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Item Type	Book
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Download date	2026-11-12 06:34:23
Link to Item	http://hdl.handle.net/20.500.12424/179325



UNITED NATIONS RESEARCH INSTITUTE FOR SOCIAL DEVELOPMENT

Structural Adjustment in a Changing World

UNRISD Briefing Paper No. 4
World Summit For Social Development

December 1994

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Acknowledgements

This Briefing Paper was prepared by Cynthia Hewitt de Alcántara. Comments by Yusuf Bangura, Solon Barraclough, Dharam Ghai and Jessica Vivian are gratefully acknowledged.

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 that debtor countries would be forced to depend heavily on multilateral financial organizations which controlled the only possible source of new funds.

The situation was further complicated by the foreclosure of the option of bankruptcy or default for private and public borrowers alike. While during earlier crises governments incapable of paying foreign debts declared themselves insolvent and renounced their obligations, the situation in the 1980s was very different: governments increased their own debt burden by assuming responsibility for private sector debt.

The negotiating strength of indebted countries was fundamentally weakened by the formation of lenders' cartels. Donor governments (working through what came to be called the Paris Club) supported debt rescheduling only if agreement on macro-economic reform had been reached between the debtor country and the International Monetary Fund. Meanwhile private banks

(forming what became known as the London Club of creditors) refused to negotiate separately with any indebted country, while international financial institutions refused to provide assistance to countries which had not reached an agreement with the relevant group of private lenders. This situation remained in force until 1989, when the very slow progress of debt rescheduling convinced the United States government that it was time to weaken the bargaining position of the banks through holding out the possibility of multilateral assistance to countries which might not yet have satisfied the demands of private creditors.

Structural Adjustment as Radical Experimentation in Free-Market Economics

It was the convergence of the debt crisis with the rise to power of groups espousing radical free-market ideas, especially in Great Britain and the United States, that placed "structural adjustment" at the centre of the development debate in the 1980s. Without the debt crisis, suggestions for Third World policy reform made by "free-market" economists would not have been adopted as frequently as they have been. And without the long political tenure of the Reagan and Thatcher governments, the debt crisis would most probably have been approached in a somewhat less recessionary way. The continuing problems of sluggish growth in the global economy throughout the 1980s reinforced demands for far-reaching reform.

"Structural adjustment" in the developing world of the 1980s became a euphemism for radical experimentation in free-market economics. While stabilization programmes of earlier post-war decades—which restored monetary and fiscal order, and preserved the capacity to import—were not usually followed by attempts to restructure the economy, stabilization 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.

In addition to the standard stabilization measures outlined earlier, the "adjustment" package upon which international assistance was made conditional in the 1980s and early 1990s paid much greater attention than had previously been the case to promoting:

- drastic reduction of trade barriers protecting the local economy from foreign competition;
- deep reduction or elimination of subsidies and price controls, which "distorted" internal prices for a number of goods and services;
- restructuring of the financial system and weakening or removal of controls on the movement of capital;
- privatization of state-owned firms;
- elimination of control on private foreign investment;
- reduction of the role of the state, not only in the economy but also in the provision of social services.

There was a tendency for advisers within international agencies to recommend moving quickly on many of these fronts at once, on the assumption that radical reforms could best be carried out jointly and that gradualism would only prolong inefficiency and promote dissent. In most cases, however, this recommendation was not accepted by the governments of adjusting countries.

The ideal public sector envisioned for reformed debtor countries thus became a relatively passive one, providing services indispensable for the efficient conduct of private business and protecting

the weakest members of society. The ideal economy would be highly integrated into global networks of investment and trade, and regulated internally by competitive private firms.

Such a picture—in the radical, stylized form which gained temporary ascendancy in the 1980s—corresponded neither to the real world of developing countries nor to that of the industrialized North. In fact, most of the advanced industrial nations were governed by far more activist states and engaged in a great deal more protection of local interest groups than the neo-liberal model would have condoned—even, in some cases, after a number of years of reform efforts by champions of neo-liberal economics. And the clearest examples of successful export-oriented adjustment among the developing countries proved also to have both unusually strong states and highly oligopolistic private sectors.

