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**LIBERAL THEORY, UNEVEN  
DEVELOPMENT AND INSTITUTIONAL  
REFORM: RESPONDING TO THE  
CRISIS IN WEAK STATES**

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## Crisis States Programme

### Liberal Theory, Uneven Development and Institutional Reform: Responding to the crisis in weak states<sup>1</sup>

#### Crisis States and the Contradictions of Liberal Transformations

Crises and breakdowns in the weakest countries in the world system are inflicting untold suffering on their peoples. They are the outcome of a long-term degeneration in their political, economic and social institutions that began with the failure of the interventionist strategies of the early post-colonial period, and continue under the liberal adjustment programmes managed by the International Financial Institutions (the IFIs)<sup>2</sup> that have replaced them. These programmes involve fundamental changes to the rules and incentives that govern their domestic political, economic and social institutions, and the way they relate to the international system. They depend on external advice and financial support, so they threaten national sovereignty and are constrained by an institutionalised commitment to the creation of an open world economic system.<sup>3</sup> Their primary goal is to transform the neo-mercantilist states<sup>4</sup> created during the post-colonial period into new ones based on multi-party democracy, competitive markets and participatory civic institutions.

The publication of the Berg Report<sup>5</sup> on the African crisis in 1981 produced a major shift in the international policy agenda by rejecting the interventionist theory that had dominated development policy since the 1940s. Since then the IFIs have assumed that the *weakest* countries in the world system should use the same liberal institutions and policies as the strongest. In doing this the IFIs denied the long-standing claim that developing countries must adopt special measures if they were to overcome the limitations imposed on them by the underdeveloped nature of their existing institutions, and their levels of social and human capital. This new approach implied that liberal institutions could function as well in weak states as in strong ones, and that the crises confronting the former could be overcome by deeper integration into an open international economic system on the same terms as the countries that already dominated it.

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<sup>1</sup> This paper is a contribution to the Crisis States Research Programme at the Development Studies Institute, London School of Economics and Political Science. It examines the theoretical and policy issues implicit in the need to meet the challenges posed by the inability to deal with the crises and breakdowns generated by state failure in many poor countries. It depends heavily on insights derived from the group discussions that have taken place in the programme over the past eighteen months, and especially at the Crisis States Programme Workshop in Colombia in April 2002. It would be invidious to single out any particular contribution here, but I am especially indebted to the comments by James Putzel and Johnathan DiJohn at Bogota. I have also acknowledged the direct use of particular contributions when they appear in the text. I would also like to acknowledge DFID's generosity in funding this work, and the demanding and fair way in which they have helped us develop it.

<sup>2</sup> The International Monetary Fund, The World Bank and The World Trade Organisation.

<sup>3</sup> See in particular J. K. Horsefield, *The International Monetary Fund*, 3 vols., Washington: International Monetary Fund, 1969; J. M. Keynes, 'Proposals for an International Clearing Union,' 1943, reprinted in Horsefield (1969), vol. III (1943/1969); and E. A. Brett, *International money and capitalist crisis: the anatomy of global disintegration*, London, Heinemann, 1983.

<sup>4</sup> Austen uses this term for the centralised, interventionist, and authoritarian states in post-colonial Africa. (*African economic history: internal development and external dependency*, London: James Currey, 1987, ch. 9).

<sup>5</sup> The World Bank, *Accelerated development in Sub-Saharan Africa: an agenda for action*, ('The Berg Report'), Washington: World Bank, 1981.

These programmes have been tried in many countries since the early 1980s, but few governments or social groups have been able or willing to implement them effectively and consistently; their partial efforts to do so have often made matters worse rather than better. This now threatens the credibility of the orthodox policy model, the normative foundations of the international system, and that of the global agencies that manage it. The result is the re-emergence of a radical critique of the 'globalisation project' that presents it as a 'western' imposition that is intensifying existing levels of subordination and uneven development. Some critics call on countries to 'de-link' from the whole system and return to some form of socialism,<sup>6</sup> others condemn the whole development project, and call for a return to traditional institutions.<sup>7</sup> These critics expose the limits of the orthodox project, but it is not clear what they have to offer instead.<sup>8</sup>

The liberal paradigm responds to the failures of neo-mercantilism by attempting to create or reform market-based institutions. This is not only so in economics, but also in politics in the form of multi-party democracy, in public administration using 'new public management', and even in civil society where agencies based on individual rights and participatory management are displacing those based on traditional loyalties and ascriptive authority. This agenda demands such radical changes in institutions, culture, and knowledge systems, and therefore in all of the factors that sustain the social order, that it is hardly surprising that it is faltering in countries where the gap between actually existing and new institutions is so wide. This being so, it is surely time for a serious reconsideration of a programme that is manifestly failing to achieve its own objectives.

This paper will look for explanations for this failure by examining the factors that led to the demise of the post-colonial interventionist programmes, and the problems now associated with their liberal successors. The former emerged out of the critique of orthodox liberalism created by classical development theorists in the 19<sup>th</sup> century that was continued by their modern successors after the Second World War.<sup>9</sup> The interventionist programmes accepted the enlightenment project's prescription to replace feudal structures with new ones based on individual freedom, market openness, and democracy,<sup>10</sup> but also claimed that 'latecomers' to

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<sup>6</sup> Patrick Bond, *Against global apartheid: South Africa meets the World Bank, IMF and International Finance*, University of Cape Town: UCT Press, 2002; Yash Tandon, 'Globalisation and Africa's options', in Dani W. Nabudere, *Globalisation and the post-colonial African state*, Harare: AAPS Books, 2000. Bond calls for the "articulation of a multifaceted post-nationalist political programme, grounded in post-neoliberal economic formulations." This seems to mean "progressive politics and basic-needs development within formal and informal organisations – based in workforces, communities, women's and youth groups, environmental clubs and churches," (Patrick Bond & Masimba Manyaya, *Zimbabwe's plunge: exhausted nationalism, neoliberalism and the search for social justice*, London: Merlin, 2002, pp.192/3) and debt repudiation, foreign exchange controls and exemplary labour standards. How states will finance future projects and retain domestic or foreign investment is not discussed.

