

POL201Y1: Politics of Development

Lecture 20:

Structural adjustment reforms

Recap

- Development assistance
- Effectiveness of development assistance
- Relatively easy fixes vs. “wicked hard” problems
- Politics of development assistance

Historical context (mid-20th century—1970s)

- State-led economic policies intended to hasten the process of modernization:
 - Funded through loans, primary resource exports, and seignorage
 - Import substitution industrialization and related tools, such as marketing boards, price controls, trade protections, nationalization of industry
- Expansion of public employment (with requirement frequently based on patronage networks)
- Establishment of welfare programmes

Historical context (1970s—1980s)

- Failure of the state-led economic policies →
- Prolonged macroeconomic failure →
- Inability to fund the welfare programmes and maintain bureaucracies +
- Global economic crisis (stagflation, 1973 and 1979 oil crises) → interest rates increase →
- Debt crisis
 - E.g. Latin American debt:
 - 1975: USD 75 billion
 - 1983: USD 315 billion (50% of GDP)
- A “wicked hard” problem

Historical context (1980s)

- Rise of neoliberalism
- Neoliberal solutions to the crisis?

The Washington Consensus

- Fiscal deficits as the primary source of macroeconomic dislocation (inflation, payments deficits, and capital flight) →
- Necessity of limiting public expenditure or increasing tax revenues
- The market should determine interest and real exchange rates
- Necessity of opening economies through liberalization of financial flows (including foreign direct investment), real exchange rates, and imports
- Necessity of promoting competition through economic deregulation and privatization
- Property rights
 - Williamson, John. 1990. "What Washington Means by Policy Reform." In *Latin American Adjustment: How Much Has Happened?*, edited by John Williamson. Washington, DC, United States: Institute for International Economics.

Structural adjustment reforms

- Application of the Washington Consensus ideas to the crisis in the global South
- Basic tool: provision of credit in return for reforms
- Primary implementers:
 - IMF: macroeconomic stabilization, short-term loans
 - World Bank: structural adjustment, long-term loans

Structural adjustment reforms

- Reduction of deficits and inflation
- Elimination of seignorage and currency devaluation
- Reduction of public spending, including social expenditures and public sector employment
- Comprehensive economic reforms
- Removal of price controls
- Privatization of state-owned banks and enterprises
- Creation of market institutions
- Deregulation
- Trade liberalization
- Encouragement of foreign direct investment

Implementation of structural adjustment reforms

Table 2.3. *Policy Reform in Africa: Patterns of Implementation, 1979–1999*

Reform	Degree of Implementation	Probability of Reversals	Comments
I. Stabilization			
a. Fiscal adjustment	mediocre-good	high	Belated progress in mid-1990s Sustainability questionable
b. Exchange rate policy	good-excellent	medium	Early focus of IMF; CFA countries devalue in 1994, maintain fixed rate
c. Monetary policy and external balance	mediocre-good	high	Uneven progress across time; reliance on large aid flow
II. Adjustment			
a. Domestic liberalization	poor-excellent	medium	High variation across cases
– Banking/credit	good-excellent	low	Early focus of adjustment programs
– Investment	mediocre	low	Large gap between de jure and de facto situation
– Export agriculture	mediocre	medium	Prices still set by state, particularly in ex-French states
– Food markets	mediocre-good	medium	Consumer prices liberalized more than producer prices Less continuing regulation in west and Central Africa
b. Trade policy	poor-mediocre	high	Little progress and often subverted in practice.
c. Public enterprise reform	poor-mediocre	low	Privatization quickens in 1990s, biggest Public enterprises remain
d. Civil service reform	poor	low	Consistently deferred, high cost and complexity

Impacts of structural adjustment reforms

- Accelerated inflation rates
- Reduction of investment
- Higher food prices
- Lower employment and real wages
- Lower per capita incomes
- Reduction of the quality of public services
- Introduction of user fees for healthcare and education services
- Increased poverty rates
- Poor health, including malnutrition
- Particular impact on women

• Stewart, Frances. 1991. "The Many Faces of Adjustment." *World Development* 19 (12): 1847–64.

Table 1. *Macrop performance at the regional level*

	1973–80	1981–85	1985–89	
<i>Sub-Saharan Africa</i>				
Real per capita GDP growth, % per year	+0.1*	–1.0		–0.1
Inflation rate, % per year (consumer prices)	+6.8	+23.1		+21.1
		1981	1985	1989
Investment ratio, % GDP		20.9	18.2	17.7
Government deficit, % GDP		–6.9	–5.4	–7.7
Current account balance, \$billion		–12.9	–3.4	–8.8
<i>Latin America and Caribbean</i>				
	1971–80	1981–85	1985–89	
Real per capita GDP growth, % per year	+3.1	–1.5		+0.6
Inflation rate, % per year	+39.8	+102.8		+260.8
		1981	1985	1989
Investment ratio, % GDP		22.6	17.5	18.2
Government deficit, % GDP		–4.1	–7.1	–15.5
Current account balance, \$billion		–43.6	–2.4	–8.9

Source: IMF, *World Economic Outlook* (April 1989; October 1990).

*GNP per capita.

Impacts of structural adjustment reforms

- Considerable variation:
 - E.g. Uganda:
 - Loss of 40% of GDP between 1970-1986
 - Structural adjustment reforms →
 - Rapid economic growth:
 - 6.3% between 1986-1999
 - 6.9% in the 1990s
 - Poverty reduction:
 - 56% in 1992
 - 31% in 2006
 - Attributed to structural adjustment reforms
 - Collier, Paul, and Ritva Reinikka. 2001. "Reconstruction and Liberalization: An Overview." In Ritva Reinikka and Paul Collier (eds.), *Uganda's Recovery: the Role of Farms, Firms, and Government*. Washington, D.C.: 15-47.
 - "The most influential development model of the 1990s"
 - Mallaby, Sebastian. 2004. *The World's Banker: A Story of Failed States, Financial Crises, and the Wealth and Poverty of Nations*. New York: Penguin Press.

Explaining the failure of structural adjustment

- Very ambitious agenda
- Intrinsic flaws of the structural adjustment reforms:
 - Disregard for the role of the state
 - Focus on solutions adopted from developed countries
- Implementation failures:
 - Lack of expertise on public service reform
 - Lack of understanding of bureaucracies charged with implementation
 - Low state capacity (further reduced by the public sector retrenchment)
 - Top-down, paternalistic implementation
- Competition from foreign aid, which lessened the need for reform (and funding conditional on structural adjustment)
- Threat to the interests of local political agents

Politics of structural adjustment reforms

- Political impacts of structural adjustment:
 - Reduction of political control
 - Reduction of rents that could be channelled to patronage networks, including through public sector employment
 - Dissatisfaction among the urban poor due to removal of subsidies
 - Dissatisfaction of owners, employees, etc. of inefficient enterprises bankrupted by elimination of trade protections, currency distortions, etc. →
- Efforts to protect elite interests:
 - Cooperation with the IMF and World Bank in transferring the costs and risks to the poor
 - Obstruction of reforms threatening neopatrimonial systems
 - Private benefits of reform:
 - E.g. privatization to clients

Politics of structural adjustment reforms

- Belated recognition of the importance of politics in public sector reform →
- Good governance agenda