility.

These more recent reforms of the institutional arrangements for state involvement in the economy should increase the credibility and medium-term focus of fiscal and monetary policy. Arguably, had they been introduced earlier, macroeconomic stabilization could have proceeded more rapidly and at less cost. However, the reforms have taken time to develop and implement. They were partly a response to the lessons of our experience in the early years of the adjustment program.

OUTCOME AND OUTLOOK

I now turn to the question of what we have achieved, and hope to achieve, from the changes we have made. Ultimately any meaningful achievement must derive from social concerns and a desire to improve the welfare of a nation's citizens. The linkages between social and economic reforms need to be clearly understood and the role that appropriately designed social programs can play in facilitating reform appreciated. For example, the introduction of a comprehensive consumption tax might not have been possible, or desirable, had compensation to low income earners and beneficiaries not been a part of the package. Improved economic performance can contribute to the achievement of social objectives by providing people with the means to improve their own well-being and security, while providing the Government with the means to maintain priority social services. The following are some of the indications that the program of reforms has started to yield benefits:

- inflation is down to 4.4 percent for the year to June 1989, compared with an average of 13 percent over the previous four years and a peak of 18.9 percent during 1987;
- the current account balance has turned around from a deficit of 9 percent of GDP in 1984 to a small surplus for the year ended June 1989;

- the Government's financial deficit (excluding asset sales) was reduced last year to 1.5 percent of GDP and is expected to be 1 percent this year, compared with 7 percent in 1984;
- official overseas debt has fallen as a percentage of GDP from 41 percent to 27 percent; and
- over the past year it is estimated that labor productivity in manufacturing has risen by 11 percent.

These changes have put our emerging economic growth on a strong and sustainable basis.

Agricultural Reform

The adjustment process can be illustrated at a microeconomic level by examining agriculture, which is one of the most important sectors in the New Zealand economy and one of the first to undergo reform. As a trading nation the outlook for agriculture is heavily dependent on the trade policies pursued by our trading partners. In many ways, I believe New Zealand's reforms in the area of agriculture and trade protection stand as an example for other countries.

In May 1988, the National Centre for Food and Agricultural Policy had this to say:

> The only convincing example of major farm policy reform in a developed country is in New Zealand . . . .
>
> Although it would be wrong to infer from the New Zealand experience that the United States, the European Community, and others are likely to make similar dramatic policy adjustments, it is nevertheless important to recognise that such reform is no longer solely an "academic" proposition.

It has now been long enough since we started to remove agricultural assistance to assess some of the effects.

As economic theory would suggest, the change in farm assistance was felt most strongly in the price of land, the factor of production in fixed supply. Farmland prices, which peaked in 1982 after rising in response to high levels of assistance, fell sharply following the 1984 policy changes and a downturn in farm incomes during 1985/86.

Farmers responded to the deterioration in their balance sheets and the high cost of debt in a number of ways. There was a decline in discretionary expenditure in areas like fertilizer and capital maintenance. Levels of farm debt were reduced and some farmers chose or were forced to leave the industry. Significant diversification has also occurred with, for example, an increase in deer farming. Marketing efforts were increased and more attention given to value-added processing instead of commodity marketing.

Although some individual farmers remain in a difficult position, many of the necessary balance sheet adjustments seem to have worked through, and spending on investment and maintenance has begun to increase. Moreover, improvement in the prospects for the sector has seen recent increases in livestock prices, the volume of land sales, and the prices of many types of farmland.

CONCLUSION

The conclusions that the New Zealand Government is inclined to draw on the last five years are as follows:

The success of some early reforms, such as the floating of the New Zealand dollar, appears to have played an important role in signaling policy resolve and increased the transparency of direction for government policy initiatives. The rapid phase-down of agricultural assistance appears to have increased the credibility of a subsequent program of tariff and import licensing reform. A notable outcome was that the farming lobby saw their interests as aligned with future reform and have supported a range of subsequent initiatives.

To our minds one of the lessons has been that fundamental gains require institutional reform both in the public sector and elsewhere. Otherwise the forces that led to poor performance in the past were likely to reassert themselves. In combination with such reforms, preannounced policy targets have seemed to provide a credible way for governments to commit themselves to an adjustment path and accordingly to alter expectations. This suggests that the necessary institutional reforms should be implemented early in the adjustment process if possible.