<sup>7</sup> See in particular the collections edited by Wolfgang Sachs, *The development dictionary*, London: Zed, 1992; Majid Rahnema & Victoria Bawtree, *The post-development reader*, London: Zed, 1997; and Escobar, Arturo, *Encountering development: the making and unmaking of the third world*, Princeton: Princeton University Press, 1995.

<sup>8</sup> The 'third way' followed by Social Democratic Parties in the north makes a stronger commitment to social provision than conservative alternatives, but replaces socialism with individualism, competition and globalisation. Tony Giddens, *The third way: the renewal of social democracy*, Cambridge: Polity Press, 1998.

<sup>9</sup> Classical theory was elicited by the way in which late developers experienced the 'first transformation' generated by the transition to capitalism in the west (for example Hegel, List, Marx, Durkheim, Weber); modern theory by the 'second transformation' involving the transition from colonialism that began in 1947, (Parsons, Baran, Lewis and their successors).

<sup>10</sup> This includes the Marxist tradition, since it recognises the progressive nature of the liberal capitalist institutions when compared to pre-capitalist alternatives.

development would have to adapt the new structures to take account of their existing levels of human, social, economic, and political capital. The orthodox project ignores these problems and is attempting to transfer these institutions fully formed to weak states, using blueprints derived from a social science based on western experience. The failure of both neo-mercantilist and liberal projects in weak states obliges us to reconsider the intellectual claims of both development and liberal theory, and the way they relate to the actually existing institutions and cultures in these Late Developing Countries (LDCs).<sup>11</sup>

This paper will do this by attempting to validate three propositions:

- that modern institutions may be failing in crisis states, but still provide the only long-term alternative that offers people freedom, security and prosperity;<sup>12</sup>
- that reforms must generate antagonistic conflict between new and old institutions and value systems;
- and that this means that new structures and theoretical paradigms must be adapted to deal with the contradictory realities of the political conflicts that they must inevitably generate during the *transition* to modernity.

Exploring the complex implications of these propositions will enable us to consider the relationship between institutional paradigms and states of (and in) crisis, and to identify the causal factors that produce cumulative processes of breakdown and decay. The paper will therefore examine the recent shift from neo-mercantilist to liberal programmes; review the case for state-led development; and then try to transcend the current impasse by drawing out the valid elements in both paradigms and explaining the widespread failure to implement them. It will conclude by identifying some of the key theoretical and practical issues to be addressed if we are to overcome the problem of crisis states.

## From Neo-Mercantilism to Liberal Capitalism

The state-led strategies initiated in the post-colonial period in the third world went into deep crisis in the late 1970s, discrediting the structuralist and socialist theories on which they were based and legitimating the ideas of a powerful group of liberal critics, particularly in economics.<sup>13</sup> State-led import substitution then gave way to market-led export-oriented strategies in the third world; corporatist social democracy was dismantled in the first world;

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<sup>11</sup> I use late, rather than less because these countries have yet to make the transition to modernity, and are therefore doing so in a context in which their reform agenda is bound to be conditioned by asymmetrical relationships with 'firstcomers'. The usage is derived from Alexander Gershenkron, *Economic backwardness in historical perspective*, New York: Praeger, 1965; I owe the point to Jonathan DiJohn.

<sup>12</sup> "Social movements (new and old) in the Third World are not expressions of resistance against modernity; rather they are demands for access to it." (Schuurman, Frans., *Beyond the impasse: new directions in development theory*, London: Zed, 1993, p. 27).

<sup>13</sup> Key texts would include Friedrich von Hayek, *The road to serfdom*, London: Routledge, 1944; Friedman, Milton, *Capitalism and democracy*, Chicago: University of Chicago Press, 1962; Michael Oakeshott, *Rationalism in politics*, London: Methuen, 1962; Karl Popper, *The open society and its enemies*, 2 vols. 5<sup>th</sup> ed. Routledge & Kegan Paul, 1966; Robert A. Dahl, *A preface to democratic theory*, Chicago: Chicago University Press, 1956; Peter T. Bauer, *Dissent on development*, London: Weidenfeld & Nicholson, 1971; James Buchanan & Gordon Tullock, *The calculus of consent*, Anne Arbour: University of Michigan Press, 1962; William A. Niskanen, *Bureaucracy and representative government*, Chicago: Aldine-Atherton, 1971; Krueger, Little & others (1970); I.M.D. Little, *Economic development: theory, policy and international relations*, New York: Basic Books, 1982; Deepak Lal, *The poverty of development economics*, London, Institute of Economic Affairs, 1984.

as were the command economies in the second.<sup>14</sup> This produced a global system where all institutional arrangements were dominated by the logic of market competition that appeared to provide the only effective way to organise “the whole of economic life without outside help or interference.”<sup>15</sup> The post-war hegemony enjoyed by socialist principles was destroyed,<sup>16</sup> and Fukuyama could claim that “the end of history” had arrived.<sup>17</sup>

This major shift also justified the elimination of development theory as a distinct discipline. Most theorists agreed that “democratic political institutions are those most conducive to human welfare” and that “superior economic performance” is directly associated with “competitive markets, secure property and contract rights, stable macroeconomic conditions, and efficient government provision of public goods”,<sup>18</sup> and that free trade would produce the “maximisation of world income.”<sup>19</sup> This implied that the privileges bestowed by liberal institutions – to vote, to buy from or sell to any willing agent, to gender equality, and to freedom of association and belief – were human rights that are “identically transferable”<sup>20</sup> without reference to local conditions or cultures.<sup>21</sup>

Development theory had claimed that modern institutions might be appropriate in DCs, but not in LDCs; the opposing view has legitimated liberal adjustment programmes since the early 1980s and was formalised in the Washington Consensus in the early 1990s.<sup>22</sup> These programmes were initiated by fundamentalists who favoured “minimalist theories of the state that emphatically limited the scope of effective state action to the establishment and maintenance of private property relations”.<sup>23</sup> But by the end of the 1980s even they had come to accept that strong states and social stability were needed to support effective market

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<sup>14</sup> This can be seen as a logical consequence of the globalisation of capitalism and validation of Marx’s prediction that “Big industry universalised competition .... produced world history for the first time, insofar as it made all civilised nations and every individual member of them dependent for the satisfaction of their wants on the whole world, thus destroying the natural exclusiveness of nations”. Marx, Karl, *The German Ideology*, 2<sup>nd</sup> ed. edited by C.J. Arthur, London: Lawrence & Wishart, 1974 [1846], p. 78.

