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STRUCTURAL ADJUSTMENT AND WORLD BANK CONDITIONALITY: A LATIN AMERICAN PERSPECTIVE

Abstract

Multilateral lending to Latin America has been facing along the 80s a growing conditionality. The net transfer of funds has been falling and even turning negative, while conditionality has tended to become tougher. Toughness has been associated, in particular, to the addition of WB conditionality to that of the IMF on issues related to overall economic and development policies of debtor countries.

Conditionality is generally recognized as needed and/or unavoidable when borrowing from multilateral lenders. The same holds for domestic adjustment when basic macroeconomic balances depart from equilibria. The question is what sort of domestic adjustment is to be implemented, and what are the features of lender conditionality that would contribute to a sustainable adjustment with growth, equity, and political stability.

The following points are stressed in this article: (i) There is no single structural adjustment rule or model valid for all economies. A flexible approach, free of rigid conditions, would be preferable. (ii) Structural adjustment must be implemented gradually; the important point is the economy's overall trend, even though at times there may be delays or regressions. A gradual process is preferable to a shock treatment. In other words, there can be a trade-off between the speed and intensity of the adjustment and its continuity and persistence. (iii) Since the result of the suggested measures is uncertain, it must be possible to carry out rectifications, i.e., there should be an ongoing evaluation and dialogue on the economy's evolution and performance vis-a-vis the implemented measures.

I. General characteristics of structural adjustment programs[1]

A distinction must first be made between adjustment and stabilization. Stabilization programs such as those of the International Monetary Fund (IMF) aim to reduce — in the short term — the disequilibrium in the balance of payments, with the related objective of decreasing the inflation rate. Structural adjustment programs (SAP), such as those of the World Bank (WB), intend to increase economic growth; their related or required objectives include expanding exports, adopting a system of free prices incentives, reducing the role of the public sector, and integrating the local markets to the international economy.

It is necessary to determine the context in which SAPs arise and develop. SAPs are loans established in the early 80's by the WB, intended mainly for countries with serious balance of payments problems resulting from the foreign debt crisis. SAPs have two advantages over traditional investment project loans granted by the WB: (i) They allow relatively fast disbursement of a great volume of resources, since they are not related to the preparation and review of a large number of investment projects. (ii) These resources may then be used to finance the balance of payments deficit.

It could be said that SAPs were created first and their rational and theoretical justification came ex-post. In other words, the new type and degree of conditionality implemented by the WB in relation to SAPs is a recent creation, that involves substantial reforms and changes in the economic policy making of Latin American countries (LACs).

SAPs have two objectives at present: (i) To increase economic growth, and (ii) to provide a permanent solution to the persistent disequilibrium in the balance of payments which apparently derives from structural factors rather than from contingencies. In order to increase economic growth, more efficient use must be made of existing resources; therefore, the prevailing structure of incentives in LACs must be modified. To eliminate the current disequilibrium in the balance of payments, the production of tradables must be increased. Consequently, it is necessary to re-orient long-lasting development strategies in LACs and to replace "inward development" strategies with "outward development" strategies. "Outward development" strategies require increasing the economy's international competitiveness. According to the WB, the principal mechanism for promoting this new strategy involves liberalizing the economy through measures such as: reforms in foreign exchange and trade policies, revision and reduction of the state's size and structure, and the role played by the government in economic activity. In general, they seek to eliminate the "domestic distorsions" which are assumed to be at the heart of the poor performance and disequilibria exhibited by LACs in the 80s.

Under the WB's present view, the distortions that usually exist in LACs are the following (Michalopoulos, 1987):

(1) Price controls, highly different incentives for tradable goods, subsidized interest rates and control of loans, barriers regarding labor mobility and adjustment of real wages. In these economies, improved efficiency in resource allocation and productivity may be achieved by eliminating price controls, liberalizing the external sector and deregulating the capital and labor market. Capital market deregulation is supposed to improve credit allocation and consequently investment, while the elimination of labor market restrictions would lead to a more efficient allocation of manpower.

(2) To increase the production of tradables there must be a stable macroeconomic context with an adequate exchange rate and a system of neutral incentives for production, either for domestic or foreign markets. The latter involves full liberalization of foreign trade by: (i) Eliminating quantitative restrictions and non-tariff barriers to imports; (ii) tariff reduction; (iii) diminishing the existing dispersion in the tariff structure, in which different types of goods should be subject to similar (and low) tariffs; (iv) reducing and eliminating export taxes.

(3) In terms of timing of trade reform, it is not suitable to follow a sequence in which imports are liberalized after exports have expanded and the country has sufficient international reserves; rather, it is advisable to do it simultaneously, with import liberalization being a determinant incentive to export expansion.

(4) Lastly, a complete re-evaluation of the government's role as owner or manager of public enterprises is recommended, and different privatization alternatives are

suggested (Michalopoulos, 1987; several World Bank internal reports; Balassa, 1989). Pari passu with privatization, it is suggested to increase incentives in order to attract foreign investment, and to avoid discrimination in the treatment of national and foreign companies.

II. A critical review of the SAPs basic assumptions

1. The performance of LACs

a) The WB's view of LA economies

A negative view emerged in the WB during the 80's regarding the economic policies and institutionality of LA countries[2]: apparently it assumes that poor and unsound policies and weak and corrupt institutions prevail in these countries. Since the volume of investment depends, among other factors, on the country's overall economic policies, in some countries the prevailing policies and institutions create so many distortions that it is hard for the WB to find feasible investment projects to finance. The ultimate cause of LA's present external imbalance apparently would stem from the fact that, for several decades, the economy operated in a situation marked by growingly distorted incentives and pervasive bureaucratic and administrative red tape. This has lead the WB to suggest the need for substantial and far-reaching economic reforms such as the ones described above.