In New Zealand the scope of reform has been broad and the pace comparatively rapid. It is an ongoing process. One of the decisions we made early on was that gradualism would reduce the Government's ability to establish credibility for the reform process. By showing commitment and resolve, the adjustment process was eased as people got on with the job of adapting rather than wasting time lobbying for policy reversals. In addition, by maintaining a consistent medium-term focus and signaling future intentions clearly, expectations were able to adjust in a way that was likely to maximize short- and long-term gains. Through these means New Zealand's economy has been transformed from an economy with major macroeconomic imbalances to one of reasonable stability and resilience. Unemployment and debt levels still remain high, but microeconomic reforms have strengthened the underlying nature of the economy and should result in significant and ongoing dynamic gains. We believe that these changes provide a sound basis for sustainable noninflationary growth.

Questions and Answers

Sir Jeremy Morse: We are coming to the question period now, and you can ask questions in one of two ways. You have a little sheet at the back of your program which you can fill in and hand to the attendant, who will bring it up; or you can stand up and ask a question. I shall give preference to questions through the microphone.

While you are preparing your questions, let me just say that even in an audience as large as this, I do not think we have often heard two more exciting stories. They really are dramatic, and the speakers spoke from their experience.

Both speakers stressed things in common: the need, on the technical side, for the proper sequencing of adjustment measures and the need, on the political side, to establish credibility. Just to remind you of the broad shape of what they said—they both gave a full overview of the task of developing an adjustment program, and laid great stress on not relying on what was called elasticity optimism.

Mr. Abbey gave us his story of Ghana's well-managed adjustment since 1983 and drew the lessons from it. He finished by suggesting that an Institute should be set up to promote interplay between the Fund and the World Bank, on the one hand, and the countries, on the other hand, so that they can work together better.

Mr. Caygill started with the crisis in New Zealand that arose both from structural defects and the macroeconomic situation. He laid out first the reform program, and then the criticisms, the answers, and the choices. He said at the end that economic restructuring was a long process.

There you have two national strategies that were successfully developed. And now I would like to take questions. Who would like to ask the first question please?

Someone be brave! I have only one written question so far, so I want more written questions or questions from the floor. The written question is addressed to both speakers and it says: Since you said that political support was essential for successful adjustments, how was this political support brought about and sustained as you went through the program in your case?

Joe, would you like to start on that one?

J.L.S. Abbey: The mobilization of political support for the program was taken very seriously by us right from the beginning. This was shown not just in terms of technical people but also people in the political area during the time of design of the program. It also was shown in the way in which we tried to explain this program to the population, by keeping the discussion at a level that people could truly participate in.

One of the examples that comes to mind is when we decided to go out to the population and talk about devaluation. While technically devaluing, we said that the exchange rate was formally unchanged but that we were instituting a system of bonuses and surcharges. And everybody discussed the question of devaluation in terms of bonuses and surcharges, because the people did recognize that foreign exchange was critical in the economy. Therefore, to say that you will pay a bonus to anybody who through production of goods or services brought foreign exchange into the country was understandable by everybody.

It was easy to make the case that we were not going to pay the bonus by printing currency, and therefore a surcharge had to be placed on the user. In these and other ways we brought home to the people the importance of devaluing the exchange rate in a way that enabled them to participate in the discussions.

We also made sure that we had the political support for this process. So, by public debate, the proper discussions, and the public support given, the process of mobilizing political support was there.

Sir Jeremy Morse: Thank you very much. David?

David Caygill: It is a fascinating parallel. I think I can point to two aspects. First, the crisis that I referred to helped to produce considerable support from the general population for a dramatic change. There really was a feeling in New Zealand by 1984 that we had tried almost everything except orthodox economic policies and it was time for them to be followed with vigor.

In addition, the incoming Government sought to reinforce the widespread perception that we were suffering from severe problems and would need to act dramatically. And we did that shortly after July 1984 when we called an economic summit conference. We had the example of a similar conference the year before in Australia, which seemed to have been successful in solidifying support for change there.

We brought the leaders of the major economic pressure groups—and many social groups as well—to our capital, for three days, and put in front of them material that we had recently received from our Treasury and from our central bank setting out the economic situation that the country confronted.