<sup>15</sup> Polanyi, Karl, *The great transformation: the political and economic origins of our time*, Boston: Beacon Press, 2001 [1944], p. 45). He provides a seminal exposition and critique of the role market theory in the development of western capitalism.

<sup>16</sup> For example in 1949 T.H. Marshall could claim that it is “obviously not true ... that basic equality can be created and preserved without invading the freedom of the competitive market. ... Our modern system is frankly a Socialist system, not one whose authors are, as [Alfred] Marshall was, eager to distinguish it from socialism. But it is equally obvious that the market still functions – within limits.” (*Class, citizenship, and social development*, New York: Doubleday, 1964, p. 71)

<sup>17</sup> He claims that “liberal democracy remains the only coherent political aspiration that spans different regions and cultures around the globe. In addition, liberal principles in economics – the free market – have spread, and have succeeded in producing unprecedented levels of material prosperity, both in industrially developed countries and in countries that had been ... part of the impoverished Third World.” (Fukuyama, Francis, *The end of history and the first man*, London: Penguin, 1992, p. xiii)

<sup>18</sup> Clague (1999), p. 1; see also The World Bank, *World Development Report, 1997: The state in a changing world*, Washington: World Bank, 1997.

<sup>19</sup> Harry Johnson, ‘International trade: theory,’ in *International encyclopaedia of the social sciences*, vol.8, New York: Free Press, 1968, p. 88.

<sup>20</sup> The phrase is from Jaspers, Karl, *The future of mankind*, Chicago, Chicago University Press, 1963, p.72.

<sup>21</sup> This includes the right to pay the same price for a pair of Levis in New York, London, or Johannesburg.

<sup>22</sup> Joe Stiglitz, ‘Foreword’ in Polanyi (2001); Williamson, John, ‘What Washington Means by Policy Reform’, in John Williamson (ed.), *Latin American Adjustment: How much has happened?* Washington, D.C.: Institute for International Economics, 1990.

<sup>23</sup> P. Evans, , ‘The state as problem and solution: predation, embedded autonomy and structural change,’ in Steven Haggard and Robert Kaufman, *The politics of economic adjustment*, Princeton: Princeton University Press, 1992, p. 140.

reforms,<sup>24</sup> so good governance, poverty reduction, and participatory development have been added to the original economic agenda in the third world. However, these changes still depend on an individualistic social theory that sees personal freedom as a primary objective of public policy and goal of development, and also assumes that people will be able to behave as autonomous individuals and not be subordinated to social, religious, economic or political power structures.

The universalisation of this liberal project has eliminated the conflict between communist and capitalist systems, and discredited all attempts to base industrial development on mercantilist policies managed by autarchic nation states. The result is an open world system, governed by market forces, and regulated by international agreements enforced by the IFIs, that have therefore become putative organisations of global governance.<sup>25</sup> This has created new opportunities and generated rapid increases in technical change, autonomy and inter-dependence in strong countries and also given crisis states the right to some financial and policy support from publicly funded global organisations. However its long-term success is still open to question, since growth has slowed even in developed countries, which have also been threatened by financial crises and recessions. Adjustment programmes in some LDCs have had positive effects,<sup>26</sup> but have not solved the problems confronting the weakest countries that concern us here. Their very survival is still threatened by a series of intensifying and inter-linked crises - of political authority, service provision, investment, employment, gender relations, health, crime and environmental degradation. These suggest that reforms that work in strong states need not work in weak ones, thus challenging the liberal claim that such reforms offer a *universal* solution to problems of poverty and exclusion. This forces us to reconsider the relationship between liberal principles and the actual processes that created the modern world order.

### **Development Theory, State-led Transformations and the Modern World Order**

The belief that liberal institutions provide the only viable route to development is not only challenged by the problems confronting crisis states, but also by the historical processes that created the modern world system in the 19<sup>th</sup> century. Latecomers in Europe, the USA and Japan, did not use free markets, co-operation and democracy to catch up with Britain then, or manage post-war reconstruction more recently. They used state power to subordinate their own citizens to the demands of capitalism, colonise weaker states, and challenge Britain's pre-eminence.<sup>27</sup> In fact the dominance of liberal ideas has constantly alternated with that of mercantilist theories as different regimes, classes and social movements have used state

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<sup>24</sup> This view was given official World Bank recognition in 1997. World Bank (1997)

<sup>25</sup> As Keynes anticipated in his paper for the Bretton Woods Conference (Keynes, 1943/1969).

<sup>26</sup> The implications of these programmes for middle income and poor countries is the subject of serious debate, with the economic evidence suggesting some improvements, and continuing serious problems. See for example David E. Sahn, & others, *Structural adjustment reconsidered: economic policy and poverty in Africa*, Cambridge: Cambridge University Press, 1997; Giovanni A. Cornia & Gerald K. Helleiner, *From adjustment to development in Africa: conflict, controversy, convergence, consensus?* London: Macmillan, 1994; Engbert-Pedersen, *Limits of adjustment in Africa: the effects of economic liberalization*, Oxford: Currey, 1996; Frances Stewart, *Adjustment and poverty: options and choices*, New York: Routledge, 1995; and E. A. Brett, 'Structural adjustment [in Uganda],' in Engbert-Pedersen (1996).