Nevertheless, in the context of deep internal economic crisis, desperate shortage of foreign capital and pressing debt obligations, many countries of Africa and Latin America (as well as some indebted countries in Asia and the Arab world) embarked on stabilization and adjustment programmes in the 1980s. Pressure to do so grew stronger as a wide range of bilateral donors and development agencies insisted upon economic reform and the World Bank developed lending activities in support of structural adjustment agendas. The creation of such networks of cross-conditionality meant that receipt of official development aid, as well as loans, became dependent upon progress in adopting adjustment measures, and that consortia of donors were eventually responsible for shaping significant areas of macro-economic and social policy in indebted Third World countries.

Lessons from Economic Reform

Over the course of the 1980s, implementation of neo-liberal economic reform in the developing world repeatedly forced both international advisers and national economic policy makers to attempt (often with little success) to impose a relatively standard set of policy recommendations on stubbornly complex and idiosyncratic societies. In the realm of economic performance alone, results were extremely mixed. By the early 1990s, most African countries were still mired in recession, while a few grew rapidly; and a number of Latin American countries experienced their first growth in almost a decade.

In some cases, international technical assistance and advice undoubtedly played a role in overcoming the immediate crisis and re-establishing order in the national economy. The threat of conditionality could also be utilized at times to give national policy makers greater room for manoeuvre within their own domestic political context. In a number of instances, in fact, Third World leaders were at least as convinced of the benefits to be obtained from radical neo-liberal reform as were counterparts in the international financial community.

Nevertheless one of the lessons to be learned from accumulated experience with economic reform over the past several decades is that neo-liberal economic policy prescriptions are of limited utility to governments of indebted countries and can in fact be dangerous.

Perhaps the most dramatic examples of this point are provided by the disastrous experiments in free-market economics initiated during the 1970s in the Southern Cone of Latin America. With the support of military régimes, policy makers in Argentina, Chile and Uruguay adopted free-market models then gaining adherents in the United States. Both the trade and financial systems were (in varying degrees) liberalized, exposing the national economy to severe shocks with serious long-term effects.

Unlike the situation in the 1980s, this was the halcyon time when international credit was widely available and cheap. The opening of financial markets in the Southern Cone therefore allowed an enormous accumulation of private foreign indebtedness, which financed both a flood of imported goods and unprecedented speculation. The experiment ended in the collapse of the financial system, the bankruptcy of many national enterprises and the generation of massive private debt, later assumed by the public sector. A significant part of that debt was attributable to capital flight, as people took advantage of easy credit to buy dollars and send them out of the country.

Ironically, then, the onset of the debt crisis in the Southern Cone was directly related to an early adoption of radical neo-liberal adjustment strategies in the 1970s. Examples of the problems created during the following decade by more piecemeal adoption of certain policies, designed in the abstract and applied with little understanding to local realities, could be recounted for many parts of the world. Although general advice to balance the budget, export a sufficient amount to cover the cost of imports, and otherwise exercise responsible economic judgement was unobjectionable, difficulties quickly arose when designing concrete measures for attaining those ends in many different national economic settings.

By the mid-1980s, the repeated failures of most free-market adjustment programmes promoted experimentation with new approaches which retained the goals of imposing fiscal discipline, liberalizing internal markets and promoting export-oriented growth while adapting the means employed to attain these ends. The extreme view that stabilization and adjustment could best be attained by entirely liberalizing all markets, and allowing all prices to be set by the unfettered play of "free-market forces", gave way to recognition that such "orthodox" programmes seemed less effective than more "heterodox" strategies relying on fixing and defending certain key prices in the economy.

The majority of the debt-related adjustment experiences now considered to have been relatively "successful"—and they are a small number in relation to the total group of countries engaged in stabilization and adjustment programmes—have restored economic order through reliance on "heterodox" programmes. They have defended the exchange rate from sharp fluctuation (often allowing it to suffer very small daily changes), imposed price controls on a few strategic goods and services, fixed interest rates within certain limits, and brought workers and employees into agreements guaranteeing relative stability of wages and mark-ups or profit margins. At the same time, trade and financial régimes have remained relatively open to international markets.

This requires a strong state, not a weak one. It also requires effective mechanisms for agreement among representatives of the government, business sector and working class—as well as channels which, in turn, link representatives of these sectors to their clientele. (In some cases, such agreement has been reached through relatively democratic consultation; in others, through the imposition of conformity through repression.) Beyond this, "heterodox" success stories seem to require fulfilling other, more specifically economic, conditions.