I would like to look at one other aspect. Frankly there were a number of instances where we felt we did not have political support—for example, the broad-based goods and services tax. In that respect, we had the advantage of our parliamentary system. In New Zealand, if you are the government, then by definition you have the majority in Parliament. We thought it proper to use that majority and to announce there would be such a tax. We were saying to people, in effect, don't bother telling us you don't want such a tax, but we would like to consult with you about the *details* of the tax. Then we went out and campaigned publicly in order to build support for this move, which included using the news media, the electronic media, and so forth. We did a lot of polling in order to measure how well we were doing. And we were pleased to see that public opinion did shift in response to the arguments that we were making.

Sir Jeremy Morse: Thank you very much. Do I have a question? Yes?

Question from the audience: I have a question for Mr. Caygill. As I come from Sweden, a country that has similar economic problems to New Zealand, I wondered what the unemployment problem is right now in New Zealand and how you are going to cope with that?

David Caygill: If I can start with the figures, we have an unemployment rate at the moment of a little over 7 percent of our labor force that is calculated on a household survey basis. That is historically very high for New Zealand, although we believe it is a little less than what a number of other countries that have gone through similar adjustment processes have had to withstand at the peak of their adjustment.

We have responded to the problem of unemployment in two ways. First, by continuing to make the arguments in public that notwithstanding that increase in unemployment, the economic changes are still appropriate and necessary, that indeed without them there would be no long-term solution to unemployment. Second, we have sought to respond to unemployment through greater efforts in training and retraining programs. The increased government expenditure in those areas has had some success in terms of finding people jobs, but we have not yet had sufficient success in bringing the aggregate number of unemployed down.

We have started just this year, our southern winter, to have seen the beginnings of a seasonal decline in unemployment as our economy has started to pick up from the recession that began at the end of 1987.

Sir Jeremy Morse: Thank you.

Question from the audience: I have a question for Mr. Caygill. I would like to have some further comments, at least in greater depth, on the fundamental differences in the fiscal, monetary, and management policies of Roger Douglas and the policies that you are now implementing. The policies of Roger Douglas seem to have been made from economic orthodoxy. They were recently commented on in the *Wall Street Journal*. I was wondering, what is the fundamental difference?

David Caygill: The question, in case everybody did not catch it, is whether there are any significant differences between the policies that we are now following, those of my ministry, compared to those of my predecessor, Roger Douglas. Reference was made to the favorable comment that his policies have received recently in the *Wall Street Journal*.

Frankly, bearing in mind the praise that his policies received internationally as well, I cannot think of a good reason why I would want to acknowledge the differences. However, the short answer is no, there are no significant differences, to my mind. But the main reason for that is not so much the obvious one, that the policies seem to work well; but, more than that, simply that I was part of the same government. I was one of Roger Douglas's two deputies. And virtually all of the policies that I referred to in my address were taken through the cabinet collectively. Roger Douglas was a very imaginative man and a very successful man in articulating the policies. But they were all taken through that collective process that operates within our system of government.

Sir Jeremy Morse: Thank you. Permit me to direct a written question to Dr. Abbey, which is commendably short. It says: You said inflation is still high in Ghana. How high and why?

J.L.S. Abbey: The first part is easy. It is about 20 to 25 percent per annum. We hope that this year, 1989, we will be able to achieve a target of 15 percent, but that seems unlikely to materialize.

Why? We have not been able to get monetary policy to work as we would have desired. This might be largely due to the fact that there are severe institutional weaknesses in our financial sector. This is an area that we should have tackled much earlier, looking at the financial sector and the way in which it is functioning. These weaknesses being due to the fact that oligopolistic commercial banks, on the one hand, charge as much as they can for lending, but, on the other hand, pay very little for deposits. And they do not have that much to lend out, since they take relatively little from the depositors.

On the financial markets generally, the alternative would be government debt instruments, but in the absence of this alternative to putting money in the banks, we think that most people have taken their financial assets out through the foreign exchange market or bought real goods. So, the weakness of monetary policy is one aspect of why this inflation is still high. We think maybe if we can get monetary policy to work a little better, we will get more financial savings.

Sir Jeremy Morse: Thank you.

Question from the audience: I have a question for Mr. Caygill. I think you have said—I am not sure—that one of your reforms has consisted in putting the public sector accounting on an accrual basis. If so, could you explain the rationale of that reform?

David Caygill: Yes, I did say that. It is something that we have begun. It will take some years. Our target is to have all government departments on an accrual accounting basis by 1991. At that point we will be able to produce a consolidated balance sheet for the public sector as a whole, which is something we certainly do not have at the moment.