<sup>27</sup> The terms are derived from Gershenkron. It is also true that even the strongest countries still break the liberal rules when it suits them. The USA supports WTO demands for trade liberalisation in poor countries, but refuses to apply it to its own agricultural, steel, and, most significantly of all, labour markets. The key text is Chang (Ha Joon Chang, *Kicking away the ladder: Development strategy in historical perspective*, London: Anthem Press, 2002).

power to overcome “the conflict between the market and the elementary requirements of an organized social life”.<sup>28</sup>

In fact free trade theory only emerged at the end of the 18<sup>th</sup> century, after a period when economic power had grown out of the barrel of a gun and not the laws of comparative advantage. It was then only seriously promoted by Britain after she achieved world dominance, initiating the first “great [liberal] transformation”, in the 19<sup>th</sup> century. However, British free trade based on Ricardo was then challenged by European, American and Japanese protectionism based on List. And it is hard to claim that List was wrong, given that Britain grew far more slowly than her protectionist rivals over this whole period. The credibility of liberal theory was then shattered by the political and economic crises of the first half of the 20<sup>th</sup> century that culminated in the 1930s Depression when Britain renounced free trade and the world descended into fascism, mercantilism and war.

The peace produced a new social compromise, based on the recognition that these beggar-thy-neighbour international policies had produced little more than war and devastation. However the new world, with the exception of the USA, was not dominated by liberal theory, but by right or left wing state-led social democracy in the west, supported by weak, but comprehensive institutions and organisations of global political and economic management. The influence of liberal theory continued in the constitutions of the IFIs, the result of US influence. But the weaker countries were only persuaded to join because they were allowed to retain state controls during their reconstruction periods. Post-war reconstruction itself depended heavily on state-led support from the USA,<sup>29</sup> and was dominated in Europe and Japan by Keynesian theory, and in LDCs by Structuralism. Both supported social controls, and saw behaviour as a function of collective and class loyalties, and resource allocation as a function of state control and central planning, rather than individualism and market competition. The east, joined by China in 1949, combined one party dictatorship with command planning, taking state control to its logical conclusion.

Liberal theory suggests that these programmes would have degenerated into inefficiency and predation, but they were actually immensely successful as a mechanism for *reconstructing* devastated states whose governments all agreed that market freedom would have to wait until they had rebuilt their infrastructure and economic capacity. Europe and Japan re-emerged as major powers, rapid industrialisation began in some parts of the third world, and colonies became independent states. Communist states ran oppressive political and economic systems, but nevertheless achieved rapid industrialisation and comprehensive social security. The successful completion of these programmes subsequently led to an ongoing programme of liberalisation, culminating in the liberal revolution in the Soviet Union and Eastern Europe in 1989. This has certainly increased political and economic freedom, but has not been associated with greater stability or growth, notably in the former Soviet Union where competitive democracy and market competition has led to de-industrialisation, unemployment, and the criminalisation of the state and many spheres of civil society.

Finally, the rejection of mercantilist development theory in the 1980s was heavily influenced by the successful shift from import substitution to export oriented strategies in East Asia. This was originally taken as evidence of the success of market as opposed to state-led

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<sup>28</sup> Polanyi (2001), p. 257. He provides the seminal account of the “double movement” through which “the dynamics of modern society [has been] governed” involving a continuous expansion of the market, always “met by a countermovement checking the expansion in definite directions.” (p. 136)

<sup>29</sup> Brett (1983); and E.A. Brett, *The world economy since the war*, London: Macmillan, 1985.

policies.<sup>30</sup> However subsequent research demonstrated that these successes depended as much on state interventions designed to overcome market failures, as on the enforcement of market competition.<sup>31</sup> Further, China, and Vietnam more recently have achieved dramatic growth led by authoritarian communist parties that are using socialist controls to build dynamic capitalist economies.

Thus, history offers us examples of many *successful* interventionist programmes managed by authoritarian states and *none* of *weak* countries that have voluntarily adopted liberal policies and overcome the problems of late development.<sup>32</sup> Open systems might maximise benefits for interdependent developed countries, but history suggests that mercantilism need not produce irrational rents and social and political degeneration, and has in fact been a *necessary* precondition for successful transitions to liberal capitalist institutions in LDCs. *This undermines the current orthodoxy, and suggests that well managed interventionism is actually the first best solution to the problems of crisis states.*

These claims are compelling, and are being used by radical theorists to justify a return to old style interventionism, but this hardly seems plausible in countries where these strategies failed so comprehensively in the recent past, suggesting that neither traditional statist nor liberal solutions are likely to solve their problems. This suggests that our first goal must be to find out what it is about the local conditions that produced these results, and then to look for *adaptive* solutions that make use of the valid insights provided by liberal and statist policies, but recognise their limitations in the particular contexts in which they will have to operate. The next section will attempt to do this, by examining the relationship between policy paradigms, state action and actual outcomes.

### Competing Policy Paradigms and Dysfunctional States

The demand for open and competitive liberal institutions depends on the claim that they provide individuals in society with higher levels of social and political freedom and economic efficiency than those based on centralised controls and ascriptively determined hierarchies. The interventionist critique of this position depends on the assumption that socially managed controls are essential in contexts where the pre-conditions for fully developed liberal institutions have yet to be created. The previous section shows that interventionist policies can succeed; what it does not do, however, is to explain why they have failed so disastrously in the weakest countries in the system. This failure challenges the very basis of interventionist theory, because it implies that *state failure is likely to be more costly than market failure in most LDCs*,<sup>33</sup> and that the risks associated with bad governance will be increased by policies that give large amounts of discretionary power to state agents. If this is

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<sup>30</sup> For example Little (1982), p.262ff; Anne O. Kruger, *Liberalization attempts and consequences*, Cambridge, Mass.: Ballinger, 1978.

<sup>31</sup> See Brett, (1983, 1985); Robert Wade, *Governing the market, economic theory and the role of government in East Asian industrialisation*, Princeton: Princeton University Press, 1990; Alice Amsden, *Asia's next giant: South Korea and late industrialization*, New York: Oxford University Press, 1989; Peter Evans, *Embedded autonomy: states and industrial transformation*, Princeton: Princeton University Press, 1995.