The first of these is obtaining access to large reserves of foreign exchange, or to a continuous flow of fresh outside resources. Defending exchange rates, interest rates and other elements of the economy which ensure predictability and attract foreign capital takes foreign exchange. Therefore it is not surprising that "successful" experiments like those in Chile and Mexico were carried out by governments owning major export industries (copper in the first instance and oil in the second). These industries were never privatized. It is possible, however, for governments to sell large state-owned industries to foreign investors, precisely to generate the foreign exchange for supporting stabilization measures, as was the case in Argentina.

Foreign aid or lines of international credit can also play a central role in permitting relatively "successful" stabilization and adjustment efforts. This has certainly been the case in Ghana, where the international community has poured resources into the adjustment experiment, and in Costa Rica, where the United States provided large amounts of new foreign aid. Very large revenues from the drug trade have also supported stabilization programmes in Bolivia and strengthened the balance-of-payments position of Colombia and Peru.

Such external support does not, of course, guarantee recovery. A number of countries are large oil or copper exporters, or have obtained foreign aid without being able to stabilize their economies. Prudent economic management, as well as an efficient institutional structure, is essential. But it is still important to note that most indebted Third World countries have not had access to the level of external resources which would be required to support a thoroughgoing economic reform with some chance of success.

Although it has become fashionable to say that the debt crisis is over, this is true on a global level only to the extent that sufficient time has elapsed since 1982 for the international banks to build protection against default and ensure the stability of the system. For most developing countries, debt continues to constitute an enormous stumbling block in the way of any "successful" stabilization and adjustment effort, which could lay the groundwork for renewed growth. Some private and public debt has been rescheduled (often repeatedly) and an increasing proportion of the bilateral debt of least developed countries has been cancelled; but multilateral financial institutions still resist any suggestion that they institute programmes of debt relief. In the meantime, continuous pressure to settle back accounts produces constant new borrowing. Between 1982 and 1991, in fact, the total foreign debt of sub-Saharan African countries grew from 57 billion to 144 billion US dollars, and that of Latin American countries from 354 billion to 470 billion.[1]

A significant reduction in international interest rates over the past few years has temporarily decreased the cost of servicing this debt. And declining interest rates in the industrialized world have also provided an important incentive for investors to turn toward "successfully adjusting" Third World countries which boast relatively stable economic and political conditions and offer significantly higher levels of interest than those which can be obtained in Europe, Japan or the United States. During the past few years, an unprecedented volume of foreign private investment has flowed into these "emerging markets", sustaining renewed growth in some countries whose economies have been stagnant for decades.

This is, however, an extraordinarily fragile arrangement. Interest rates in the industrialized world are beginning to rise again, thus tempting capital to return to Northern markets and simultaneously increasing the volume of expenditure required to service Third World debt. Furthermore massive flows of foreign capital toward "emerging markets" in recent years have created onerous obligations. Investors in stocks and bonds expect high returns and are prepared to withdraw on very short notice. Therefore economic policy in "successfully adjusting" countries is fundamentally constrained by the potential for instability inherent in the current model of recovery, based so precariously on foreign private capital markets.

The Social Cost of Recession and Restructuring

Stabilization and adjustment have always implied temporary hardship for many people within the countries concerned, justified by the momentary need to correct the course of the economy and provide conditions for renewed growth. The peculiarity of adjustment during the past two decades, however, is that conditions throughout the world economy have not promoted recovery in most

Third World countries attempting to deal with economic crisis through recessionary policy. Furthermore the radical free-market prescriptions of the 1980s encourage a profound reorganization of the economy and society which of necessity generates extremely onerous social costs.

In this context, even the relatively "successful" cases of stabilization and adjustment in highly indebted countries during the last decade (when judged in terms of economic management) can hardly be judged a success when viewed in social terms. Although the governments of "successful adjusters" are dealing more effectively with the threat of economic instability than many others, they remain mired in an intractable social crisis.

The level of living of the majority of the population in African and Latin American countries has declined markedly over the past decade. Per capita income in most of these countries during the early 1990s was lower than in 1980, and the average income of the poorest strata 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 were badly paid and insecure.

The public sector was decimated by personnel cuts and declining wages, and public services functioned erratically. Attempts to rationalize general subsidies, so that they would represent less of a drain on the public budget, often eliminated benefits in the fields of nutrition, transport, health and education which had been important in the livelihood strategies not only of the poorest, but also of the working and middle classes. The disappearance of subsidies which supported production in certain vulnerable sectors of the economy, and/or in remote regions, also created extended pockets of depression in many countries.

