A HETERODOX APPROACH TO THE ADJUSTMENT PROBLEM

The First Adlith Brown Memorial Lecture
Delivered by
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I am twice honoured by your invitation to deliver the First Adlith Brown Memorial Lecture - first, that you should think me qualified to address the leading economists in the region; secondly, that you should think me worthy to commemorate the valuable services, both technical and administrative, rendered by the late Dr. Adlith Brown to the West Indian economics profession.

I only really got to know Adlith since she took up the directorship of the Regional Monetary Studies Programme. From time to time she would come to my office to convince me that the Programme deserved the support of the Central Bank of Barbados. She invariably succeeded with a happy combination of intellect, persuasiveness and female charm. She was also prepared to help when I needed a favour.

But my impressions of Adlith Browne have been much sharpened by her passing. In preparing for this lecture, I collected as many of her papers in the Social and Economic Studies periodical as I could get hold of and I read them through. First, I was struck by her prolificity. Adlith wrote more papers in one year than some of her contemporaries have written in an entire career.

Secondly, she left no doubt in my mind that she had mastered the theory and techniques of her profession. But most of all I have been touched by her concern with policy issues. What is more, her passion to improve the lot of her community glowed through her writings. Which reminded me of an observation by the great economist Kenneth Boulding:

> In consideration of economic policy....the ends of society cannot be left out of the picture, and the abstractions of pure economics can only carry us a small part of the way.

These memorial lectures should help ensure that the good that Adlith has done is not interred with her bones but will live on after her.

In selecting a topic for today's lecture I asked myself which issue appeared closest to her heart. I observed that two of her papers touched on the adjustment problem. Her paper "Economic Policy and the IMF in Jamaica", is marked by penetrating insight into practical problems which still confront us e.g. "... as capital outflows continue, given the unresponsiveness of direct flows to interest rate changes, the usual priorities of monetary policy become less relevant." The conclusions of her paper "Issues of Adjustment and Liberalization in Jamaica: Some Comments," were indeed prophetic. She ended it with these remarks:

> These issues raised here suggest that there are inconsistencies in the stabilization and liberalization programme; that foreign exchange uncertainty and a slow recovery of capital inflows and, therefore, of domestic investment, are likely to continue. In effect, in the absence of a windfall

> which raises the available flow of foreign exchange, the basic strains are ever present. These are continuing high levels of unemployment and slow investment and output growth.

These issues of adjustment with which Adlith grappled with such insight and tenacity still haunt us, and so I have chosen as my topic: "A Heterodox Approach to the Adjustment Process." I think she would have approved of this selection even though she would have done far greater justice to it than I ever could.

Needless to say, the perspective of my lecture reflects my experience as a contributor to economic policy-making in Barbados. over the past thirteen years. The Barbadian economy weathered the oil shocks of 1974 and 1979 more elegantly than most other non-oil exporting developing coutries. Throughout the difficult 1970's Barbados achieved an average real growth rate of over 4%. Negative growth was experienced only in 1975; and, except for 1973 and 1974, when inflation reached 23% and 38%, respectively, price increases have not been too far out of line with those in the U.S.A.

It has taken the most severe depression since the Great Depression to disturb the Barbadian growth trend. The sharp reduction in tourist arrivals from North America and poor yields and prices for our sugar crops resulted in negative economic growth in 1981 and 1982 - minus 2½% in 1981 and minus 4½% in 1982.

The 1981-82 recession, combined with regional trading difficulties, an overly-expansive fiscal policy in 1981, and a

lock-up of half our gross foreign reserves in the suspended Caricom Multilateral Clearing Facility, forced Barbados into a Stand-by Agreement with the International Monetary Fund. The balance of payments and fiscal performance targets were all met and the drawings were completed on schedule without interruption.

The essential ingredient in the programme's success was the anticipation of the foreign exchange difficulties well in advance of crisis. This ensured that an adjustment programme could be put in place while the problem was still manageable and within the scope of available IMF financing and acceptable domestic sacrifices. The timeliness of the approach to the Fund, and the availability of alternative sources of borrowing, ensured for the local authorities the leverage necessary for negotiating a programme which they trusted and which they believed would work. The requirement of devaluation was conspicuously absent from the package of adjustment measures.

Recovery in the U.S. economy prevented further decline in 1983. In 1984, however, the brisk U.S. expansion was reflected in a 50% increase in American visitors and a 12% increase in overall tourist arrivals. In addition, sugar production expanded by 18%, crude oil production increased by two-thirds to 635,000 barrels, or 40% of our petroleum requirements, and a new cement plant was commissioned. As a result, real output grew by 3% in 1984.