<sup>32</sup> Hong Kong is an exception, but too exceptional (as a British Colony, City State, and recipient of a large inflow of entrepreneurial refugees from the Chinese revolution) to count.

<sup>33</sup> See Lal (1984), p. 108, on state failure; Arnold J. Heidenheimer, *Political corruption: readings in comparative analysis*, New York: Holt, Reinhart & Winston, 1970, on the complex role of corruption in development. "Markets fail, but so do governments. To justify intervention it is not enough to know that the market is failing; it is also necessary to be confident that the government can do better." (The World Bank, *World Development Report 1991: The challenge of development*, Washington: World Bank, 1991, p. 131).



so, market solutions represent, at the very least, the best second best option available to policy makers in countries with weak states.

The strength of this argument stems from the fact that neo-mercantilist policies give politicians and officials wide authority to set prices and transfer resources, an authority that is ultimately dependent on their capacity to control force rather than make welfare maximising economic decision. These policies allow governments to transfer assets and manipulate prices to overcome infant industry and information problems, protect marginalised groups, and provide public goods like roads, environmental controls, health and education. These powers gave them great discretion, but statisticians assumed that they would always act in the public interest to correct market failures. However, neo-liberal economists challenged this belief in the 1970s, arguing that they were more likely to maximise their own interests than those of their citizens,<sup>34</sup> by exploiting the ‘rents’ created by the ability to use state power to set prices and transfer assets.<sup>35</sup> These arguments do not hold in strong states, but they certainly do in weak ones dominated by predatory regimes.<sup>36</sup>

This means that the success or failure of interventionist policies is not pre-ordained, but a function of the political competence, integrity and accountability of the regimes in power. Strong ‘developmental’ states can maintain the necessary disciplines to achieve success, but where states are weak neo-mercantilist strategies maximise the rents available to predatory regimes, and the temptation to abuse their powers in order to retain them. Here transferring control from states to markets should eliminate the worst of these abuses, suggesting that liberalisation might represent a second best, but preferable, alternative to neo-mercantilism until the countries concerned have built up the political capital required to guarantee effective performance. This also means that weak states cannot be relied on to adopt socially responsible policies without external pressure, thus justifying the policy conditionality tied to adjustment programmes, which is primarily designed to reduce the range of monopoly rents available to non-accountable political elites. Hence the simplistic critique of adjustment programmes presented by the radical protesters on the streets of Seattle and elsewhere simply fails to address the realities of the problems confronted by the IFIs in many of the states that concern us here.

Thus the claim that state failure is more significant than market failure is difficult to deny in most of these countries, nor is it easy to reject the rationale for most of the policies being implemented in current adjustment programmes. The ‘good governance’ initiative is designed to strengthen state capacity, but this is clearly a long-term enterprise that cannot be expected to overcome high levels of corruption and deep-seated weaknesses in civil service capacity and political representation. Instead the democratic deficit and collapse of civil service capacity is still intensifying in many weak states. This being so, there are clearly so many benefits to be derived from removing monopoly powers from corrupt and oppressive state agents and agencies, that it would be irresponsible not to do this when the conditions allowed.

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<sup>34</sup> Notably Gordon Tullock, *The politics of bureaucracy*, Lanham & London: University Press of America, 1987; Niskanen, (1971).

<sup>35</sup> The classic text is Anne O. Kruger, ‘The political economy of a rent seeking society’, *American Economic Review*, 64 (1974), pp.291-301; also Rowley & others, *The political economy of rent seeking*, Boston: Kluwer, 1988.

<sup>36</sup> See, for example, the growing literature on the ‘predatory state’ in Africa. Jean-François Bayart, *The state in Africa: the politics of the belly*, London: Longman, 1993; Jean-François Bayart & others, *The criminalisation of the state in Africa*, Oxford: James Currey, 1999; Patrick Chabal & Jean-Pascal Daloz, *Africa works; disorder as political instrument*, Oxford: James Currey, 1999; Christopher Clapham, *Africa and the international system: the politics of state survival*, Cambridge: Cambridge University Press, 1996.

These powers include the ability to control exchange rates and allocate foreign exchange, to provide corrupt and inefficient state enterprises with subsidies and monopoly privileges, and to suppress small and informal businesses through oppressive controls.<sup>37</sup>

Further, the claim that there is no alternative to liberal adjustment policies does not only depend on these positive claims, but also on the fact that most countries have systematically evaded many of the policies they were expected to implement. The belief that liberal programmes have failed is only valid if they have actually been implemented, and this is a very demanding task. Viable reform programmes depend on the rigorous implementation of a wide-ranging set of policy changes that are far-reaching and interdependent. They require improvements in monetary, exchange rate, and fiscal management; the end of irrational monopolies and subsidies; the liberalisation of financial, trade, and labour markets; strong environmental regulation, and the provision of public goods. Few governments ever implement all of these policies consistently, and crisis states hardly implement them at all,<sup>38</sup> so failures in adjustment programmes have often stemmed from the refusal to let markets operate, rather than a willingness to do so.<sup>39</sup>

Evidence to substantiate this claim is not difficult to find. Spending cuts are not the result of adjustment programmes, but of the inability of the local state to tax, or manage its debts. The severity of the financial crises in Mexico in 1994, Asia in 1997/8 and in Argentina in 2002 was certainly intensified by exchange rate rigidities, and lax enforcement of financial regulations. Increases in unemployment in Zimbabwe in the 1980s, and in South Africa in the 1990s, are often attributed to excessively rigid labour regulations. Uganda only achieved financial stability, and rapid and equitable growth after it actually began to implement the key reforms demanded by the IFIs in 1991.<sup>40</sup> These problems are not confined to LDCs, because their industrial and agricultural opportunities have always been heavily constrained by protectionism in developed country markets. Thus policy-makers ignore many of the liberal demands for economic discipline at their peril. Economic progress does require fiscal discipline, competitive exchange rates, real interest rates, the elimination of abusive monopolies, and a competent and accountable civil service. State managed populism has never produced sustainable and equitable development.

