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Structural Adjustment in a Changing World

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Summary
In a complex world economy, adjustment is inevitable. The normal process of competition is periodically marked by crises which disrupt national economies, create severe balance-of-payments problems and threaten to exclude many people from international markets. Whether these crises stem fundamentally from unwise interference in the market or, on the contrary, from lack of adequate regulation is one of the central debates in economic policy-making.

Although technical expertise (based upon underlying theoretical assumptions) is an important element in designing a response to crises, adjustment is above all a political process. The content of policy reform is shaped by the ability of different groups within adjusting countries to promote and defend their own interests; by the bargaining power of specific deficit countries in the international economic and political arena; and by the internal political agenda of creditor countries during the period when programmes of economic stabilization and assistance are being worked out.

These elements in the political equation of adjustment have changed considerably over the past 50 years; and, in consequence, the content of adjustment programmes has also undergone modification. While stabilization programmes until the 1970s—which restored monetary and fiscal order, and preserved the capacity to import—were not usually followed by attempts to restructure the economy, adjustment in the 1980s and early 1990s was associated with intense pressure to abandon inward-oriented national projects of economic development and to stake the future of people in the developing world on increasingly unprotected participation in the international market.

After briefly reviewing factors which contributed to the rise of the radical free-market form of adjustment, the paper considers some of the lessons which can be learned from experiences with economic reform during the 1980s. The most basic of these is simply that the power to impose solutions, conferred upon creditors through the mechanism of conditionality, can be counter-productive. Reform policies designed in the abstract and applied with little understanding of local realities, often prove unsuited to solving concrete problems in stubbornly idiosyncratic national settings.

The majority of the adjustment experiences now considered relatively “successful”—and they are a small number in relation to the total group of countries engaged in reform programmes—have restored economic order through tempering free-market orthodoxy with regulation of key prices. Defending exchange rates from sharp fluctuations, imposing price controls on a few strategic goods and services, fixing interest rates within certain limits and maintaining wage stability have required a strong state, not a weak one. “Success” has also depended upon obtaining access to large reserves of foreign exchange (whether through state-owned export industries, foreign aid, renewed lines of international credit, or even—in some cases—from the drug trade).

“Successfully” adjusting countries depend for renewed growth on large flows of foreign private investment. Their real accomplishments are therefore threatened by the extraordinary volatility of these capital markets as well as by exposure through indebtedness to the dangers of rising interest rates in the industrialized world. In this sense, it is safe to say that for “successful” adjusters, as for

a much larger number of indebted nations which are still mired in deep recession, the debt crisis is far from over.

The social cost of continued recession and restructuring in many Third World countries is high. During the early 1990s, per capita income in most African and Latin American nations was lower than in 1980; and the average income of the poorest strata was much lower. Minimum wages stood at half or less than half their former value. Unemployment in the formal sector was often much higher than at the outset of the debt crisis, although in relatively more successful cases this problem had been resolved in part by generating a great many new jobs which are badly paid and insecure.

During the latter 1980s, governments and international financial institutions began to review the adjustment experience. Under pressure from angry citizens of Third World countries as well as from concerned citizens' groups in the North, economic reform programmes began to take social welfare considerations more explicitly into account. And, in response to obvious problems of reform implementation, attention was increasingly focused on such institutional issues as the need to improve efficiency, transparency and accountability in Third World government; the importance of restructuring and upgrading public bureaucracies; and the urgency of strengthening local level institutions through decentralization and promotion of citizens' organizations.

Nevertheless this incorporation of institutional issues in the adjustment model is still fragmentary and does not systematically explore the links between economic, political and social reform. This situation must be remedied. In fact, it is vitally important to consider how patterns of social change under conditions of continuing economic crisis and restructuring are affecting the capacity of societies to provide a minimal framework of stability and justice, within which people can interact productively.

Local level research suggests that the coping strategies adopted by many different kinds of people, as they confront severe challenges to their livelihood, weaken modern institutions and make good governance more problematic. Diversification of income strategies affects the quality of work and the commitment of employees to the institutions they serve. Growing fragmentation of loyalties weakens unions and other forms of interest association which are in fact essential instruments of dialogue between government and the public. This kind of problem stands behind many of the failed efforts to forge pacts in support of stabilization programmes.

Furthermore the erosion of a structure of modern interest groups in many indebted Third World countries affects the strength of political parties and thus the capacity of political systems to create stable governing coalitions. Violent and unorganized protest is likely to take the place of more formal bargaining procedures in such situations.

Finally, the pronounced widening of income differentials within many countries over the past few decades has played a significant role in weakening broader networks of social interaction and solidarity. There is often a marked cultural dimension to this process of polarization. As they are integrated further into international markets, some people become part of global consumer culture; while others are left to reinforce more traditional ties of identity and support.