Nineteen eighty-five started out promisingly, but the economy has weakened as the year progressed and will be hard-pressed to

record real growth for the year. The decline of the electronics industry in the U.S.A., continued weakness in commodity prices, the high cost of vacations in Barbados for Europeans resulting from the strong Barbadian dollar, and the virtual collapse of our Cariom markets, all give grave cause for concern. In particular, the fierce protectionist measures taken by Trinidad & Tobago against our exports have struck hard at our labour-intensive industries and have driven unemployment to their highest levels (almost 20%) in a decade. Inspite of this, our balance of payments remains quite strong as international financial markets once again have opened up to Barbadian debt issues.

Although there have been broad areas of agreement between the IMF and the Barbadian authorities, our policies throughout the last fifteen years have been based on economic principles which, from the conventional IMF-World Bank perspective, must be viewed as distinctly heterodox. The major source of departure from the IMF-World Bank economists doctrine over the years has been over the concept of stable equilibrium and the efficacy of the free market both in the adjustment process and in the promotion of economic development.

For example, upon realigning our currency from the pound sterling to the U.S. dollar in July 1975, the Barbadian authorities revalued upwards by 10%. We went on to enjoy five of the most prosperous years in our economic history and have maintained that parity ever since. In the high inflation years of 1973 and 1974

we rejected the prescription of positive interest rates; by 1976 inflation had fallen to 6%. Since 1977 we have rejected the approved global credit controls and applied selective credit controls which discriminate in favour of the productive sectors.

After the failure of the neo-Keynesian school to diagnose and prescribe for the stagflation of the 70's, the monetarists led by Milton Friedman, were able to launch a successful counter-revolution. In the process the free market has been restored to the central position from which Keynes had dislodged it. Indeed, the monetarist Karl Brunner argues that "price theory is the crucial paradigm - as a matter of fact, the only paradigm - that economists have."[1] Most professional economists in the North, including those in the IMF and World Bank, now subscribe to this school. The prolonged agony of LDC's involved in IMF progrmmes, euphemistically described as structural adjustment, suggests that we should take a new hard look at the economics of adjustment.

The next section of this paper explores the mechanics of the balance of payments adjustment process. The analysis is intended to shed light on the differences between adjustment in developed and developing economies. The third section points out the limitations of the market system in the adjustment process. Section four discusses the issue of equity in the adjustment process both on the domestic and international fronts. Section five grapples with the contradictions of economic growth and the

adjustment process to which Adlith first directed our attention. Finally, some practical suggestions for approaches to the adjustment problem are put forward.

The Balance of Payments Adjustment Process

As long as countries trade with each other they must make continual adjustments to changes in the international trade environment. The prices of various commodities constantly fluctuate; national currencies continuously change their value in relation to each other; for example weather conditions and other acts of God produce variable crop sizes and new technologies continually create new products and render old ones obsolete. Some changes are seasonal and predictable; other business fluctuations show a cyclical though unpredictable pattern over time. Sometimes economies are assaulted by random and violent shocks which can have disastrous effects on their productive capability.

Most countries adjust satisfactorily to minor changes in international trade. In the major industrial countries the depth and efficiency of real and financial markets bring about considerable adjustments to external shock almost automatically. Solow[2] explains this process in an argument which he attributed to Axel Leijonhufvud:

> There is an equilibrium path that is surrounded by a corridor, a range above and below the equilibrium path. If the economy is disturbed off the equilibrium path and remains within the corridor, normal market forces can bring the economy back; if the disturbance moves the economy outside the range, then inflationary and contractionary expectations and assumptions may become so strong that the normal market forces are unable to push the economy back to a satisfactory state. Physically, it would be like the cup on the desk. If you tilt it a little bit, it will go back to upright, but if you tilt it too much, it will fall.

If the economy is pushed outside the corridor intervention into the market will be needed to restore equilibrium. The classical form of intervention in these circumstances is through some combination of fiscal, monetary and interest rate policies.

It may further be noted that in major industrialized countries Government policy measures are expected to take effect primarily through the market mechanism. General equilibrium theory tells us that changes in any market price will be transmitted throughout the economy through the Walrasian process of "tâtonnement". Sometimes the Central Bank operates on some variable such as the quantity of money or the price of securities; sometimes the national Treasury operates through taxation or other price incentives to induce households and firms to change their behaviour.

Countries with highly developed markets show a tremendous resilience in the face of external shocks. With the exception of Italy, the Western industrial economies and Japan adjusted with remarkable elegance to the two oil shocks. In both instances they experienced balance of payments deficits for only one or two years before swinging sharply into surplus.