In fact, a biased outlook on LA countries seems to predominate in SAPs. There is noticeable hostility towards the government and public enterprises since both, according to the WB's view, generally imply a hindrance to growth. Government involvement in the economic sphere inevitably introduces "distortions"; for this reason, the government's participation in the economy must be curbed sharply. It appears that, by definition, public enterprises are assumed to be inefficient; therefore the way to achieve efficiency and welfare increase is through privatization. Public bureaucrats are seen as inept and corrupt and private entrepreneurs are viewed as efficient and honest.

The evidence in Latin America on these issues indicates that they cannot be seen as black and white, but rather as much more complex matters.

In brief, SAPs are very ambitious and their package of economic reforms obviously imply clear interference in the development strategy and in the management of economic policies; all these affects the evolution of a country's distributive patterns.

b) LAC performance in 1950 — 80

Despite the existence of a complex and distorted incentive system and an administrative structure noted for its traditional slowness and annoying procedures, these factors are not the main cause of the LA economic imbalances observed during the 80s[3].

Actually, many of the features that the SAPs seek to replace were present with diverse degrees during prior decades. However, (i) in the period 1960 — 80 (1950 — 80), LA had an annual average GDP growth of 5.7% (5.5%). (ii) In the same period, the manufacturing sector grew by 6.5% (6.5%) per year. (iii) The quantum of total exports increased 6.5% per year between 1960 and 1980.

Thus, up to 1980, LA recorded a satisfactory — though not spectacular — economic growth. Surely, less "microeconomic public intervention" and instability in rules would have allowed an even larger growth. It is generally agreed that problems and obstacles generated in the operation of the economy must be reviewed and rectified periodically; however, this does not mean that the current system should be swiftly dismantled.

The relevant question is then, what happened, that stopped growth. The leading problem can be traced back to the debt accumulation and subsequent overhang.

The growing debt in the late 70s fostered a growth pattern increasingly intensive in imports, i.e., a composition of demand and supply intensive in importables which subsequently generated a growing capital service. However, it must be stressed that, in average, LACs increased their investment ratio, that is, part of borrowing was used to complement domestic savings in several, though not all, countries. In fact, the gross fixed capital ratio rose 5 points of GDP between the 60s and the second half of the 70s.

The diversity among countries seems to be associated to a different mix of market forces and policy regulations. For instance, regulations avoiding exchange rate appreciation in response to inflows of bank loans, and encouraging the allocation of these foreign funds to investment rather than to consumption.

Events during the 80s departed sharply from what was expected in the early 80s. The sharp reversal of net transfers, coupled with terms of trade worsening, made a downward adjustment in domestic aggregate demand absolutely necessary; it had to be complemented with a change in the composition of demand and output. But was it necessary to privatice, to liberalize imports, to liberalize the capital market as much as debtors were requested to do? Actually, there were countries that had moved in that direction before the debt crisis, and in net terms they did not perfom better than the average LAC, neither before nor after the crisis[4]. Some of the features of SAPs contribute during the adjustment period to make it more efficient but some work in the opposite direction. As Sachs (1988) concludes "programs are more likely to be successful when macroeconomic stabilization is given priority over large-scale liberalization".

c) Adjustment without growth in the 80s

SAPs are recent and they have been implemented only in some LACs. Nonetheless, the overall performance of LA might be revealing of some of the strong features of adjustment.

The main macroeconomic problem at hand in the early 80s was an excess domestic demand. In economies with some price inflexibility and "structural heterogeneity", underutilization of productive factors rises during the transition to the new equilibrium, and some human and physical capital may be destroyed in the process. Thus, during the process of adjustment, the rate of resource utilization diminishes; the adjustment path in output is traced below and not along the optimal transformation path. This is an undesirable "output-reducing effect".

The negative effect on resource use appears to have been stronger in nations that used more neutral adjustment policies (and in countries under abnormal political events and widespread populism)[5].

Moreover, the adjustment performed below the full employment optimal path, also has negative implications for growth. The most obvious one is the bias against investment (see section V). There is a series of sources of negative effects that are usually observed. Capacity underutilization and a recessive framework tend to discourage investment. Additionally, direct curtailment of public investment, as a means to balance the budget and to reduce aggregate demand, may intensify the mowding-out of private investment, together with rising real interest-rates and increased costs of imported capital goods in response to exchangerate devaluations (in countries where investment is import-intensive). Devaluations also may worsen the financial position of public and private debtors in foreign-currency. In short, the adjustment path may imply a case of underemployment and under-investment during a long period.

Actually, average output has been much lower than capacity in 1983 — 88. One rough conservative estimate place it in 7% of GDP, that is US$ 40 billion per year (Ffrench-Davis and Marfán, 1989). In other estimate, Ramos (1988) finds that improving the trade balance in one dollar had a cost of two and a half dollar in foregone output. The fact then is that output-reducing effects were notably large, as reflected by the underutilization of productive capacity.

Another component of output-reducing effects was a large fall in investment per capita. The average drop was larger than 7 percentage points. That is, investment per capita in 1983 — 88 was 32% below 1980 -81[6]. This can be contrasted with the rising trend in the seventies.

Low investment has obviously contributed to make more difficult the structural adjustment of output, and thus it has limited the utilization of resources. The issue that emerges is how can investment be fostered more effectively and efficiently.

The way in which adjustment has taken place has meant, then, a double inefficiency. On the one hand, the contractionary adjustment reflects a misuse of domestic resources in the short-run. On the other hand, the sharp drop in investment reflects ineffectiveness from the longterm growth perspective.

2. *The foreign debt problem*

The loans obtained by most LACs through SAPs have clearly been allocated to finance a fraction of the existing disequilibrium in the balance of payments. From a theoretical standpoint, the loans provided by SAPs could be used to finance balance of payments disequilibrium only when it was directly linked to an economy's structural adjustment needs. However, the main structural factor and the major component absorbing external resources in recent LA external imbalances has been the foreign debt service. Therefore, loans granted by the WB have been used primarily to cover part of the foreign debt service, principally to creditor banks. In general, LACs have been unable to use these resources to finance the basic structural changes required by SAPs.