As it became clear during the latter 1980s that there would not be a rapid recovery from recession in the great majority of cases and that the deteriorating social situation would engender serious political unrest, governments and international financial institutions began to experiment with new forms of targeted support for the most vulnerable groups in society. Emergency social funds, financed in some cases with the proceeds from privatizing state-owned industries and in others through foreign aid,[2] were established in a growing number of countries to provide employment and support income-generating projects for those most in need.

Pressure to Rethink the Free-Market Adjustment Model

These efforts to create compensatory mechanisms within adjustment programmes were among the first signs of a significant new shift in the overall approach of international financial institutions and Northern governments to stabilization and adjustment. Pressure came not only from angry citizens of Third World countries, who took to the streets in what came to be known as "IMF riots", but also from concerned citizens' groups and non-governmental organizations engaged in grassroots development assistance in Third World countries. Evidence of worsening social conditions, brought to the attention of the international community by bilateral and multilateral agencies (among which UNICEF assumed a leading role), also played an important part in encouraging a policy shift. Threats to demand serious organizational and administrative "adjustment" efforts within the World Bank and the International Monetary Fund themselves, and to tie these efforts to a possible reduction in their resources, underlined the advisability of rethinking the lending practices of these institutions.

The emergence in the early 1990s of groups within international civil society which could claim to have a legitimate voice in shaping the approach of multilateral institutions to stabilization and

adjustment was unprecedented. It represented a challenge not only to the prevailing ideology of development, but also to the legitimacy of a style of international economic policy-making which had become highly technocratic and secretive.

Structural Adjustment and Institutional Reform

The need to define a new economic policy approach to stabilization, as well as a new social policy for adjustment and restructuring, became particularly urgent following the collapse of communism in Eastern Europe and the disintegration of the Soviet Union. The full difficulty of implementing a thoroughgoing free-market reform, of the kind proposed in the 1980s for Third World countries, was highlighted dramatically in the Commonwealth of Independent States and Eastern Europe during the early 1990s. The collapse of communism created institutional chaos, leading to situations which were socially inhumane and politically volatile; and the willingness of many people to support free-market reform opened up a vast field for experimentation in social and economic restructuring on the part of international advisers and agencies. This experience proved extremely difficult.

In the former communist world, the basic institutions underpinning the market in developed capitalist countries were either very weak or entirely lacking. Such a situation, visible in an extreme form in the ex-Soviet bloc, called attention to a problem faced from the inception of the radical free-market adjustment effort: the lack of compatibility between existing local institutions—in Third World countries as well as in Eastern Europe and the ex-Soviet Union—and the (often implicit) requirements of the neo-liberal project of reform.

The experience with restructuring in the former communist world thus reinforced the gradual emergence of a new current of thinking on adjustment, gaining ground in the international business, donor and financial community, which explained difficulties encountered by economic reformers in the course of the 1980s and early 1990s through reference to deficiencies in existing economic, social and political institutions in the countries involved.

The World Bank clearly presented this point of view in its analysis of African adjustment at the end of the 1980s. In a marked departure from its previous position, the Bank focused less on macro-economic policy reform than on the need to improve efficiency, transparency and accountability in government; to restructure and upgrade public bureaucracies; and to strengthen local level institutions through decentralization and promotion of citizens' organizations.

Renewed interest in institutional analysis marked a step away from economic idealism, toward investigation of the complex social and political foundations of different economic systems. When combined with growing interest in designing compensatory social policies, it also implied greater recognition on the part of the Bretton Woods institutions that good economic advice must rest on strong social and political analysis.

Nevertheless incorporation of institutional issues in the economic adjustment model is still fragmentary. As long as the indissoluble links between economic, social and political reform are not systematically explored, the economic adjustment model will continue to produce situations which make it impossible to solve basic problems of governance.

Furthermore there is a danger that, in the context of high indebtedness and conditionality still shaping relations between international financial institutions and their clientele, the shift toward institutional reform will be associated with a type of top-down social engineering not essentially different from the top-down economic engineering already associated with stabilization and

adjustment programmes. Standard prescriptions for social and political reform can be urged upon a large number of governments despite the patent differences among them. As in the realm of economic policy, such a course can be counter-productive.