Severe shocks may create circumstances which require extra-market measures. For example, in times of war, when a country is blockaded or resources are pre-empted for military purposes, governments regularly have resort to non-market measures.

Rationing, price controls, incomes policies and other administrative measures are then used to allocate strategic resources. In these circumstances no one pretends that the market is an optimal allocator of resources, or relies on market-oriented policy instruments. Rather, the economics of disequilibrium is substituted for the economics of equilibrium. In short, we do the best we can.

In extreme cases, for example, when economies are devastated by war as in the case of post-war Western Europe and Japan, it is recognized that extra-market intervention must be even more drastic and extensive. A massive introduction of resources from without then becomes necessary to enable the economy to be restored to a new equilibrium path when the market system may once again be used to facilitate adjustment.

Limitations of the Market System

From the above examination of the mechanics of adjustment in highly industrialized countries, four principles can be extrapolated for ~~the~~ adjustment management in developing countries. First, since markets in LDCs lack the depth and sophistication of those in develop~~ing~~ed countries, the corridor around a stable equilibrium path in developing countries will be much narrower than for developed countries (See Figure I). This situation has been exacerbated by the propensity of several LDCs for autarchy, economic centralization, and extensive state-ownership of production. This approach, besides being prejudicial to economic progress, has stifled the development of the market system in LDCs and so limited the flexibility of their economies in response to external shocks. We might say that the corridor of those LDCs, like Singapore, Hong Kong, South Korea, Taiwan and Barbados, which have generally pursued open systems policies, has proven to be wider than in the case of those countries which have pursued closed-system strategies.

The second principle of adjustment management is that in LDC's market-oriented measures will be less efficient in pushing the economy back within the corrior than in developed countries. Modifications which take into account the market imperfections will have to be made in policy measures designed to push the system back into the equilibrium corridor. In particular, the global approach favoured by the IMF and The Economist will have

to be tempered by considerations of rigidities and imperfections of markets in developing countries.

The market imperfections will be especially marked in small economies, such as those of the Caribbean, where the law of large numbers is hardly operative. As Kenneth Boulding so elegantly explains:

> "...In the mass human behaviour is fairly regular - which explains, incidentally, why so much of economics assumes the mass-interactions of perfect competition and why indeterminacy appears in the theory of oligopoly - i.e. in the interaction of few exchanges.

The policy maker in Barbados or Antigua can never contemplate leaving the determination of interest rates to a "free" market in which three or four commercial banks control 80% of the market.

Thirdly, when violent shocks cause structural damage to the system, i.e. a state in which there has been virtual collapse of the market system, resort to extra-market measures become necessary. The two oil shocks, followed by the deepest recession since the 1930's, have dislocated real and financial markets in several LDCs. Some of them have been driven to the edge of bankruptcy by a staggering debt burden. Others find it extremely difficult to maintain their populations above starvation levels. The plight of many LDCs is similar to that of Western Europe and Japan after World War II and require similar treatment.

The fourth principle is that the absence of a sophisticated market system will prolong the time required for restoration to a satisfactory growth path. A major problem is that the time

horizon of policy makers in developed countries is too short in the circumstances of LDC's. They think in units of years, forgetting that the development of their own countries took place over centuries.

The case against contemporary economists is that their prescriptions hardly distinguish between industrialized economies with highly developed markets and LDC's with underdeveloped and sometimes non-functioning market systems. Most of them appear never to heard of the work of Joan Robinson and Edward Chamberlin on imperfect markets! They believe that the perfect markets of their model actually exist in real life.

What is more, as itinerant practitioners, the economists of international financial institutions must travel light. They carry a few standard medicines which must fit all the diseases encountered. The standard medicine bag includes (1) devaluation, the economic penincilin, (2) positive interest rates, (3) the reduction of fiscal deficits, and (4) credit control.

Devaluation is the most frequent prescription for restoring equilibrium in LDCs. A recent issue of <u>Development Finance</u> gave several reasons why overvaluation was so harmful. I have never read anywhere about the evils of undervaluation of a currency! The impression is given that an LDC can never have too much of it! The most ridiculous exposition of the virtues of devaluation appeared in <u>The Economist</u> of August 31, 1985: It went something

like this: President Shagari was thrown out in 1983 because the Nigerian naira was overvalued; General Buhari was thrown out because he propped up an over-valued naira; Major-General Babanzida would be wise to instantly devalue the naira or else he too will be over-thrown. How would The Economist explain the failure of massive devaluations to bring about economic recovery in Jamaica? Perhaps it is the frequent devaluations which have averted coups in Kingston!