The emphasis of SAPs seems to underestimate the adverse conditions faced by LA economies, which basically stem from the foreign debt problem. (a) Foreign debt service is a chief factor in the structural disequilibrium currently faced by LACs in their balance of payments. It should be borne in mind that the improvement in the relative indicators of the foreign debt, as of 1988, does not compensate for the deterioration experienced in previous years. In 1989, several LACs were facing a severe foreign debt problem almost comparable to that of 1982. (b) Payment of LA foreign debt interests represents an annual (average) transfer abroad of resources amounting to approximately 4% of GDP (from 1983 to date); this has obviously affected productive investment in the countries of the region. (c) Due to the foreign debt problem, LA has limited access to international private capital markets. Furthermore, implementing the adjustments established by SAPs requires a vast amount of resources. (d) Debt servicing is a determinant source of budgetary deficits in several LACs, these countries having in many cases a large surplus in the non-financial budget.

Consequently, it is hardly feasible for LACs to service the foreign debt by annually transferring resources abroad amounting to roughly 4% of GDP, while simultaneously trying to implement the far-reaching economic changes targeted by SAPs. Both the rate of use of resources and of capital formation have been undermined in the process. The two raise the economic costs of adjustment.

There is an essential discrepancy between the growth-oriented adjustment strategy needed by LA and the approach implicit in SAPs. The basic intention of the latter is for the LAC concerned to achieve an equilibrium in the balance of payments that is consistent both with the outflow of foreign debt service and with the inflows of new loans. Under this scheme, the country's economic growth rate is obtained as a dependent variable; that is as a residual. Yet to achieve steady growth, the adjustment strategy-approach should be different. The objective is to ensure a minimum level of adequate growth by determining the volume of external resources needed by the country. Thus, what is obtained as a residual is the external flow of loans. Therefore, the crucial question is: Where will these resources come from? (Fishlow, 1987).

3. Liberalization and sustainability[7]

It is generally agreed that, in order to implement structural adjustment measures, a stable macroeconomic setting is highly desirable. A stable macro situation implies low inflation rates, relatively small and financiable deficits in public and current accounts (balance of payments), and a stable and "adequate" real exchange rate.

From an empirical standpoint, however, for most LACs this stable macro setting does not seem feasible in the short term. In general, therefore, SAPs will be primarily applied to economies whose main macroeconomic variables are in a state of imbalance under a sharp foreign exchange shortage, binding economic activity and investment. Furthermore, SAPs tend to be implemented in economies in which stabilization programs are already underway in order to achieve macroeconomic stability. Consequently, this strongly conditions the effects of SAPs policy focus and measures.

In fact, the main purpose of SAPs should be to maximize growth while adhering to the condition of achieving greater macroeconomic stability. In other words, SAPs should avoid economic measures that destabilize the macro setting in the short term. This is particularly valid for economies in a state of disequilibrium, in which domestic or external shocks have severe destabilizing effects that may worsen the initial imbalance.

It can be inferred from the above that the main suggestion contained in SAPs is questionable since it proposes an unrestricted economic liberalization both of domestic markets and of the external sector. The liberalizing package could cause destabilization in a situation of disequilibrium; liberalizing shocks amidst an acute crisis may cause both economic and political destabilization. Sustainability seems to become then under strong strain.

A significant import liberalization program may worsen the foreign exchange shortage and reinforce the need to reduce aggregate demand and/or investment; it also directly discourages investment opportunities and fasters unemployment (see section IV). Theoretically, all can be compensated with devaluation. Devaluation was needed, and was actually used intensively in the 80s; in fact, several LACs accumulated in the 80s real devaluations as large as 50%. However, there is no unlimited space for real exchange-rate depreciation, free of growing side-effects and heavy losses of domestic purchasing power. Also, in this context, large privatization of public firms may crowd-out new private investment which is diverted to acquire already existing firms.

Many other examples can be provided of perverse incentives of policy measures of SAPs, that may increase the cost of transition, in relevant cases of hysteresis.

In brief, the implementation of SAPs should avoid increasing the existing macroeconomic disequilibrium; if this is taken into account, policy reversals that generate contingent destabilizing imbalances may be minimized, and sustainability enhanced.

III. A general critical review on the conditionality of SAPs

1. Sources of divergent views of countries and WB

a) The economic program suggested by WB SAPs should lead, supposedly, to growth-oriented adjustment which, in turn, would increment welfare in the country concerned. This gives rise to a strange paradox (Streeten, 1987). If the economic program associated to WB conditionality operates in favor of the country implementing the program, why do governments not apply it of their own accord? Why is it necessary to exert pressure through conditionality in order for them to do so? (Sachs, 1987).

There are many reasons explaining this paradox (Streeten, 1987). The main ones are: i) SAPs may involve very high costs in the short term. ii) There may be significant disagreements between the WB and the countries concerned regarding the economy's operation, and the perceptions and expectations regarding its future evolution. Certain elements in WB SAPs make them unattractive to countries that require external financing. Loan alternatives other than those offered by multilateral organizations will be preferred even at a higher cost (as was evident in the late 70s). This queries the role usually attributed to multilateral organizations and confined them to the role of "lenders of last resort". This has been the case in the 80s, in the absence of private financing.

In this respect, one of the conclusions in Killick's case study (1984) is that the IMF's traditional adjustment programs have a higher probability of success when the local government is fully agreeable to their application. In accordance with the above, the WB suggests, as a prerequisite for implementing SAPs, that "the Government needs to 'own' the program ..., the authorities must understand [the program] fully and be satisfied that it is the appropriate course of action for their country". Actually, however, this is presented as a marketing problem regarding WB SAPs. The correct inference from Killick's study (1984) is that what really needs to be done is to improve the dialogue between the different parties involved, i.e., between countries and multilateral organizations.

b) There is no theoretical analysis modeling of the transition from disequilibrium to equilibrium, particularly when that process includes determining the appropriate time sequence of structural reforms (opening up trade and finance, capital market liberalization, economic deregulation, etc.). It is difficult to create a model on the dynamics of change in markets affected by imbalance; indeed, there is no generally accepted model for this purpose (Helleiner, 1986). Nevertheless, and in a context in which imperfections and distortions abound, the conditionality of SAPs systematically suggests the use of free price incentives and liberalizing everything that may be subject to liberalization. A comprehensive approach is warranted only when applied with flexibility, moderation and extremely good judgment, but "as a general rule it is neither politically nor economically valid or acceptable" (Helleiner, 1986).