The fact that most of our government operations did not have separate balance sheets, that fact alone suggests to my mind that departments did not have an adequate idea of the value of the assets that they were responsible for. That suggests some of the advantages of an accrual system as distinct from a system of accounting on the cash flow.

We believe that the quality of management in the public sector will be improved significantly if we look not at the cash that is being used but at the total resources, including in particular the capital resources, of each government department, and not just the trading operations but also the core government departments. We see this new system of accounting—not new to the private sector, just relatively unusual to see it applied in the public sector—we see that as the counterpart to giving our departments more independence of management. But we are reluctant to give them greater independence of management if they do not have the proper tools with which to manage.

Sir Jeremy Morse: Thank you.

I will now take a written question to Dr. Abbey. It says: The important component of the structural adjustment programs for African countries is the promotion of the export of primary goods. But it is a fact that the more Africa exports, the less it gets for its commodities: cocoa, cotton, coffee, etc. Where is the way out? Production for self-sufficiency or for export?

J.L.S. Abbey: The cocoa question has been raised by several people, the facts being that for some time now, the world supply of cocoa has been growing at about 7 percent per annum, while its consumption has been growing at 2 percent per annum. Now, there have been several people who have looked at this and have felt that this is basically the result of what you get when you advise countries individually to devalue and increase producer prices.

I think that some people look at the recovery of cocoa in Ghana and say that the success of the Ghanaian program has contributed to this glut of cocoa. But, of course, the agronomy of cocoa belies this. The truth of the matter is that it is typically five to seven years before you see improvements from the cocoa planted, longer than our period of adjustment so far.

I think what we want to be able to do is to get on with the job of diversifying our commodity base. Our problem is that we have very few commodities in our export sector, and typically we export to very few countries. We need to look at markets and to grow other crops. In Ghana, for example, we are looking at pineapples and other fruits that we can export.

I do not think the choice is, really, should we produce for ourselves or should we produce for export. We want to produce for both. I think in fact that one of the difficulties, and my message to the other countries in Africa, in particular, is that it is important that the Bretton Woods institutions do not just assume that we have the flexibility and the responsiveness to do this as a consequence of the devaluation. That may be true of developed countries. I think that we also must seek to remove whatever constraints make for such slow responses to market signals in our economies.

We live in a world with markets where to survive in the market environment it is no use to sit in one place and always talk about situations where we cannot adjust because of our markets. We must get the markets to work better. We must move in response to opportunities. This is what we should be doing rather than these distinctions about if we produce more, we will lose more, and so on.

We really need to take the analysis a little more seriously in that respect. I think we want to give our economies the resilience. We want to give our economies the ability to respond to opportunities. If we do not do that, our adjustment will always be very painful.

Sir Jeremy Morse: Thank you. I will take two more questions.

Question from the audience: This is a question for both speakers, if I may. These two examples are rather successful cases, and I would like to hear more about the political background for the success. Could both the speakers identify those elements of good luck that have contributed to the success of their programs?

Sir Jeremy Morse: Right, an excellent question. I think it will probably have to be the last question. We will see how long it takes. First David.

David Caygill: At the risk of shocking you all, one of the pieces of good luck that we had was the intervention of a Northern Hemisphere country which probably I should not name. They came down to New Zealand and sank a boat that happened to be sitting in Auckland Harbor. I say that was good luck because it took the attention of the New Zealand public away from some of the economic . . . [laughter].

We were able to fortuitously exploit international events like that. The disagreement we had with another country about nuclear weapons, and so on, falls into a similar category.

I should emphasize that we did not set out to use those incidents in that way. They were important events in their own right. But at a stage when people like myself and Roger Douglas were concerned with economic policy, much of the country's attention was diverted elsewhere. I know such situations have sometimes been exploited for improper purposes in the past. We felt we were able to put them to slightly more benign use.

Sir Jeremy Morse: Thank you very much. Joe?

J.L.S. Abbey: Actually, it is surprising. Looking back, we literally took advantage of the drought of 1982–83 to launch our program. It was clear to us that if we waited until after the harvest improved, it would be a lot more difficult to launch an austerity program, which we knew the country needed.

People knew that it was not some financial program involving higher cost of imports into the country, but the fact that we could not get food because of the drought that forced austerity; and the fact that we got one million Ghanaians coming from Nigeria, whom we had to absorb in the countryside. So, we made the best of the drought, because people accepted that. Of course, you had to come up with an incomes policy that would make sure that nobody was going to show conspicuous consumption and create problems for us when introducing the program.