Devaluation is the classical technique for bringing the balance of payments into equilibrium. Theoretically, devaluation corrects a deficit by effectively reducing the price of a country's exports thus leading to an increase in foreign demand for them; at the same time, devaluation raises the cost of foreign goods and leads to a reduction in the quantity imported. This model has some validity for developed economies, like that of Japan, where the volume of exports is responsive to relatively small reductions in prices. Relatively small reductions in the price of manufactured goods, especially of capital goods can produce significant increases in exports; correspondingly, the increased price of imports calls forth an expansion of dometically produced substitutes. Evenso, exports from some advanced economies, e.g. the U.K. and even the U.S.A., have responded slowly and rather insensitively in recent years to substantial currency depreciations. Lord Kaldor, a strong advocate of the 1967 devaluation in the U.K. later admitted: "I greatly overstated the effectiveness of the price mechanism in

changing the relationship of exports to imports at any given level of income."

In LDCs the elasticities of foreign demand for exports, and especially of the domestic supply of goods for export, are likely to be negligible. Lower export prices merely result in reduced foreign exchange earnings; increased import prices lead only to increased domestic and export prices, since a large proportion of inputs into domestic production must be imported.

I have argued elsewhere that the optimal exchange rate level for developing countries is the highest at which they can dispose of all their exports. Devaluation as a tool of short-term balance of payments adjustment is contra-indicated; successive minidevaluations make even less sense. To be effective such devaluations must be sharp enough to preclude the possibility of wage catch-up by trade unions. The true purpose of devaluation in LDCs is to reduce the real income of consumers to a level consistent with a sustainable volume of imports or to reduce domestic labour costs after other measures to achieve balance of payments equilibrium have failed.

Positive interest rates are another prescription in current vogue with IMF and World Bank economists. Positive interest rates are needed, the argument goes, to stimulate savings hich may then be transformed into investments and economic growth. There is an obvious confusion here between financial savings and

real savings. At any rate empirical evidence suggests that savings are more likely to be a function of income and of custom than of interest rates. Deena Khatkate[3] observes:

> The evidence for developed and developing countries alike is not quite conclusive in regard to the interest elasticity of savings. For the United States, income and wealth are found to have a more predominant influence on personal savings than interest rates. For less developed countries, even allowing for the dubious nature of statistics, the evidence points toward the same kinds of doubt about the interest elasticity of savings.

I would also argue that negative interest rates are distinctly desirable in circumstances where powerful trade unions are able to extort wage increases in excess of productivity gains. In this case negative interest rates restore to investors some of the excess wage tax imposed upon them by the trade unions Moreover, in countries where capital is scarce, the commercial bank overdraft is frequently a substitute for equity finance, which in developed countries attracts no interest charge unless firms are profitable.

Once markets have collapsed, market-oriented policy instruments like devaluation and interest rates lose their efficacy and may even do a lot of harm. By market collapse, I mean a situation where markets do not clear and are unlikely to clear in the immediate future. In Jamaica and Guyana, for example, foreign debt arrears are so huge that it would require an inconceivably large devaluation to bring about the equalization of demand and supply of foreign exchange. By which time the domestic inflation

engendered by the massive increase in the cost of intermediate and consumer goods would have extinguished both domestic production and the consumers themselves.

Figure 2(a) shows the situation which exists in a functioning foreign exchange market. Note that a movement up the supply curve from P_1 to P_{11} - i.e. a currency devaluation - results in a restoration of equilibrium. Figure 2(b) shows the situation which exists in a foreign exchange market which has collapsed. The supply of foreign exchange is realistically portrayed as being inelastic; the demand for foreign exchange is shown as far over to the right, signifying that markets are not clearing. The shaded part shows the extent of the disequilibrium. In this situation, a movement up the supply curve does not move the system to equilibrium; devaluation merely forces citizens to give up increasing units of output for decreasing quantitites of imports without any visible improvement of their situation. It is most reminiscent of the prescription of bleeding in primitive medicine. Usually, only those patients who removed the leeches survived the cure.

Privatization and deregulation are currently the "in-thing" among international economics, based on the dubious premise that whatever appears to work for the U.S.A. must be good for everyone else. In fact, deregulation has led to a dangerous instability in the American Airlines industry. Fierce price-cutting wars have driven some airlines out of business and the others to the

brink of collapse. It is merely a matter of time before desperate cost-cutting measures begin to compromise safety. And the jury is still out on the break up of A.T. & T.! Small developing countries cannot afford the luxury of such dislocations.