Crisis, Adjustment and Social Change

The fundamental socio-political problem faced by indebted countries in the Third World and in the ex-communist bloc is how to create a climate of stability and solidarity after decades of economic crisis, verging in the worst cases on collapse. This is a far more complicated task than phrases like "restructuring" or "institutional reform" might suggest. Relations among people have been reordered in countless different ways by their experiences with crisis and adjustment, and the results are not always easy to explain.

Since relatively similar remedies have been applied, to a greater or lesser extent, in so many countries mired in recession and undergoing adjustment in the 1980s and early 1990s, the experiences of hundreds of millions of people have in some sense been similar. Contractionary economic policy reduces opportunities for employment and access to income wherever it is implemented. At the same time, the central objective of the radical neo-liberal form of adjustment—to remove obstacles to market integration, both within and among countries—requires both deregulation and the systematic disprotection of particular sectors of national economies and sections of local populations through policy shifts which also have relatively similar implications for individuals in many parts of the world.

This point can be illustrated by looking briefly at agriculture. In countries (particularly in Africa) whose governments have traditionally controlled agriculture closely and taxed export commodities heavily, deregulation of markets has often provided an incentive to agricultural production. Whether farmers have been able to gain from more direct participation in the market has, however, depended (among other things) upon their capacity to obtain marketing and other services on more favourable conditions than those originally offered by the government.

The commercial agricultural sector of many indebted countries has in fact been harshly affected by continuing economic recession and free-market reforms. In region after region, the elimination of government subsidies to agriculture (manifested in support prices for basic grains, marketing services and subsidized inputs) has meant that both large and small commercial farmers—producing for export or for the national market—at best confront rapidly rising costs. At worst they lose access to inputs and services essential for production. Rising costs have been offset in part by lowering wages paid to farm labourers. This contributes to depressing local markets, in which both large and small traders find it harder to make a living. Recession in rural areas is further compounded by declining remittances from family members in the cities, which constitute a significant element in the livelihood strategy of semi-subsistence and subsistence farmers.

An often radical opening of national economies to foreign competition permits governments and private traders to supply net deficit regions and families with cheap imported food. The impact of such measures on farming can, however, be devastating. It is obviously difficult for producers of basic foodstuffs in Third World countries to compete with imported products whose price in part reflects very large subsidies provided by Northern governments. Geographical remoteness or the breakdown of transport systems can still protect local producers; but in general adjustment has expanded the boundaries of international markets in a way which brings together farmers possessing highly unequal initial resources.

Something similar occurs in industry. Radical neo-liberalism has used the tool of conditionality to weaken protection of national industry and open local markets to international competition. This has encouraged a profound reorganization of the manufacturing sector in adjusting Third World countries. In many instances, stagnation has been followed by deindustrialization, as countries stop producing many goods which can be imported. Some forms of manufacturing shift into the informal sector. At the same time, certain sectors of industry in relatively more advanced Third World economies have developed strategies which allow them to compete effectively in international markets. They are the exception within the industrial sectors of these countries, which tend to be marked by very low or negative growth in formal sector industry oriented toward national markets.

To survive during recession, and within the context of pressure from much more technologically advanced international competitors, businesses in adjusting Third World countries have relied upon what is frequently their only competitive advantage: access to cheap labour. In this, they have been influenced by the tendency throughout the world economy to promote the flexible use of the workforce, renouncing when possible the obligation to provide formal employment benefits and avoiding collective bargaining. They have also been assisted by governments following specific adjustment-related guidelines to keep wages down.

Throughout most of the highly indebted Third World (and, more recently, within the former Soviet bloc as well), the formal sector working class is therefore shrinking and working conditions within it are becoming more difficult. Under threat of unemployment and/or political repression, many of the gains won in earlier periods by organized labour have been lost. Workers are now less likely than 10 or 20 years ago to have a say concerning the way production is structured within the factory or shop, and to be able to protect themselves from arbitrary changes in their status or remuneration.

Increasingly, the workforce includes women and young people pushed out of home and school by declining family income. The entry of new groups, often with little experience in the workplace, tends to push wages down and further weakens existing union organization. These less protected strata are particularly sought out by one of the few sectors of the economy which are currently growing in many heavily indebted countries—the labour-intensive assembly plants and agricultural processing establishments producing exports under contract to foreign buyers.