Clearly, the particular form of adjustment in vogue for the past 15 years has not created the necessary conditions for most people in indebted Third World countries to have a better future. The paper therefore closes with a plea for wide ranging consideration of new approaches to adjustment and restructuring. Among other things, this debate should take a systemic view of adjustment, assuming that dealing with imbalances in world trade and finance is as much a problem for creditor as for debtor countries. And it should recognize the fact that improving the reform process is as important as improving its policy content. Since there is no single prescription which can be relied upon to solve the complex problems of economic recovery, specific approaches must be worked out through adequate consultation at the national level. In this respect, conditionality should be used with caution: it can pre-empt dialogue and permit imposition of policies which are either technically inadequate, given local conditions, or politically unfeasible, or both.

Introduction

Structural adjustment programmes have fundamentally affected the life chances of hundreds of millions of people in Third World countries over the past several decades. With the collapse of communism, they have begun to assume a central role in economic and social policy-making in Eastern Europe and the former Soviet Union as well. It is therefore impossible to discuss the three principal areas of concern of the World Summit for Social Development—poverty, unemployment and social disintegration in the 1990s—without reference to the current debate on the role of structural adjustment in worsening or alleviating these problems.

The purpose of this paper is to provide background for the debate. After considering what "adjustment" means, in general terms, the paper will highlight different approaches to adjustment problems. Then it will focus on the macro-social and macro-political effects of the particular form of structural adjustment—based upon promotion of radical free-market restructuring—which gained currency in conjunction with the debt crisis of the 1980s. And it will close with a series of suggestions for rethinking adjustment policy in the 1990s.

What Adjustment Means

In a complex world economy, adjustment is inevitable. Governments, firms and individuals are constantly adapting to changing conditions, in an attempt to offset disadvantages and improve their position in relation to others. Their strategies are shaped not only by the outcome of competition and negotiation within the international arena itself, but also by the balance of power within their own countries. The changing policy environment in each nation affects the terms on which citizens participate in international markets.

The normal process of economic and political competition is marked by crises which threaten to disrupt national economies and to create severe balance-of-payments problems. In designing policies to deal with these situations, policy makers are influenced not only by immediate pressures of a very practical kind, but also by underlying assumptions concerning how economies function and why crises occur.

One school of thought, often referred to as "liberal", would attribute these crises above all to interference with the free play of market forces. In this view, if governments exercise strict monetary and fiscal discipline and remove all barriers to the operation of a self-regulating market, equilibrium can automatically be restored in world finance and trade.

Others doubt that a fully self-regulating market exists. They stress the importance of government intervention to develop and protect local economies, as well as to regulate cycles of recession and growth. In the world arena, they hold that international institutions are required to regulate global finance and trade and to create the conditions for redistribution from countries with long-term balance-of-payments surpluses to those with serious problems of deficit.

In practice, the institutions and policies which developed following the Second World War to deal with serious balance-of-payments problems grew out of a compromise between these two positions. The fact that the World Bank and the International Monetary Fund (IMF) were established at all (at the Bretton Woods Conference in 1944) reflects recognition by the victorious powers of the importance of institutional co-ordination of the global economy. But international financial organizations, now celebrating their fiftieth anniversary, were never given the authority to regulate surplus as well as deficit countries. Although the subject was broached at Bretton Woods, there was no agreement to redistribute persistent surpluses through adjusting commodity prices which had fallen too low, or to tax the reserves of countries consistently earning more foreign exchange than they spent. International institutions could extend loans to countries experiencing balance-of-payments difficulties, but the ultimate responsibility for finding a way out of crisis rested in the hands of countries themselves.

Over the past half century, developing nations confronting internal economic crisis and balance-of-payments problems have sought solutions through reaching individual agreements with the governments of industrial powers, bankers and others within the international financial community. This has been a pragmatic exercise: Third World governments have used strategic or other arguments as bargaining tools; and industrial countries, bankers and international financial institutions providing resources have insisted on the implementation of certain kinds of policy reform in the deficit country.

Adjustment as Stabilization: Adaptation to Crisis until the 1970s

During the first three post-war decades, stabilization programmes worked out between Third World countries and their creditors tended to focus on:

- cutting budget deficits in countries experiencing economic crisis, through reducing public spending and/or increasing public revenue;
- exercising monetary restraint (limiting the amount of credit and money in circulation) in order to reduce inflation;
- improving the balance of trade of deficit countries through increasing incentives for traditional exports and developing new export activities;
- reducing demand for imports and fighting inflation through implementing deflationary economic policies, including wage restraint;
- ensuring that the exchange rate was set at a competitive level for exports. When change has been required, it has been more likely to involve devaluation than revaluation, although the latter could be recommended in some circumstances in order to fight inflation.

These changes in public policy, which still form the core of adjustment programmes, were generally contractionary in nature. They tended to hurt the weaker members of society more than the stronger. Nevertheless governments did have some room for manoeuvre. The burden of adjustment could be spread somewhat more broadly within the population: government budget deficits could, for example, be attacked by raising taxes on the wealthy; and the balance-of-trade deficit could be lowered by limiting imports of luxury items, rather than basic goods. Whether such measures were taken depended upon the ability of different groups within adjusting societies to promote and defend their own interests.