So, you have to follow through and make sure that whatever suffering there was, our objective was that with economic aid people should start planting corn—maize—like never before, following the drought and following the price incentives that we also gave out. And the incomes policy that followed on that, spread the feeling that whatever investment we are making, we share the burden, the risk together, and we will start to gain from the benefits together.

So, that was our big element of luck.

Sir Jeremy Morse: Thank you. The art of politics is making sure that the ill wind blows you some good.

That brings us to the end of this discussion. I have a little sheaf of questions here and I am sure some of you have others. You will have a chance to talk to the speakers at the reception. And later on you would be able to have the written text. We shall publish both of the speeches as well as the answers to the questions. Those have been excellent, I think.

Before I say a word about next year's lecture, I think we should show our appreciation to our two speakers. [Applause.]

Next year the Annual Meetings of the Fund and the World Bank will again be in Washington, so we shall be holding this lecture on this Sunday again, September 23. We shall have a single lecturer next year, Paul Volcker.

We hope to see you then. Thank you.

Biographies

J.L.S. Abbey has been Ghana's High Commissioner to the United Kingdom since 1986. Born in 1940, Mr. Abbey was educated at the London School of Economics and Political Science (where he received a B.Sc degree in Economics), the Iowa State University of Science and Technology (M.Sc and Ph.D. in Statistics), and the University of Western Ontario (M.A. in Economics).

Mr. Abbey was Assistant Statistical Officer at the Central Bureau of Statistics in Ghana in 1964–68 and taught at the University of Ghana during 1968–74. In 1971–73, while on leave from the University of Ghana, he was Associate Research Fellow at the University of Western Ontario.

During 1973–74, Mr. Abbey was Research Officer at the United Nations Conference on Trade and Development in New York. Upon returning to Ghana, he served as Permanent Member, National Economic Planning, and as Government Statistician, Central Bureau of Statistics, during 1974–78, and as Government Economist, Ministry of Economic Planning, during 1975–78. From 1978 to 1979 he was Commissioner for Economic Planning and in 1979 also became Commissioner for Finance and Trade.

Mr. Abbey was appointed Director and Chairman of the Board of the Premier Bank in Ghana in 1980, and during 1982–83 he was a member of the National Economic Review Committee. In 1983 he became Executive Secretary, Policy Monitoring and Implementation Committee. From 1984 to 1986, Mr. Abbey served as Ghana's High Commissioner to Canada, and assumed his present position in 1986.

Mr. Abbey has been an economic consultant to the United Nations Development Program and the UN Economic Commission for Africa and has published widely in academic journals. He was awarded the Companion of the Order of the Volta in 1979.

David Caygill is the Minister of Finance and Minister of Revenue of New Zealand.

Mr. Caygill was born in 1948 and was educated at the University of Canterbury, where he received a B.A. degree in 1970 and an LL.B. degree in 1974. From 1975 to 1978, Mr. Caygill practiced law with a Christchurch legal firm. He entered Parliament as member for St. Albans in 1978.

During the first term of the fourth Labour Government (1984–87), Mr. Caygill held the portfolios of Trade and Industry, National Development, and Associate Finance. After the re-election of the Government in 1987, Mr. Caygill was appointed Minister of Health, and held this portfolio in conjunction with that of Trade and Industry. In September 1988, when Mr. Caygill was appointed Deputy Minister of Finance, he relinquished his Trade and Industry responsibilities. After being appointed Minister of Finance and Minister of Revenue in December 1988, Mr. Caygill relinquished the Health portfolio.

In Opposition, Mr. Caygill was Associate Shadow Minister of Finance between 1981 and 1984, Shadow Minister for Local Government in 1981, Shadow Minister of Energy in 1982, and Labour Spokesman on Trade and Industry in 1983.

Mr. Caygill is a past executive member of the Canterbury Regional Council of the Labour Party and has been a member of the Labour Policy Council. In his career, Mr. Caygill has served in a number of municipal, regional, and educational positions.

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1970 *Toward a World Central Bank?*—Lecture by William McChesney Martin; Commentaries by Karl Blessing, Alfredo Machado Gómez, and Harry G. Johnson (Basle); English and Spanish editions out of print.

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