A large number of people attempting to make a living within the confines of sluggish and debt-ridden economies have turned to trade. Liberalization of trade creates extraordinary opportunities for exporters and importers, and especially for those who can operate on a large scale. At the same time, small-scale importing has gained central importance in the livelihood strategies of many middle class and poorer families which respond to demand from their neighbours and friends for imported goods which are highly competitive with products produced at home. The new middle class of Jamaica, for example is increasingly composed of higglers who bring in goods from Miami and Panama. Factories formerly producing sweaters and cotton clothing in central Mexico stand idle, since their owners have begun importing bales of used clothing from the United States.

In the search for additional income, many households now count members within the informal sector, which has grown at a very rapid rate within the framework of adjustment. Here a process of diversification is occurring, as established informal sector businesses feel pressure from new entrants. Members of middle or working class families who turn to informal sector activities are often better educated and may dispose of more capital than traditional businesses; and competition is forcing many already precarious enterprises to shut their doors, or to adopt still harsher methods of exploiting unremunerated labour.

Developments within the public service sector are closely related to the rapid growth of informal or unregulated business activity. Reduction of government expenditure in many countries has been accomplished both through eliminating programmes and personnel, and through keeping wages low. Sharply declining income has affected not only the livelihood strategy of civil servants but the quality of their work. And cutbacks within such fields as public health and education have forced many people who formerly depended upon access to these services to look for alternatives within the private or informal sector.

Multiple Coping Strategies, Weakened State Capacity and Fragmented Identities[3]

It is no doubt true that, in some cases, deregulation of internal markets and foreign trade, as well as the reduction of the role of the state in the economy, has permitted people to gain new freedom of action. Nevertheless it is important to think carefully about how patterns of social change under conditions of continuing economic crisis and adjustment are affecting the capacity of societies to provide a minimal framework of stability and justice, within which people can interact productively.

Over the past several decades, the efficiency of modern institutions has been severely eroded by the combined impact of economic crisis and free-market reforms in many Third World countries. Particularly in Africa, it is not too much to say that prolonged recession seems to be reversing the process of modernization which was the hallmark of post-independence development. The school systems, health services, public enterprises and government agencies established to support construction of national economies and secular, national societies are all too frequently in ruin.

Furthermore the coping strategies adopted by many different kinds of people, as they confront severe challenges to livelihood, reverse earlier trends toward occupational specialization. Workers and civil servants in Africa, for example, are increasingly devoting a part of their time to farming on the outskirts of their towns, or in the countryside. Teachers and nurses in many countries now opt to supplement miserable salaries by opening small shops, selling street foods, and so forth. Professionals may drive taxis. Such diversification of activity requires devoting attention and time to a number of concerns in different places. This affects the quality of work and weakens the commitment of employees to the institutions they serve.

Multiple survival strategies also weaken the kinds of institutions which modern societies have developed for the defence of group interests. Trade unions, farmers' associations, mutual insurance societies and so forth depend for their effectiveness on the commitment and financial support of their members. As professional or workplace identity erodes, however, and as the interests of members become more diffuse, these institutions lose much of their ability to represent their constituents in formal bargaining processes.

Although it is often noted that strong "vested interests" can block needed reforms, it is also true that weak interest group representation can make it harder for governments to design an effective response to economic crisis. In the first place, dialogue between policy makers and key sectors of the society becomes more difficult; and agreements on issues such as wage and price restraint—even when drawn up—are less likely to be kept. This kind of problem stands behind many of the failed efforts to forge pacts in support of stabilization programmes in African and Latin American countries during the 1980s.

In the second place, growing fragmentation and diversification of interests in response to crisis affect the coherence of the economic planning process itself. It becomes very difficult to predict the impact of policy on the behaviour or life chances of different groups when the latter are extremely heterogeneous. Thus, for example, the benefits of targeted credit schemes intended to assist small enterprises in the urban informal sector quite frequently find their way into the hands of the middle class. Or incentives designed to promote one form of behaviour within a part of the population may in fact promote an entirely different one. This has, of course, always been an unresolved problem in economic policy-making; but it is particularly acute today.

Finally, 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 when a growing part of the population does not feel represented by any intermediate level organizations.

As many states lose both capacity and legitimacy, there has been a resurgence of regional, religious and ethnic movements, most particularly in Africa and the former Soviet bloc. Sometimes people reactivate traditional ties for very practical reasons: they are the only available way to fill the gap in social service provision left by the withdrawal of the national government. Thus in villages in Guinea-Bissau, for example, the crisis of the modern educational system has forced parents to rely on Koranic schooling. And for many impoverished city dwellers in West Africa, herbalists, soothsayers and religious sects are once again becoming a popular alternative to modern medicine.