However, the fact that market disciplines have not yet been enforced in most failed states, should not blind us to the valid counter-claims of interventionist theory. The attempt to overcome weak state capacity by shifting economic decisions to the market, and increasing

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<sup>37</sup> Hernando De Soto, *The other path: the invisible revolution in the third world*, New York: Harper & Row, 1989, provides the classic evidence of the regressive effects of mercantilist policies on small businesses. The elimination of crop marketing monopolies in Africa have also had highly beneficial effects. (E. A. Brett, *Providing for the rural poor: institutional decay and transformation in Uganda*, Brighton: IDS; Kampala: Fountain Press, 1992/93; 'Responding to poverty in Uganda,' *Journal of International Affairs*, 52:1 (1998), pp.313-38).

<sup>38</sup> See for example Lionel Demery, 'Structural adjustment: its origins, rationale and achievements', in Cornia & others (1994). Little, for example, reviews a large number of interventions in the 1970s and finds that "the countries did not have a well worked out system of incentives that they were trying to achieve, and ...did not have a plan for achieving it by stages that would minimize the inevitable transitional costs – nor did the IMF or the IBRD." (Little, 1982).

<sup>39</sup> This is not a new argument, but one that "does not find support in innumerable recent infringements of economic freedom only, but also in the indubitable fact that the movement to spread the system of self-regulating markets was met in the second half of the 19<sup>th</sup> century by a persistent countermovement obstructing the free working of such an economy." (Polanyi, 1944/2001, p. 150).

<sup>40</sup> Brett, (1996, 1998).

democratic accountability, also depends on the existence of a strong state, so market based reforms alone cannot overcome the problem as Evans shows:

the state remains central to the process of structural change, even when change is defined as structural adjustment, [and this] ... inevitably leads back to questions of state capacity, [demanding the] ... enduring institutionalization of a complex set of political machinery [that] ... can by no means be taken for granted.<sup>41</sup>

Successful liberal programmes therefore also depend on the existence of a strong state.<sup>42</sup> However, to concede this is of little help where countries are undergoing intense political and economic crises with a weak national bourgeoisie,<sup>43</sup> weak political and social movements, low levels of literacy, crumbling infrastructure, a defunct civil service, and adversarial class and ethnic relationships. These countries are clearly incapable of building viable market based institutions without conscious management and large asset transfers, but do not have the capacity to manage these. This has produced the contradiction between the need for strong political and economic institutions, and weak political and economic capacities that was responsible for the breakdown of the neo-mercantilist state in the 1960s and 1970s, and continues to destabilise current attempts to produce viable market based alternatives. This obliges us to reject the apparently easy options offered by both liberal and statist fundamentalists, and to try to transcend the sterile debate that continues between them.

Yet even here we have to enter another caveat. Those who berate the IFIs for refusing to recognise the centrality of the state are surely now attacking a straw man. The need “to bring the state back in” has been accepted since the early 1990s,<sup>44</sup> so policies do now recognise the need for ‘good governance’, poverty reduction strategies, and increased aid flows and debt relief.<sup>45</sup> These dilute the fundamentalism of the original stabilisation programmes, and require conscious controls and asset transfers managed by Governments, donors, or NGOs, that go far beyond the minimalist role supposedly allocated to them in liberal theory.<sup>46</sup> Their content, and the limitations imposed on national governments by the obligations embedded in the international regulatory regime, can and should still be contested on many fronts. Chang has shown that none of the major developed countries followed these principles during their early development phase;<sup>47</sup> new patent rules and the demand for open markets threaten infant industry programmes; many aid programmes are inefficiently<sup>48</sup> and sometimes corruptly run. It is also clear that the dynamic process of technological change in the developed world continues to marginalise all of the countries that do not have the political, economic, social

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<sup>41</sup> Evans (1992), pp.141/2.

<sup>42</sup> I owe this point to Ha-Joon Chang.

<sup>43</sup> “A vigorous class of town dwellers has been an indispensable element in the growth of parliamentary democracy. No bourgeois, no democracy.” (Barrington Moore, *The social origins of dictatorship and democracy*, Harmondsworth: Penguin, 1973, p.418).

<sup>44</sup> See for example World Bank (1991), ch.7. Little, a leading proponent of market theory could claim in 1982 that “Only when a country itself has a strong and determined government that sees the need for reform is reform likely to succeed.” (Little, 1982, p. 146).

<sup>45</sup> The argument is expressed even more forcibly in The World Bank, *Entering the 21<sup>st</sup> century: world Development Report 1999/2000*, Washington: World Bank, 2000.

<sup>46</sup> Interestingly they also conform to Polanyi’s account of the emergence of the ‘countermovement’ against the “absurd notion of a self-regulating market system”. He claimed that this “was not due to any preference for socialism or nationalism on the part of concerted interests, but exclusively to the broad range of the vital social interests affected by the expanding market system.” (Polanyi, 1944, p.151)

<sup>47</sup> Chang (2002).

<sup>48</sup> For example James Ferguson, *The anti-politics machine: ‘development’, depoliticization and bureaucratic power in Lesotho*, Cambridge: Cambridge University Press, 1990.

and human capital required to compete on anything like equal terms.<sup>49</sup> But it is also true that a major international enterprise is now devoted to an attempt to overcome the ongoing crisis in weak states through conscious interventions of many kinds, suggesting that we cannot simply attribute the failure to overcome them to liberalisation and globalisation.

Therefore serious theorists now recognise the need for strong state action, and for the elimination of the perverse incentives and monopoly rents associated with old-style neo-mercantilism. Current policies differ from those by trying to support markets and private property rights, not to destroy them. However they are also attempting to develop strong public management to institutionalise progressive social, political and economic institutions that would produce immense welfare gains if they were allowed to succeed. *This suggests that the central problem for crisis states is not the nature of the policy agenda, but the obstacles to its effective implementation.* This therefore places the tension between the demands of reform programmes and the social, economic and political conditions under which they have to be implemented at the centre of the analysis.