2. *Over-conditionality*

SAPs have been usually implemented in economies where an IMF stabilization program is already underway. The coexistence of the IMF and the WB requires that their respective stabilization and adjustment programs be reciprocally consistent. However, the need of this consistency should not imply cross-conditionality. Programs and disbursements of one institution should not be constrained by the other (Group of 24, 1987).

a) The official practice has been that the search for compatibility leads to a sort of IMF-WB *double conditionality* for a framework of coherent, consistent and complementary policies; therefore, it is assumed that, for growth-oriented adjustment to be successful, this (double) program must be applied as a whole. The argument leads to the following: to ensure that stabilization and adjustment programs are actually carried out, a mechanism such as *cross-conditionality* would be considered to be advisable. This implies that even if the country is complying with one of the lenders, the failure to comply with the other one would lead to the curtailment of all sources of funding.

From the standpoint of the countries concerned, cross-conditionality would deeply affect the social and political stability, since the continuity or non-compliance with some aspects of *double-conditionality* would affect practically *all* foreign loan flows obtained by a given country. Vis-a-vis the *cross-conditionality* imposed by the IMF and the WB, countries requesting loans from these international organizations would be exposed to a delicate mix of political, social and economic instability (Lizano and Charpentier, 1986; Dell, 1988; Meller, 1989).

b) A basic problem in a "growth-oriented adjustment" strategy is that it requires a large volume of resources over a prolonged period of time. The main objective, i.e. to increase aggregate supply, mainly tradables and specially exports in the medium and long term, involves mobilizing a volume of resources greater than that of the IMF's traditional short term adjustment programs. External financial resources are essential during the first years in which a growth-oriented adjustment strategy is applied, so as to avoid additional decreases in economic activity. Otherwise, the fall of economic activity leads to a drop in per capita consumption. For instance, in 1983 — 88, the fall in the supply of foreign resources (due to three external shocks: worsened terms of trade, increased interest payments and curtailment of new loans) was equivalent to 8% of GDP. However, aggregate demand experienced a larger drop, mounting to 15%, since output fell 7%[8]. Constructive adjustment should follow a path of increasing output in tradables in a volume similar or larger than the drop in non-tradables. The general rule for LACs has been the opposite in the 80s: a net fall in output per capita[9].

c) The conditionality established by WB SALs (and SECALs) implies much greater interference and intervention in political and economic matters and in the development strategy of individual countries, than that involved in the IMF's traditional stabilization programs. In addition to other socioeconomic objectives, development strategies, and the magnitude and type of growth, it affects basic elements of national sovereignty. A country's vulnerability will be affected when there is obvious interference in key economic and political matters such as liberalization, deregulation, privatization, foreign investment, etc. In the opposite end, to exert pressure in favour of an economic program solely for its effect on the balance of payments is undoubtedly a limited objective. Furthermore, the criteria used to evaluate the program's success cannot be confined to assessing how adequately it covers the foreign debt service (Miller, 1986). From the technical point of view, it is not a complex matter to adjust to the target of generating a given surplus in the non-financial current account, if other crucial objectives are omitted.

Success has been defined, excessively, by the effects on debt servicing and liberalization itself, and too little by the effects on the rates of use of capacity and of capital formation, and on distributive socioeconomic objectives.

3. *Structural adjustment and income distribution*

A country will be encouraged to implement SAPs when it is clearly aware of the short run costs entailed and also that it has the adequate resources to face (alleviate or neutralize) these costs.

SAPs that include measures such as trade liberalization, real devaluation, and price decontrol, imply significant income redistribution; adjustment programs may involve drops in real income and possibly widespread unemployment. When there are no compensatory measures, the feasibility of this redistribution and of sustaining it through time creates doubts regarding the irreversibility of SAPs. If the government insists on upholding SAPs to avoid violating WB conditionality, this will evidently generate social tensions that may affect the political stability of the country concerned.

Three main elements characterize the income distribution situation in LACs: (a) The existing distribution of income and opportunities is highly unfair. (b) A significant percentage of the population is extremely poor. (c) The web of social organizations, that could prevent further deterioration of the economic situation in lower income groups, is very weak.

Consequently, WB SAPs should identify and quantify, among the costs of adjustment, its negative impact on the most impoverished groups and those with lower relative incomes; different alternatives should also be suggested to neutralize or compensate for this negative impact. From a practical point of view, there are information problems linked to this issue. Therefore, the WB should encourage and finance studies to provide the necessary information on the initial situation and on the distributive implications of adjustment programs. A similar procedure was used in the quantification studies of effective protection, and its results made it possible to illustrate the degree and dispersion of protection in LA.

As mentioned above, there is no adequate web of social organizations in LA countries. It could be said that, just as an adequate macro setting is a fundamental prerequisite for the success of SAPs, there should be an adequate social organization web providing a solid foundation for the distressing situation of the underprivileged. This social web would reduce or avoid negative popular reactions and political explosions against adjustment programs that create unemployment and a drop in real wages in the short term, and might improve sustainability and overall efficiency of adjustment programs.

IV. SAPs and the foreign trade system

SAPs cover three different but related areas: foreign exchange policy, import policies, and export incentives. In general, there is agreement regarding the need of active exchange rate policies and incentives for exports; the most controversial issue is, undoubtedly, the suggested reforms regarding imports.

1. Exchange-rates

The exchange rate is a crucial policy variable for the production of tradables and for regulating the domestic demand for them; an overvalued rate (with no compensations) discourages exports, and fosters the demand for imports. These effects, in face of an initial situation of foreign currency shortage and given capital movements, implies that the chance of an adjustment process closer to the production frontier fades away. Under external shocks such as those of the early 80s, real devaluation was a necessary, though insufficient tool to assist restructuring in favour of domestic supply.