On a deeper level, however, the sharp sense of uncertainty and insecurity generated by recession and restructuring—by the threat of unemployment, the collapse of wages and the deterioration of public services—provides fertile ground for fundamentalism. And the growing fragmentation of livelihood, as households explore multiple survival strategies, is likely to reinforce the need to reassert primordial loyalties.

Finally, it should be remembered that 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. The poor tend to be poorer now, not only in absolute but also in relative terms—as some members of society have been able to take advantage of the unusual new opportunities created by free-market reforms. Frequently there is a marked cultural dimension to this process of polarization. The most lucrative activities often involve growing involvement in international markets and integration into global consumer culture. In consequence, the bases of national culture (often of recent creation in Third World societies) are narrowed and challenged.

Toward the Future: Issues and Options

When the Social Summit convenes in 1995, most countries in Africa and Latin America will be further in debt than they were 20 years ago. A larger proportion of the population will be in poverty. The institutional framework for providing social support will, on the whole, be weaker. And the capacity of many governments to ensure a stable environment for dialogue will be less.

Clearly, the particular form of adjustment in vogue for the past 15 years has not permitted the world community to deal effectively with problems of indebtedness and recession. A radical free-market programme, rigidly linking balance-of-payments assistance to disprotection of national markets and reduction of the public sector, has not created the necessary conditions for most people in adjusting countries to have a better future.

One reason for this lack of success may well be the failure to address the broader structural problems within the world economy which play a role in prolonging the crisis. There is therefore renewed interest in many quarters in taking up the debates which surrounded the creation of the post-war international system in the 1940s, in which adjustment was widely assumed to be as much a problem for creditor as for debtor countries.

Such a debate would have to consider questions like the following: What changes in the policy of the industrial nations would be required to make adjustment in the Third World more successful? What new mechanisms of debt relief can be found? And how could the system of international finance and trade be restructured to facilitate renewed development? It is perhaps particularly relevant to **take a systemic view** in the 1990s, as global economic integration advances rapidly.

In the attempt to develop new approaches to the problems of indebted countries, it is also important to **discard stereotypes**. The most simplistic, and least useful, debates on economic reform have involved contrasting "state" and "market", or "public" and "private" sectors, in highly ideological fashion. This obscures the real problems of specific social and economic systems and interferes with the design of pragmatic solutions.

Adjustment is not primarily a technical exercise. Technical expertise is of course an important element in designing policy reform; but in the last analysis, adjustment poses dilemmas which can only be resolved politically. There are many ways to deal with any problem of imbalance in the economy, and each way implies a varying distribution of benefits and losses for people within the society in question.

In consequence, measures worked out through **adequate consultation with affected populations** are likely to be more effective than those which are imposed. Although this point would be judged obvious when considering the design of economic reform in the industrialized North, it is sometimes forgotten in the context of the developing world.

Since **conditionality** is the principal mechanism through which the will of the international financial and donor community can be imposed on indebted countries, it **should be used with caution**. Withholding international assistance unless certain conditions are met is no doubt necessary in many cases. But conditionality can cut off dialogue and impose policies which are either technically inadequate, given local conditions, or politically unfeasible, or both.

Creating effective mechanisms of response to economic crisis requires a degree of familiarity with real local situations which cannot be expected of foreign advisers. Therefore there is a strong argument for **reconsidering the role of international experts in designing adjustment policy**, particularly when that role confers extraordinary power.

In the last analysis, improving the reform **process** is central to improving the likelihood that different groups of people, at various levels of society within many different countries, will find useful ways to put the crisis behind them. If there is one overriding lesson to be learned from the experience of the past two decades, surely it is that **there is no single prescription which can be relied upon to solve the complex problems of development**.

[1] For sub-Saharan Africa, this meant an increase in the ratio of debt to gross national product, from 60 per cent in 1982 to 110 per cent in 1991; while for Latin America, somewhat better growth reduced the ratio from 52 to 41 per cent. United Nations, Department of Economic and Social Information and Policy Analysis, World Economic Survey, 1993, New York, 1993, Tables A-35 and A-36.

[2] To date, Chile is the only country which has financed a significant part of its emergency social fund through increased taxation.

[3] This section is based on Yusuf Bangura, Economic Restructuring, Coping Strategies and Social Change: Implications for Institutional Development in Africa, Discussion Paper No. 52, UNRISD, Geneva, July 1994.