The precise distribution of the burden of stabilization in any particular case depended, however, not only upon the kind of political interests sustaining the government of the adjusting country itself, but also upon the bargaining power of specific deficit countries in the international economic arena, and on the internal political agenda of creditor countries at the moment when terms of stabilization agreements were being worked out. In this international sphere of bargaining, conditions for Third World countries were far more favourable in the first two post-war decades than they were to become from the 1970s onward—or than they are today.

In the first place, the 1950s and 1960s were a time of global economic expansion. Therefore while stabilization programmes implied hardship for many people within the countries concerned, it was likely that policy reform would lead to renewed growth. And, in fact, until the 1970s a period of adjustment-related recession was generally followed by an upturn of the economy.

At the same time, the international balance of power during the early Cold War period provided adjusting countries with strategic bargaining tools. The great powers were concerned with rebuilding the "free world", and international financial institutions understood the need to obtain support in Third World countries. Economic assistance flowed toward allies in the Cold War, which also increased their ability to deal with economic difficulty.

Finally, the domestic agendas being pursued in the advanced industrial countries were congruent with nation building in the developing world. Political coalitions in Europe and the United States supported the expansion of the state in order to protect and improve people's livelihoods, both at home and abroad. The reconstruction of Europe and Japan, and the improvement of welfare coverage throughout the developed market societies, implied the expansion of public programmes. For this reason, although stabilization efforts in the Third World during this period might well imply reducing some areas of government activity, or responding to pressure to open some areas of the local economy to greater international competition, they did not involve profound free-market restructuring of the national economy.

From Stabilization to Free-Market Restructuring

From the 1970s onward, the international economic and political context for adjustment underwent profound modification. Within the course of a decade, a number of changes created gradual openings for the stringent free-market form of "adjustment" which eventually came to dominate not only economic stabilization efforts but also social policy in the 1980s and early 1990s.

In the advanced industrial countries, increasingly vocal lobbies for free-market liberalism gained terrain in their political struggle against groups traditionally favouring a central role for government in the economy. In part, this development must be seen against the background of rapid transformation in the world economy as a whole. New technologies in the fields of transport, communications, robotics and cybernetics speeded exchange within increasingly global markets for capital, goods and services. They revolutionized the production process in some industries, lessening the importance of traditional raw materials and often reducing the use of human labour. They made it easier for businesses to divide up their operations, locating different phases of production in regions where the most advantageous conditions prevailed. And they facilitated the rapid growth of transnational and offshore banking operations, effectively outside the control of governments.

The rising tide of neo-liberalism must also be seen against the background of recession and inflation in most of the industrialized world from 1973 onward. Government spending, responsible for stimulating unprecedented post-war growth, now seemed to be fuelling inflation, which hurt investment and saving, and eventually contributed to worsening problems of unemployment. The stubborn problem of stagnation-with-inflation fed criticism of past development models and—

particularly in Britain and the United States—promoted a new call for reduction of the role of the state in the economy.

In most of the developing world (with the notable exception of oil producing states), economies were deeply affected by recession and structural change in the North. They were also affected by the sudden increase in the price of oil in 1973 and 1979. Thus the 1970s were a time of impending economic crisis, forestalled in many cases by recourse to borrowing on a massive scale.

The Debt Crisis

Several developments converted this indebtedness into the explosive debt crisis of the early 1980s. The first—for many developing countries which depended heavily on the export of primary products—was the severity of deterioration in commodity prices. Africa was particularly hard hit during the 1980s by this change in the market, which (despite a recent upturn for some products) is likely to constitute a continuing threat.

A second element in the debt crisis was an unprecedented jump in interest rates, encouraged by the United States Federal Reserve Board, as it attempted from 1979 onward to brake inflation and to attract foreign investment through a dramatic manipulation of the price of money. This strategy was shortly mimicked by other governments, in a bid to remain competitive with the United States. Since many Third World loans carried flexible rather than fixed interest rates, the cost of debt service quickly became unmanageable.

The third development ensuring a particularly deep and long lasting debt crisis was the imprudence of both banks and borrowers, who during the latter 1970s had often agreed upon loans which were not only economically risky, but at times frankly speculative in nature. A considerable part of the money borrowed by Third World governments, enterprises and individuals at that time found its way into private foreign bank accounts, leaving the developing country in question with a debt which corresponded to no ongoing local income-generating activity. It should be noted, however, that governments and private businesses also took out loans for projects, to increase industrial capacity or improve infrastructure, which seemed justified given the originally low level of interest rates and the abundance of capital in the international market during the latter 1970s.

The debt crisis was also worsened by the termination of all private lending to heavily indebted countries in late 1982. In the wake of the temporary suspension of payments by Mexico, the private banking system hastily withdrew from these markets, leaving foreign enterprises and governments to generate the large resources required to service their debts without access to new private borrowing. This not only ensured that any solution to the crisis would be long and painful, but also