Given that growth of the export sector requires a long-term scope, a stable real exchange rate must be established; its instability discourages investment maturing in the long-term. Consequently, maintaining a *real* exchange rate that ensures profitability for the export sector is a necessary condition in any strategy to promote exports; in the presence of inflation it is important to apply a crawling-peg policy to keep a stable real rate. Exchange rate stability in real terms has proven to be a significant support for export diversification and growth.

Given the relative shortage of foreign currency that generally prevails in LACs, the exchange rate should not be left to be determined by the free market. Foreign exchange markets are highly unstable and erratic, a fact that is particularly true in situations of disequilibrium with small foreign exchange markets. This tends to be reinforced by instability among first world nations. Free exchange rates can experience fluctuations due to speculation and not solely to the "fundamentals" linked to resource allocation. Therefore, economic authorities should control the exchange rate, in order to guarantee a stable macroeconomic environment and to give a clear allocative signal to productive investors.

Another important feature of foreign exchange policy are the conditions of access to the market. Countries with regulated access to the market, in companion with stable crawling-peg policies, have tended to experience proportionally much smaller capital flight.

The two points discussed — on exchange-rates and access to the foreign currency domestic market — are outstanding examples of the dilemma pragmatism versus ideologism. There is a pragmatic need of advancing in the knowledge of fine tuning crawling-peg policies, that imply using the market more than traditionally was the case in prior decades, but in a way consistent with public regulations and the need of achieving stability and economic growth. Contrariwise, outright liberalization of the foreign exchange market may imply an overkill, generating instability and weakening productive activities.

2. Export promotion

In the situation prevailing in most LACs, there is a high degree of widespread protection for import substitution. This introduces biases against the export sector: increases the cost of imported inputs and may tend to appreciate the exchange rate. Therefore, there are three ways to promote exports: reducing, eliminating or neutralizing (compensating) these biases. SAL programs emphasize measures that favour the first two alternatives; in several cases the third alternative may be the more efficient one (i.e., compensating incentives), in terms of the rate of use of resources and of the rate of capital formation.

Measures geared to encourage exports (besides the exchange rate management mentioned above), can be classified as follows: (a) Elimination of direct disincentives to exports, such as quantitative restrictions to the volume of exports or direct taxation. (b) Reduction or elimination of the general anti-export bias present in the foreign trade system. An extreme position proposes the accross-the-board liberalization of all imports. There are more selective alternatives that suggest focusing liberalization on imported goods used to produce manufactured exports (i.e., inputs, machinery). (c) Given that it is impossible to completely eliminate the existing anti-export biases by tariff exemptions, it is suggested to implement incentives that compensate and neutralize the effects of import regulations on the competitivity of exports. For example, through fiscal subsidies, subsidized loans, tax rebates, etc. (d) One problem presented by the latter measure is that export subsidies must be accepted by the GATT, thus minimizing possible retaliations from member countries. On the assumption that we are dealing with a small country, however, it could be argued that subsidies for relatively small export volumes could not significantly damage the markets of developed countries. Additionally, a series of subsidies, broadly acceptable to the GATT, can be applied (Balassa, 1989): Liberalization of domestic taxes on export goods and on their direct and indirect inputs; tariff exemption for imported inputs for export goods; government participation in costs related to information and marketing of exports; public expenditure in the infrastructure needed to reduce export costs; incentives to the preparation of feasibility studies and project financing.

One problem, insufficiently tackled in present adjustment programs is the adding-up problem generated by concomitant export drives in all debtor LDCs. Advance information to avoid saturation of markets, and systematic efforts to diversity both the composition of exports and of markets of destination may contribute to surmount such problems.

Consequently, there is a broad space for export promotion, independent from accross-the-board import liberalization (Helleiner, 1988). The latter is not necessarily a prerequisite of the former. Incentives to exports also encourage, in recessive situations, the use of capacity and the increase of investment. Contrariwise, abrupt import liberalization of goods competing with domestic production, in the short run will tend to aggravate recession and to directly crowd-out investment in importables, and in non tradables too if overall economic activity is depressed.

3. *Import liberalization or policy rationalization*

Given the highly complex and restrictive Latin American import system, a sequence to rationalize the import system has been suggested (Halevi, 1989; Balassa, 1989). The sequence involves: (a) Substituting quantitative restrictions to imports by their tariff equivalent. Theoretically, this should not affect the trade balance nor domestic production, except in cases of external instability which are discussed below. Furthermore, this substitution would achieve a twin purpose: The protection system would become more transparent, and the government would collect the private rents previously yielded by quantitative restrictions. (b) Reducing the existing dispersion in the tariff structure. The idea is to reduce excessive dispersion of incentives, that is, when dispersion is not justified by market distorsions such as the existence of acquirable comparative advantage. There is an additional advantage: It is evident that fewer tariff categories also simplify the administrative procedure. (c) The third stage consists in reducing the degree of protection to a low uniform tariff. This is the more disputable part of trade reforms.

Let us now examine the objections posed to a fast, comprehensive, and indiscriminate import-liberalization program:

(a) There is concern regarding the possible impairment to the balance of trade and to local production activity that may result from a rapid and considerable increase in imports. In fact, a significant import liberalization program may worsen the foreign exchange shortage and reinforce the need to reduce aggregate demand and/or investment; it may also directly discourage investment opportunities. This indicates the need for a sequential and gradual rationalization of the foreign trade system, and

of measures directed to minimize adjustment costs of domestic production activities and labor. This suggests the convinience of an expansion of exports prior to the liberalization of imports, thus improving the balance of trade, employment and investment opportunities. Once a sufficient trade surplus is achieved on the basis of a fairly diversified export basket, more ambitious stages of import liberalization can be applied.