Equity in the Adjustment Process

The commitment to free market solutions has led conventional economists to neglect issues of equity in their adjustment programmes. Fiscal and monetary measures are applied in a global fashion and the chips allowed to fall where they may. Almost invariably they fall with greater severity on disadvantaged sections on the community. Severe deflationary measures are imposed, requiring widespread lay-offs, severe cuts in subsidies on basic foodstuffs, and deep currency devaluations which trigger spiralling inflation.

Indeed, conventional economists seem far more concerned that the aggregates in their econometric models approach equilibrium than with the welfare of the population. This approach is an excellent demonstration of what philosophers describe as the "fallacy of misplaced concreteness" - the mistaking of the model for the real-life system it purports to explain.

The above approach is in marked contrast with that taken by John Maynard Keynes in his much neglected tract "How to pay for the war", published in 1940. In it Keynes set out an economic strategy for the conduct of war against the Nazis. The rationale of his strategy was that the sacrifices necessary in the conduct of war should not fall primarily on those least able to bear them. Keynes proposed an extensive programme of family allowances as well as a system of rationing and price controls. In this way he established a floor under the general welfare and

ensured that the rich could not bid scarce goods away from the poor as would have happened in a free market situation.

The consideration of equity is also absent from the current approach to the international debt crisis. In the first place, it is forgotten that the most serious effects of the sharp rise in oil prices were deflected from the developed economies to the less developed non-oil exporting countries. On the other hand, the non-oil developing countries, lacking both the flexibility engendered by efficient market mechanisms and the advanced technology to exploit alternative sources of energy, sank deeper and deeper into the morass of debt which now envelopes them.

The inequality between developed and developing countries worsens as the existing international order operates to transfer a massive volume of resources from the developing to the developed world. Expanding U.S. deficits suck vast capital resources into the American economy which serve to maintain high positive interest rates. When we consider that positive interest rates in the U.S.A. have traditionally been between one and two percent, the recent positive rates of five to six per cent paid by developing countries on Eurodollar debt, represent a rate of exploitation not achieved even at the height of the British or Spanish Empires.

Once again we might learn from Keynes that equity is an essential element of sound policy. Keynes warned in "The Economic Consequence of Peace" that insistence on war reparations

would damage both the Germans and the Allies. By 1932, when Germany was finally forgiven her war reparations debt, it was too late. The lessons from the Treaty of Versailles were not lost on the Allies after the Second World War. Extra-market measures were taken in the form of the Marshall Plan to restore the economies of Western Europe, victors and vanquished alike, to the mutual long-term advantage of both Western Europe and the U.S.A.

It is astonishing that the politicians and economists of the developed world have not perceived the current international debt crisis as analagous in important respects to the German War Reparation issue or the Marshall Plan. The current case by case approach purchases the integrity of the banking systems of developed countries at the expense of painful declines in the living standards in the debtor nations. Those less able are required to bear the major share of the adjustment burden. To anyone acquainted with the Prisoner's Dilemma problem in game theory, case by case negotiations are an obvious manoevure by an international creditor cartel to maintain its leverage over individual debtor nations.

Considerations of equity require a shift in emphasis from structural adjustment in the debtor nations to the refinancing of the debt in a manner whereby the creditors bear a fair share of the burden. The situation calls for extra-market measures which bring into being an international lender of last resort along the lines suggested by the Lever Report. Such a programme should promote a positive flow of real resources back to the LDCs,

restore them rapidly to a real growth path, and enhance their ability to repay their debt over the long term.

What is more, this approach is in the enlightened self-interest of the developed countries. The world-wide terroism and political turmoil which now exercise the political leaders of the First World can only be alleviated by the emergence of stable and democratic regimes. At this very time, major Latin American countries like Argentina and Brazil are in danger of stumbling into democracy. Some traditionally democratic societies are in danger of collapse. Prolonged social unrest occasioned by crushing adjustment programmes could very well abort promising democratic movements and create new tyrannies – to the peril of us all.

Economic Development, The Market and the Adjustment Process

It was accepted by the economics profession in the 1950's and 1960's that the analytical tools required for the analysis of developing economies differed from those applicable to developed economies. Joan Robinson[4] wrote in her work "Economic Philosophy":

> In this situation both static neo-classical analysis of the allocation of given resources between various uses, and Keynesian short period analysis of how given resources are employed, appear quite inadequate. A dynamic long-run analysis of how resources can be increased is now what we require.

In his celebrated Theory of Economic Growth, Sir Arthur Lewis[5] also argued:-

> But if we are concerned with long-term studies of changes in propensities, or if we wish to account for difference between groups or countries, we have usually to look beyond the boundaries of contemporary economic theory.