### **Vested Interests, Institutional Dualism, and the Politics of Non-Compliance**

Where policy failure stems from non-compliance rather than paradigm failures, we have to look beyond technicalities and blueprints, and identify the motivational factors that lead elites and social groups to reject even potentially beneficial changes. Compliance with reform programmes depends on the existence of a state apparatus run by groups that are willing to forego the benefits to be derived from existing institutions, and able to manage the conflicting interests and resource transfers that change always generates. These benefits are a function of the fact that changes to the existing rules and incentive systems don't only affect behaviour, but also the allocation of power and wealth.<sup>50</sup> New rules threaten the rents that elites can extract from existing relationships, and undermine the social networks, coping mechanisms, knowledge systems and cultural values associated with them.<sup>51</sup> Introducing and sustaining them therefore requires more social, economic and political capital than is available in most weak states.

Thus the willingness to do this *is not just a matter of intellectual choice, but depends on the extent to which the power relations and incentive systems implicit in existing institutions induce elites and influential social interests to accept or evade the demands imposed on them by the new rules.* Beneficiaries of existing incentive systems, however perverse, are usually the most powerful elements in society, and many less privileged groups also depend on them for their immediate survival, so both elites and many popular movements are likely to subvert and resist, rather than implement such changes. We can explore the implications of this central proposition by looking at the inter-related problems of vested interests, institutional dualism, the politics of adjustment, and the contingent nature of the reform process.

First, institutional reforms threaten existing rights and value systems by creating new rights and new beneficiaries. For example democratic and market-based reforms allow previously disempowered citizens to vote out corrupt regimes or bankrupt inefficient firms, so their beneficiaries are hardly likely to implement them with great enthusiasm. Stalin, Hitler,

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<sup>49</sup> This is best understood as an infant country problem.

<sup>50</sup> I owe this point to Jonathan DiJohn.

<sup>51</sup> "Rapid transformation destroys old coping mechanisms, old safety nets, while it creates a new set of demands, before new coping mechanisms are developed. This lesson from the nineteenth century has, unfortunately, all too often been forgotten by the advocates of the Washington consensus, the modern-day version of liberal orthodoxy". (Stiglitz, 2001, pp.xi/xii).

Chaichescu, Pinochet, Mobutu, Taylor, and Mugabe were all more interested in retaining power than accepting liberal reforms, and willing to lie, cheat, torture and kill to do so. Since compliance depends on the costs that reforms will impose on those with a vested interest in the old structure, their content should not be determined by economic logic alone, but by the need to secure the support of relevant political and social movements.

Second, institutional reform creates situations where new structures emerge before old ones, and the class and value systems that sustain them, disappear. Integration occurs slowly and partially, so new rules and incentives co-exist with old, and some groups benefit by invoking the former, others by invoking the latter. *The result is institutional dualism and a contradictory and antagonistic relationship between the competing power structures, rules, incentive and value systems embedded in the new and old structures.* Here non-compliance is not only a function of limited knowledge, or vested interests, but of the extent to which people not only support the new arrangements, but have also acquired at least some of the skills and values required to make them work.<sup>52</sup> Modern institutions depend on a culture of ‘possessive individualism’<sup>53</sup> where people see themselves as autonomous agents motivated by self-interest, but also willing to grant equal rights to the other individuals in society.<sup>54</sup> This principle is difficult to reconcile with the need for collective responses to political and economic problems, even in well-functioning democracies, as new institutional theorists have demonstrated.<sup>55</sup> It is far more problematic in contexts where personal autonomy is still deeply compromised by membership of collective and hierarchical social groupings, and by the rules imposed by autocratic political systems and command economies designed to suppress dissent, competition, and access to inconvenient information.

Third, reforms threaten the interests of existing elites and groups, and create new opportunities and assets for others. Thus the antagonistic relationship between competing institutions will also manifest itself in political conflict over the gains and losses associated with the transfer from one system to another. These conflicts may be represented as a debate between competing ‘paradigms’ (in the language of science, ‘ideologies in the language of politics), but outcomes will not be determined by theory but by the willingness of powerful social movements to support changes that might involve a life and death struggle between groups that stand to benefit from one set of rules as opposed to another.<sup>56</sup>

And fourth, this analysis tells us why no two countries can follow the same developmental path, since differing social, economic and political conditions will ensure that policies that work well in one context will fail dismally in another. This means that we cannot assume, as current orthodoxy does, that successful transformations can only be based on ideal typical models carried from one country to another by donor officials and consultants. Democracy and competitive markets may offer people greater freedom and efficiency than autocracy and

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<sup>52</sup> See, for example Mary Douglas, *How organisations think*, London: Routledge & Kegan Paul, 1987.

<sup>53</sup> The classic exposition is in C. B. MacPherson, *The political theory of possessive individualism: Hobbes to Locke*, London: Oxford University Press, 1962.

<sup>54</sup> Even Herbert Spencer, the great protagonist of liberal individualism in the 19<sup>th</sup> century, recognised that this willingness was not a natural human characteristic, but a function of the creation of a complex social system in which it would be possible for everyone to maintain “his own claims ... [while] respecting the claims of others.” (Spencer 1868, pp.480-3).

<sup>55</sup> Douglass North, *Structure and change in economic history*, Cambridge: Cambridge University Press, 1981; Mancur Olson, *The logic of collective action*, Cambridge: Harvard University Press, 1965; Elinor Ostrom, *Governing the commons: the evolution of institutions for collective action*, Cambridge: Cambridge University Press, 1990.

<sup>56</sup> Civil wars and revolutions are often fought over competing institutional paradigms.

planning, but they will fail in their developed liberal form in countries where their demands conflict directly with the needs and capacities of the existing social and institutional arrangements. This leads us into a contingent world where basic theory is still of fundamental importance, but where it can never provide agents with a determinate guide to action. *Instead we need adaptive strategies that will make use of these models to strengthen the leverage of the poorest elements, without necessarily insisting on them being implemented in accordance with all of their basic principles.*

### **Conclusions: Towards a Transformatory Methodology**

This analysis has shown that freedom, security and prosperity require the creation of modern institutions in crisis states, but that attempts to build them create serious contradictions between new and old institutions and knowledge systems. This means that reform programmes cannot be treated as a technical exercise based on the implementation of imported blueprints, but a political process that demands solutions that are adapted to local conditions that take account of the demands, assets, and capacities of the contending parties. This claim challenges many of the dominant assumptions of current theory and practice. We cannot expand on the implications of this claim here, only identify some of the methodological and empirical issues that should be included in such an exercise. These include the static and functionalist assumptions implicit in current thinking; the need for distinctive analytical models to conceptualise the specific problems created by late development; and the need to find distinct and adaptive solutions to resolve them.