(b) Timing is crucial for the implementation of a trade liberalization program. There is general agreement regarding the importance of replacing quantitative restrictions; however, when the economy is affected by a serious balance of payments crisis and by a severe shortage of foreign currency, the discretionary management and control of foreign exchange may temporarily be more efficient than decontrolling imports and/or applying a larger exchange-rate devaluation.

However, in general, the replacement of generalized QRs by price regulations tends to improve productivity, to alleviate bottlenecks and to increase fiscal income.

(c) Rationalization of the foreign trade system should aim to provide gradually a global framework; for example, in general in the long term there should be no quantitative restrictions and few tariff categories. Notwithstanding the above, countries can make exceptions to this general rule; there are countries that, for reasons linked to their prerogatives, identify some sectors as "vital" or "strategic" and thus determine that certain types of goods are not to be imported but rather produced domestically. Insofar as these cases are the exception and not the rule, these preferences should be respected. Public intervention may be advisable also to face external instability. More thought ought to be devoted to the design of stabilization devices, of both significant exports and imports whose international prices are too unstable.

(d) There is agreement that gross policy errors have been made in the supply-side in past decades (Helleiner, 1988). There was neglect of agriculture, gross mistakes in the pricing of energy, long lags in moving forward to export promotion, cases of negative value-added in import substitution and enormous dispersion in effective protection. Avoiding this gross mistakes can be extremely rewarding. However this does not lead to abrupt full trade liberalization, particularly in periods of foreign exchange crisis and instability.

V. SAPs and economic growth

It is supposed that economic growth is a predominant target of SAPs. In order to achieve comprehensive development, growth should progress pari passu with equity.

Economic growth is the result of a broad mix of variables. Depends on technical progress, training of labor, the working of the domestic capital market, volume of capital flows, trade policies, etc. Their effects on growth can be synthesized in two variables, that are the volume of investment and its productivity[10].

Across LACs, since the debt crisis emerged, both have tended to be lower than they were before it. The result has been a notoriously lower GDP growth rate.

1. The rate of use of resources

There is one crucial factor that has affected "productivity" negatively during the 80s. It is the lower rate of use of resources. In fact, no matter how potentially efficient it is the stock of productive resources, the overall productivity expost will depend on how intensively they have been used. The level of factor underutilization increased significatively during the 80s, thus reducing the macroeconomic or overall productivity.

In every year between 1981 and 1989, the rate of utilization was lower than in the prior decade. This was the consequence of predominantly demand-reducing adjustment policies.

In rough terms, as said above, GDP per capita in 1983 — 88 was 7% lower than in 1980 — 81, while capacity per capita probably increased slightly[11]. As a result of the lower rate of use of resources, productivity expost (the ratio of change in GDP to net fixed capital formation) decreased sharply.

In exportables, probably the rate of use of resources rose, associated to the expansion of output. The share of total exports in GDP, moved from 16% in 1981 to 21% in 1988. Investment and use of capacity in the production of exportables were encouraged by sizeable devaluations. In several LACs depreciation was large enough to compensate to domestic producers the worsening of real export prices that took place for the region during the 80s.

2. The rate of capital formation

The investment rate also decreased. As said above, the gross investment ratio dropped by one-fourth in 1983 — 88 as compared to the early 80s. Obviously, the drop was sharper for net capital formation.

What were the forces behind the drop? We can distinguish four groups of forces. We will sketch their probable effect on capital formation, disregarding their effects in other grounds.

a) The lower rate of use of resources discourages investment. In the production of non-tradables and import-competing goods, the fall in domestic demand reduces the use of installed capacity, eventually with a negative effect on profits. Naturally, in those conditions, investment tends to be limited to replacements, and exceptionally to expansion and new projects. The main exception locates in exportables, which are fostered by switching policies favoring the output of tradables. However, exports represent roughly only one-fifth of the total domestic economy in LA.

b) The functionment of the domestic capital market is fundamental. (i) Investment requires availability of long-term credit. In many cases capital markets are incomplete, with weak long-term segments. Uncertainty after the crisis tended to shorten market terms. It would be important to change the composition of domestic capital markets where a significant percentage of deposits is concentrated in the short term, shifting them to longer term deposits and loans. (ii) Fiscal crisis and financial reforms on occasions have reduced in some countries the support to domestic development banks, aggravating the shortage of investment financing. (iii) Some types of financial reforms and large negative foreign transfers have produced too high domestic real

interest rates. There is broad agreement on the need to seek positive real interest rates, but extreme liberalization has resulted frequently in abnormally high real rates. This may be as negative for efficient resource allocation as real rates below zero are.

c) Privatization is an incentive to private investment, but implies a direct divestment of the public sector if the sales proceeds are not devoted to increase public capital formation. If there is limited capacity to invest by the private sector, it is most probable that overall investment will tend to decrease. That is, privatization tends to crowd-out new private capital formation, at least during the transition to a new equilibrium. If there were a notorious short-run rise in social efficiency, then the net result would be a larger GDP, but that does not seem to be the only actual outcome.

d) Debt service implies the exportation of a share of domestic savings, which has been as large as 5% of GDP in 1983 — 88. Consequently, it involves a shortage in the sources of financing for investment. The public sector, in countries that had been large borrowers or where there was a "nationalization" of the debt after the crisis, experienced a significant pressure on the budget, leading frequently to a direct cut of public investment. If public investment were complementary with private investment, the public sector reduction would tend to crowd-out the former. The larger the cut, the higher the possibility of (at least) marginal complementarity; consequently, increased public investment would have a high social rate of return.

To complete the circle, low investment makes it more difficult to change the composition of output. As a consequence, with reduced capital formation, structural changes would probably work below the production frontier. Thus, the adjustment program becomes more costly during the transition to a new equilibrium.

The size of the external constraint, determined by persistently negative transfers with creditor banks and more recently with multilateral institutions too, has been a major factor explaining the low rate of capital formation. Several features of adjustment programs have tended to reinforce those effects. Actually, the design of SAPs seems to apply uniform conditions both to countries that are net takers of funds and to those that have been net suppliers of funds since the early 80s.