Sometime ago, President Reagan, reflecting the attitudes of his economic advisers, recommended that LDC's should rely on the "magic of the market" in their quest for economic development. As if market forces constructed the Erie Canal, laid the railroads across America, established the Land Grant Colleges, or pionerred the space age!

In an issue early this year, The Economist suggested that developing countries had merely to trim their deficits, devalue their currencies, and hit their monetary targets and, presto, growth would follow. The notion that economic development should be achieved through a pure market strategy was

carried to its critical conclusion in Chile by General Pinochet. The results have been disastrous. The 1983 World Development Report suggested that the economic growth of a number of LDC's during 1970-80 was related to price distortion, as indicated by exchange rates, factor pricing and product pricing. One of the countries included in the exercise was Ghana which in the decade of the 1970's had experienced sundry military coups and counter-coups. These upheavals must certainly have had a greater effect upon Ghanaian growth prospects than any price distortion.

The history of developed nations reveals that in the early stages of their economic development their governments invariably made critical interventions in the market place. In some instances, as in the case of Japan, intervention was more systematic and comprehensive. As economic development proceeded, the market for goods and services became deeper and more extensive and governments, even in Communist countries, found it possible or necessary to reduce the extent of market intervention or to shift their attention to new areas. The Japanese are only now relaxing their controls over the flow of international capital. The trick in economic management is to make intelligent interventions into the market place.

The theory of economic development is properly concerned with the processes by which stable and progressive political systems evolve, how efficient public services are developed, how economic enterprises are effectively organised and managed,

and how entrepreneurship is made to flourish. Economic development has little to do with positive interest rates, monetary targets or exchange rates. As societies develop, so will their capacity for the management of these economic variables.

The trickiest aspect of adjustment, as Adlith so clearly recognized, is how to promote the necessary structural changes in the economic system without undermining the capacity for future growth. Current programmes of adjustment being imposed by international institutions on LDC's have the effect of depressing investment which is the engine of growth.

An analogy from aeronautics is instructive. An aircraft must maintain a minimum stability while in flight. If the pilot is unable to control pitch and yaw, the plane is in danger of falling out of the sky. At the same, time, he must maintain forward propulsion. If his engines fail he will certainly come to grief. And it matters little whether his plane hits the ground ~~up~~ right side up ~~or~~ (in perfect equilibrium, if I may use economic jargon) or upside down.

There is a slight ray of hope. Secretary Baker has discovered that econmic growth is essential to the adjustment proces. Let us hope he will soon come to understand that the reverse flow of resources from developed to developing countries is also indicated. Then the rest will be up us!

Recommendations

There is an urgent need for the IMF and World Bank economists to review their ideology about adjustment in LDCs. I would make the following suggestions:

(1) A more rational and non-ideological view of the role of the market system in the functioning of an economy must be developed. The market has no magical attributes. It is merely an ingenious social device for the inexpenive allocation of resources. Like all devices, it can be used or misused, depending on the circumstances. The circumstances of developed countries are clearly more appropriate to its usage than those of developing countries. In the latter, a fine judgement is required to determine what adaptations are necessary and when extra-market measures are required. However, it is readily admitted that whenever results of market allocation are acceptable, we should use it; when the results are unacceptable or perverse, we will have to design extra-market measures to the best of our ability.

(2) Economic theorists should move towards a systems rather than a generalised approach to LDC problems. The systems approach treats each country as a peculiar system and focuses on its unique characteristics. One frequently gets the impression that international economists have determined their prescriptions long before their arrival in an LDC and that specific facts

and situations do not affect their judgement. In this respect, much greater respect should be paid to the opinions of local officials, especially those who have been around for sometime. In this respect, we should heed the advice of John Dickenson that "experience must be our guide. Reason may mislead us."

(3) Modern economists should refocus their attention away from their econometric models to the human problems of the society. A programme which sharply increases unemployment, significantly increases the price of food, and threatens the cohesiveness of the society, cannot be viewed as a success. The more serious the adjustment problem, the more time will be required for LDC's to adjust. The IMF must begin to think of structural adjustment periods of five years and more. Moreover, much larger amounts of concessionary financing must be mobilized as they were for Europe under the Marshall Plan.

(4) A new look at the Theory of Economic Development is also required which places greater emphasis on institutional factors and less on free-market theoretical formulations. We should not behave as if efficient markets exists when, in fact, they do not. Since the development of efficient markets is a prolonged process, a theory of disequilibrium will be necessary. While they are at it, attention should also

be paid to the Theory of Games, especially those aspects which deal with the transactions among unequal players.

(5) It should be recognized that "non-economic" factors, such as political stability, social cohesion, educational levels, technical and managerial skills are much more critical to long-run development than interest rates, exchange rates and monetary targets. Economists should try to incorporate these factors into their models.