First, orthodox theory cannot explain structural change as opposed to stability because it is designed to specify the principles used to manage already developed institutions in advanced countries. Here it must identify the ‘functional prerequisites’ that enable social systems “to constitute a persistent order [as opposed to its disintegration], or to undergo an orderly process of developmental change”.<sup>57</sup> Such static theories work where existing institutions *have* evolved “to meet a society’s functional needs”, and “persist because they continue to satisfy [its] needs”.<sup>58</sup> *But regressive institutions in weak states fail to satisfy people’s needs, so maintaining them will merely perpetuate their weakness.* Here theory cannot only focus on how to sustain existing structures, but must provide a *critique* of the regressive ways in which they structure the interactions between agencies and the needs and aspirations of society.<sup>59</sup> This requires explanations of the processes that produce crises and breakdown, and tendencies to radical structural change, as well as those leading to co-operation, stability and equilibrium.

Second, orthodox theory offers people access to the positive benefits that could be derived from the successful transfer of open institutions to countries where they hardly yet exist. It also provides them with a rigorous basis for exposing the weaknesses of the claims put forward by defenders of oppressive systems, and clear evidence of the negative costs that they impose on society as a whole. But orthodox theory ignores the contradictions created by the antagonistic relationship between new institutions and old ones, and the limitations imposed by existing levels of capital, value systems and skills. These cannot be eliminated by policies that ignore the realities of dualism and uneven development, which produce perverse incentives, limited skills, ethnic and/or sectarian hatreds, survivalist struggles, dependency

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<sup>57</sup> Parsons, *The social system*, New York: Free Press, 1964, p. 27.

<sup>58</sup> Jack Knight, *Institutions and social conflict*, Cambridge: Cambridge University Press, 1992, p.94.

<sup>59</sup> E. A. Brett, ‘Institutional theory and social change in Uganda,’ in John Harriss, Janet Hunter & Colin Lewis, *The new institutional economics and third world development*, London: Routledge, 1995, pp. 203ff.

complexes and much else that will disrupt and undermine imported institutions. The result is rigged elections, corruption, regulatory capture, monopolistic markets and attacks on rational science and gender equality. These problems had to be overcome in all DCs during the first transition to modernity, but they rarely used liberal best practice in their efforts to reconcile political, economic, and social stability with the long-term goals of institutional transformation.<sup>60</sup>

Third, these arguments imply that the problems of *late* and *uneven* development, and the crises, conflicts, and breakdowns associated with them, cannot be solved by orthodox theory alone. Instead solutions depend on a *comparative institutional methodology* that will not only specify the requirements and benefits stemming from the extension of more developed institutions, but also identify the obstacles to their introduction created by the demands and incentives implicit in the regressive arrangements that already exist. Orthodoxy ignores the theoretical and institutional implications of the differences between latecomers and first-comers, and thus cannot provide a distinct body of theory and policy for the analysis and solution of the intensifying crises that afflict weak states. These can only be overcome by acknowledging the contradictory realities of institutional dualism and the inability of functionalist blueprints to resolve them.

This insight, of course, is only new to those who have lost their memory,<sup>61</sup> since it has underwritten development theory since (at least) Hegel, List and Marx. Current orthodoxy ignores the work of the generations of scholars who confronted the intellectual and political struggles generated by the institutional transformation initiated by the enlightenment in the 18<sup>th</sup> century, and its post colonial successor. However, their work needs to be revisited and extended in the search for viable solutions to the moral, technical and theoretical challenge posed by the ongoing crisis of a newly internationalised world. The maturation of liberal institutions in DCs may or may not signal ‘the end of history’, but it certainly does not in weak states where ‘history’ still involves faltering attempts to replace actually existing, and often regressive institutions, with the modern ones prescribed by donor agencies. The crises in these processes have exposed the limits of a new orthodoxy and show that this transition cannot be exclusively managed using a paradigm that denies the problems of historical specificity and difference, because this ignores the central problem of *objective possibility*.<sup>62</sup> Earlier theorists recognised that the actually existing conditions in weak states create structural obstacles to the implementation of many potentially beneficial institutional reforms, and attempted to address them, however imperfectly. It is time that their modern successors took up the task again.

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<sup>60</sup> See, in particular Karl Polanyi (1944/2001).

<sup>61</sup> I owe this point to Eddie Webster.

<sup>62</sup> G. Lukacs, *History and class consciousness: studies in Marxist dialectics*, London: Merlin, 1971.

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The aim of the Crisis States Programme (CSP) at DESTIN's Development Research Centre is to provide new understanding of the causes of crisis and breakdown in the developing world and the processes of avoiding or overcoming them. We want to know why some political systems and communities, in what can be called the "fragile states" found in many of the poor and middle income countries, have broken down even to the point of violent conflict while others have not. Our work asks whether processes of globalisation have precipitated or helped to avoid crisis and social breakdown.

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### **Research Objectives**

- We will assess how constellations of power at local, national and global levels drive processes of institutional change, collapse and reconstruction and in doing so will challenge simplistic paradigms about the beneficial effects of economic and political liberalisation.
- We will examine the effects of international interventions promoting democratic reform, human rights and market competition on the 'conflict management capacity' and production and distributional systems of existing polities.
- We will analyse how communities have responded to crisis, and the incentives and moral frameworks that have led either toward violent or non-violent outcomes.
- We will examine what kinds of formal and informal institutional arrangements poor communities have constructed to deal with economic survival and local order.



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