VI. Recommendations

There are some broad targets which, most if not all, should be fulfilled in order to achieve a sustained vigorous growth. They refer to the monetary, fiscal budget and external sector balances. However, they are not self-sufficient to achieve growth: low inflation and stability may coexist with stagnation. It is also relevant what is the path taken in the way to balances. Particularly, how in the process of achieving balances are affected a) the incentives to invest and to save, b) the incentives to creativity and to increase productivity, c) how widespread are these effects through society in order to achieve social integration rather than further segmentation.

1. A more flexible approach

SAPs entail a broad and varied range of policy measures that affect practically every agent in society; therefore, SAPs will have a strong impact on the specific income distribution and the self interest of all socio-economic sectors. Adjustment requires and causes deep social and political changes. In brief, it greatly modifies the life-pattern that has prevailed for a long time in the country concerned.

Every deep change generates mistrust and uncertainty; if no positive results are observed within a relatively short time, pressures may emerge to stop the process and/or to revert it. This has an additional complication in LACs characterized by political fragility, several of which have experienced a succession of populist governments and military dictatorships. The current international situation, marked by greater economic interdependence between countries, imposes the need for farreaching structural adjustments in LA. However, each economy started out from a different situation and has followed a different socio-political course.

The following may be inferred from the above: (i) There is no single structural adjustment rule or model valid for all economies. A flexible approach, free of rigid conditions, would be preferable. (ii) Structural adjustment must be implemented gradually; the important point is the economy's overall trend, even though at times there may be delays or regressions. A gradual process is preferable to a shock treatment. In other words, there can be a trade-off between the speed and intensity of the adjustment and its continuity and persistence. (iii) Since the result of the suggested measures is uncertain, it must be possible to carry out rectifications, i.e., there should be an ongoing evaluation and dialogue on the economy's evolution and performance vis-a-vis the implemented measures.

2. Adjustment for growth rather than for debt servicing

The objective of structural adjustment should not be conditioned by nor oriented to the service of foreign debt by LACs. With political strength and powerful demand-reducing policies a large trade surplus can be generated. Subsequently, that country may serve debt and recover economic activity. But will hardly exhibit sustained growth.

The main objective of SAPs should be to increase economic growth. This is by no means identical to the objective of liberalizing the economy. Liberalization measures must be suggested only if they do not create or increase the economy's macro instability. The short-term deterioration in areas such as inflation, unemployment, or disequilibrium in the balance of payments leads to a reversal in SAPs. Therefore, it is essential to identify components in SAPs that might have a negative effect on the economy, and efforts must be made to compensate or minimize the possible trade-offs between SAPs and macroeconomic stability. SAPs must be sufficiently flexible to allow for temporary interruption in case of a severe deterioration of the macroeconomic situation. In this respect, SAPs should include a clause allowing LACs to temporarily interrupt, for instance, import liberalization programs when the existing international reserves are less than those required to cover imports over a given period.

There is a widely accepted ordering of some measures that are essential for growth while some other are within the realm of very disputable actions. SAPs should give preference to the former. Several examples have been discussed along this article.

3. Improving acceptability of conditionality

From a LACs standpoint, a SECAL program is preferable to a SAL program. SECALs interfere much less than SALs in domestic decisions regarding economic policy and development strategy. Furthermore, since they only focus on one sector, a more exhaustive analysis on costs and benefits of the suggested measures is possible.

It should be explicitly stated that SECAL conditionality does not constitute a pre-requisite nor the reference basis for other types of loan programs that the WB might establish with a country.

Since efficiency of structural adjustment tends to be more difficult to achieve when it is made simultaneously with stabilization programs, the design of SAPs should take into consideration this fact. In addition, and given the coexistence of WB and IMF programs, it is important to explicitly state that no cross-conditionality is to be required for loan disbursements.

Finally, the dialogue on the adjustment programs must be improved. In this respect, further debate between WB mission economists and local economists is advisable. An external *pluralistic* team of consultants, acting as moderators or catalysts in the debate (Feinberg and Bacha, 1986) would also be positive. Furthermore, academic seminars should be held to discuss general and theoretical aspects of adjustment programs in LACs. If WB adjustment programs are to be applied in LA economies, it is not logical that their nature and conditionality should only be discussed in Washington.

4. Capital formation

LACs have suffered a sharp fall of investment ratios. Evidence shows that, together with efficiency and technical change, the volume of investment is determinant of growth.

A careful consideration of some crucial factors may be essential in order to achieve an increase of capital formation. (i) A better mix of demand-reducing and of switching policies may contribute to increase the rate of use of given resources, and thus to improve overall productivity. (ii) To implement financial reforms that generate long-term funding (rather than the reverse) and that produce moderate real interest rates (rather than negative real rates or rates abnormally high). (iii) Apply effective export incentives, and eliminate those import regulations that are an obstacle to exports, to use installed capacity and flexibility in the allocation of resources. (iv) Implement a policy of regulated real exchange-rate, in order to provide a stable signal for the allocation of investment in the production of tradables. (v) Improve tax collection and the selection of public investment projects that are complementary with private investment. (vi) The reduction of negative transfers abroad, in order to soften the external constraint, to increase the rate of use of domestic productive capacity, and to enhance the financing of capital formation.

5. *Trade reforms*

(a) It is not at all obvious that (unrestricted) import liberalization is a pre-requisite for export growth. Several specific measures may be used to promote exports; import liberalization should be a subsequent stage, carried out after achieving a solid and varied export basis that generates an adequate trade surplus.

(b) The sequence suggested by WB SECALs regarding import liberalization (substituting quantitative restrictions for equivalent tariffs; reducing the existing dispersion in tariff structures; reducing high protection levels) is valid both from a theoretical and an empirical perspective.

However, the fundamental discrepancy apparently concerns details, that in this case are not trivial. The first problem is the timing of a trade reform. In this respect, a fundamental restriction should be to avoid creating macroeconomic destabilization. A second problem refers to the duration of the various stages in a trade reform program. There are no settled rules regarding this matter, since it is rather a process of learning by doing, where results produced by the first measures suggest the timing and intensity of subsequent measures. The third problem refers to the specific levels and categories required for the final tariff structure. In this respect, there should be general principles rather than very specific rules.