(6) The current case-by-case approach to the International Debt Crisis should be abandoned by the international financial community. Indeed, the IMF and World Bank should place their prestige and resources squarely behind the implementation of the Lever Report. The most urgent item on the agenda is to reverse the massive flow of resources from LDC's to the developed countries.

FIGURE I

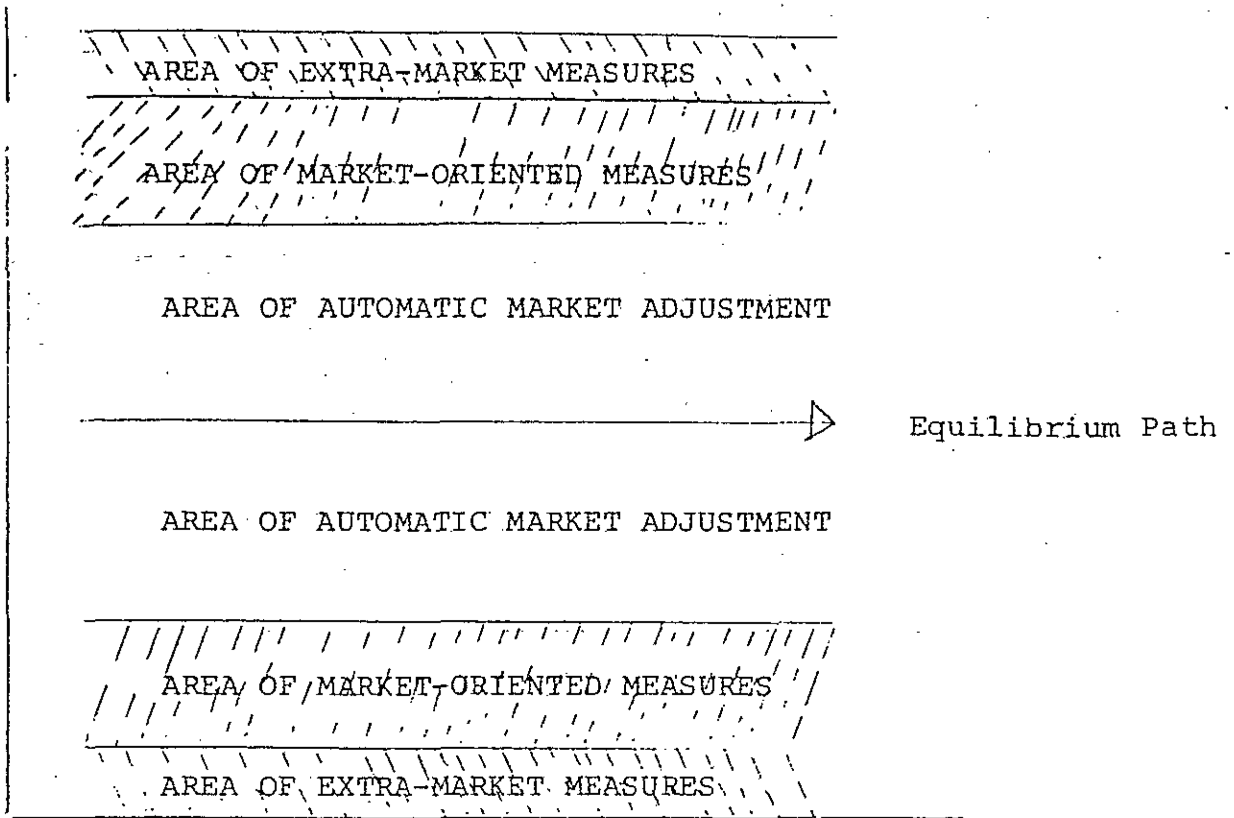

Fig. 1(a) Corridor for Developed Countries

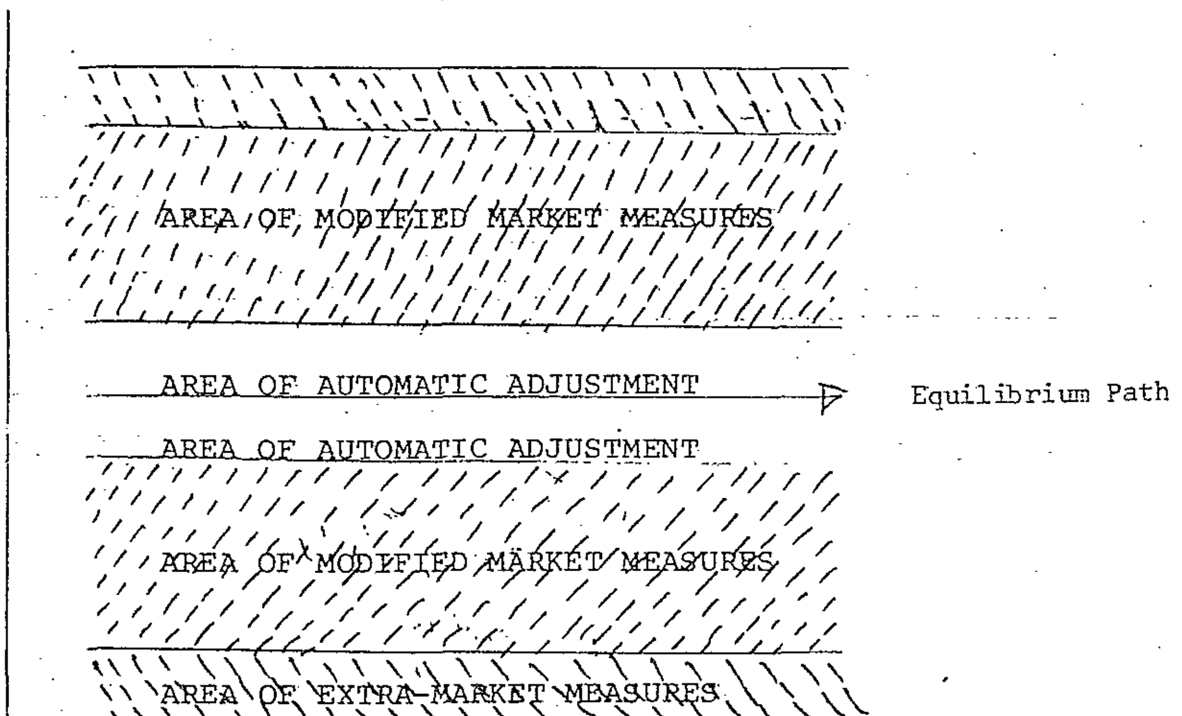

Fig. 1(b) Corridor for Developing Countries

FIGURE 2

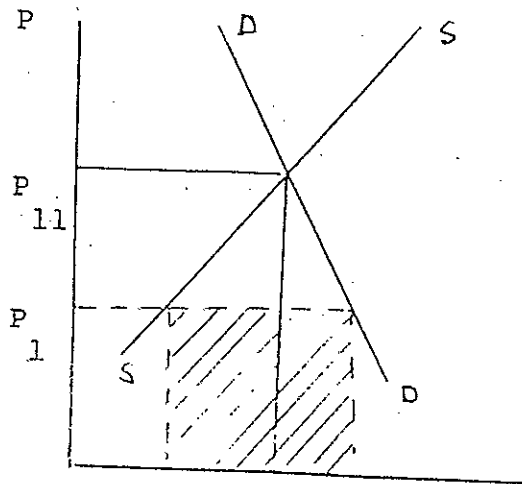

Figure 2(a): Functioning Foreign Exchange Market

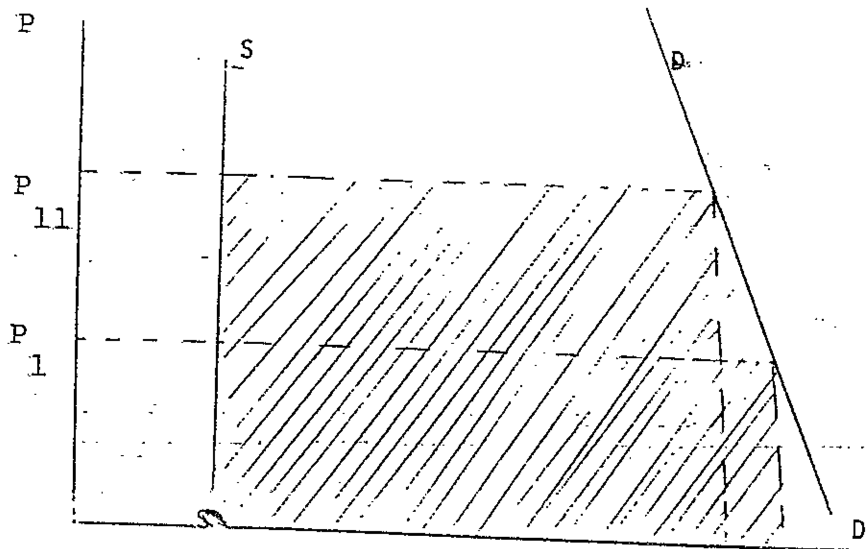

Figure 2(b): Collapsed Foreign Exchange Market