6. *Distributive effects*

SAPs should include a detailed analysis of the costs arising from the program's implementation and also identify the sectors most affected. Furthermore, they should suggest alternatives and measures to alleviate or neutralize such costs in the more vulnerable social sectors.

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NOTES

[1] Summary based on WB documents and evaluation made by the staff. There is heterogeneity in the policy recipes presented in these reports. There is not a single comprehensive official view nor a stable one; it is a matter in evolution. Some studies are very careful and moderate in their proposals of market liberalization, while some other are not so. This summary reflects more the emphasis that has been more visible in the 80s, that seek a faster and deeper accross-the-board economic liberalization.

[2] References on the subject: Annis (1986), Bacha and Feinberg (1986), Feinberg, et. al. (1986), Helleiner (1986), Miller (1986).

[3] There is not a convincent discussion of why LA grew rather fast, in the three decades prior to the debt crisis of the early 80s, with an active public sector role. What changed in the 80s that made extremely inefficient institutions that had been efficient for growth before?

[4] Chile, the country making a more systematic and deeper liberalization in the 70s, in 1982 experienced the larger GDP drop among LACs, and a GDP fall sharper than in the average LAC, in the aggregate of the years 1982 — 88, as compared to the peak before the crisis (CEPAL, 1989, table 2; Ffrench-Davis and Marfán, 1989, table 2).

[5] A discussion on 12 highly indebted LACs, for 1980 — 86, is presented in Ffrench-Davis and Marfán (1989, pp. 12 — 17).

[6] Domestic savings increased from 22.6% to 25.1% of GDP, but decreased slightly, in constant prices, 1% in per capita terms. Consequently, that is not a factor explaining the sharp drop in financing of capital formation. Financing diminished because net transfers from abroad changed from plus 1.6% of GDP in 1980 — 81 to minus 3.7% in 1983 — 88; that is a fall equivalent to 23% of gross capital formation. Moreover, the terms of trade decreased by the equivalent of 17% of GCF.

[7] This issue is dealt in more detail by Rodrik (1988).

[8] All these figures are expressed in per capita terms and as a percentage of the average GDP of 1980 — 81, the peak biennum before the debt shock. See Ffrench-Davis and Marfán (1989, table 2).

[9] Output in the 70s was increasing 5.5% per year in LA. Here we are using as point of reference a 2.3%, that is the rate of population growth, thus resulting in zero per capita growth of GDP.

[10] Some economists assert that investment is not a too significant variable as compared to efficiency. However, the fact is that it is difficult to increase efficiency of given resources without investment; moreover, increasing static efficiency, i.e. reaching the production frontier is very important, but is a once and for all effect. Efficiency may also lead to technological change, thus expanding the production frontier. However, this expansion, and the efficiency of restructuring, would be limited with low net capital formation. It is a fact that dynamic and sustainable economic growth requires significant real investment.

[11] Recall that GDP per capita grew 3% per year in the 70s and 35% along the decade. This is the recent historical point of reference.

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DIE VERTEILUNGSWIRKUNGEN VON WIRTSCHAFTSKRISE UND ANPASSUNGSPOLITIK IN MEXIKO[1]

Abstract

The Mexican debt crisis and adjustment policies following the financial breakdown of 1982 had serious social consequences. Covering the administration De la Madrid (1982 — 1988) the article resumes the available information about variations in primary incomes. The distributive changes are analyzed according to the classical cleavages capital/work, formal/informal and urban/rural sector. Existing evidence suggests that members of the urban informal economy were as hard hit as the formal sector workers who experienced a halving of their remunerations within few years. Agricultural incomes seem to have been relatively protected only during the first years of the crisis. Finally, a small group of entrepreneurs located simultaneously in various economically strategic positions can be identified as unequivocal beneficiaries of the crisis.

Zu Beginn der 80er Jahre konzentrierte sich die Aufmerksamkeit der „internationalen Entwicklungsgemeinschaft" auf die Ziele der makroökonomischen Stabilität und der mikroökonomischen Effizienz. Das Thema der „sozialen Kosten" der Schuldenkrise und der Stabilisierungspolitiken wurde kaum diskutiert, und die wenigen journalistischen und akademischen Beiträge, die es dennoch aufgriffen, konnten sich zwar auf den alltäglichen Augenschein sichtbar zunehmender Armut und sozialer Ungleichheit berufen, kaum aber auf mehr statistische Belege denn die im „verlorenen Entwicklungsjahrzehnt" Lateinamerikas allgegenwärtigen Tatsachen fallender Löhne und sinkender staatlicher Sozialausgaben. Dies hat sich inzwischen geändert. In der entwicklungspolitischen Diskussion hat gewissermaßen eine „Wiederentdekkung des Sozialen" stattgefunden, und die Versuche, soziale Kostenbilanzen der Wirtschaftskrise und der Krisenpolitik zu erstellen, haben an Häufigkeit und Salonfähigkeit gewonnen.

Für Mexiko kann ein paralleler Diskussionsverlauf nachgezeichnet werden. Die ökonomischen und sozialen Folgekosten des negativen externen Ressourcentransfers, der in den 80er Jahren an die externen Gläubiger geleistet wurde,[2] schoben sich erst allmählich in den thematischen Vordergrund.

Die folgenden Ausführungen versuchen — auf dem Daten- und Diskussionsstand von Mitte 1990 —, die *direkten Einkommenseffekte* der mexikanischen Krise und Krisenpolitik auf vier großflächige *soziale Kategorien* abzuschätzen: auf die Arbeiter und Angestellten (Abschnitt 2) und auf die Unternehmen des formellen urbanen Sektors (Abschnitt 3), auf die informell Beschäftigten (Abschnitt 4) sowie auf die Kleinbauern und Landarbeiter (Abschnitt 5). Dabei soll zumindest ansatzweise auch