THE IMPACT OF STRUCTURAL ADJUSTMENT ON THE POOR

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INTRODUCTION

Once again, we find ourselves at a juncture where the need for Caribbean economies to adjust is dominating the policy agenda in the wake of an adverse external trading environment that is threatening the basis of our economies. The imminent loss of preferential trading arrangements for key producing sectors, as the new rules of engagement for international trade take hold, is presenting the Region with one of its sternest challenges. Policymakers have long recognised the fundamental structural weaknesses of Caribbean economies and the need to effect transformation, but the necessity of structural adjustment has taken on a new urgency in an environment in which the prevailing ethos is "every man for himself" or its perhaps more accurate to say "every country for itself". The OECS Development Report 2002 and the OECS Development Strategy summarise the challenges confronting the sub-region. Given the acceptance of the inevitability of adjustment, policymakers are of course concerned about preserving the social and economic gains that have been achieved thus far, while laying the foundation for the continued growth and future prosperity of the Region and sustained human development. Hence the concern over the "Impact of Structural Adjustment on the Poor".

Structural adjustment can be defined as the varied policy action (whether home growth or externally driven) that attempts to alter the nature, structure and functioning of economies. Perhaps it is useful to remind ourselves that Caribbean economies have been "adjusting" to shocks of various types since the plantation days. What is different at various points in time, are the immediate stimuli for adjustment, who and what is driving the adjustment process, the focus of the adjustment efforts and the policy instruments deployed. We may note that in the early post independent Caribbean societies, leaders set about restructuring their societies and sought to raise the mass of their population from poverty through a combination of broad-based social policy (i.e. aggressive social spending) and economic measures aimed at modernising their economies via the route of import substitution industrialisation (i.e. altering the economic base). These broad-based social policies reaped significant successes as captured in improvements in a number of social indicators. Unfortunately the model of development being pursued proved unsustainable for a number of reasons, both internal and external to the countries. By the 1970s countries found themselves in deep economic crisis with imbalances on their external and fiscal accounts. This opened the way for the involvement of the IMF, World Bank and other international financial institutions (IFIs) in the economic management of these countries in a very significant way up to the present time. Since the late 1970s, the paradigm of adjustment as advanced by the IFIs has come to dominate policy discourse and policy action, and structural adjustment has come to be associated with the policy recommendations emanating from the IFIs (adjustment *a la* IMF/World Bank) and more recently the World Trade Organisation[1]. This heralded a fundamental shift in policy focus, in the priority accorded economic issues as against social/human development issues and in the approaches to addressing these.

Underlying the IFIs approach, is a view of how best economic activities should be organised, how development is attained, and what is the appropriate role for the state. The private sector is expected to play a lead role in development with the state providing the supporting macroeconomic and institutional framework. This view champions the supremacy of the market and the removal of all barriers to the free functioning of the market. Greater integration into the international economy of developing countries, through opening their borders to trade, capital flows, technology etc., is also encouraged as the key to "catching up" with the advanced industrialised countries. Economic growth, and more recently, broad-based economic growth is held to be the key to poverty reduction.

Given the overall dominance of the IFIs paradigm of adjustment and its overwhelming influence on the public policies of individual countries, the impact of the IMF/WB model of structural adjustment on poverty is discussed. Some of the evidence on the impact of structural adjustment on poverty is reviewed. A brief overview is given of the evolution of IMF/WB approach to the issue of poverty reduction. I conclude by offering some observations on structural adjustment in the OECS Region.

LESSONS FROM EXPERIENCE - THE POOR UNDER STRUCTURAL ADJUSTMENT

The first generation of IMF/WB structural adjustment programmes (SAPs) were overwhelmingly concerned with restoring macroeconomic stability (ie restoring external and internal balance) in crisis countries with a view to promoting economic growth. These early SAPs can be described as purely "economistic" in their orientation with little explicit attention paid to the social and human dimensions of adjustment. Robust economic growth was expected to benefit the poor (i.e. through the trickle down effect). These early programmes, with their emphasis on stabilisation and deflationary measures in the short run and restructuring the economy to scale back the activity of the state together with measures to free up the domestic economy and liberalise trade, have been heavily criticised for the social dislocation caused. These reforms have been denounced for seeking excessive reduction in aggregate demand, resulting in an unwarranted contraction of output and employment, as well as declining living standards

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[1]Structural adjustment is used here to cover short term stabilisation policies that are aimed at reducing imbalances on the external and fiscal account and controlling inflation; and longer term adjustment measures aimed effecting the reallocation of resources between various sectors (private versus public, tradeable versus non tradeable, exports versus domestic production etc.)

for the poor, and for altering the distribution of incomes in favour of the non-poor. For some Regions, notably Latin America and some countries in the Caribbean, the 1990s is regarded as a lost decade precisely because of the absence of economic growth and significant reversals on the social front. Szekely (2001) argued that SAPs in the 1980s resulted in the dismantling of the previous social development strategy, whilst the restraint of government spending across the board, the removal of subsidies, cost based pricing for publicly provided goods and services and cuts in social spending adversely affected the poor disproportionately.

The impact of structural adjustment measures on poverty remains mired in controversy. While the evidence shows that progress in reducing poverty has been far from satisfactory, and in fact poverty and inequality have grown significantly in some countries and regions (the Governor spoke about this in his opening address), disagreement reigns about the proximate cause of this. Some of the key findings from a review of the theoretical and empirical literature on the relationship between structural adjustment, growth, inequality and poverty are highlighted:

1. Have Structural Adjustment Measures Led to Economic Growth?

While the theoretical bases of IMF/WB policies are being questioned, there is an ongoing debate as to whether these programmes have actually resulted in economic growth. The evidence points to slow growth or no growth, and in cases where growth was recorded the rates of growth achieved were below that of the preadjustment period. Economists from the World Bank and the IMF argue that slippage on the part of the countries is responsible for the poor performance observed.

2. Has Economic Growth Led to Reductions in Poverty and Inequality?

The findings suggest that SAPs have had a disproportionate and detrimental effect on the poor and inequality or at best the condition of the poor did not improve. Evidence has been gathered which shows that during growth episodes the poor may not benefit, and in fact the poor are more adversely affected during a downturn, while an expansion may have a more limited effect (asymmetric effect) on the poor. Further, growth may give rise to increasing inequality. In countries that achieved moderate growth rates, increases in inequality of primary income have been recorded. SAPs in Latin America led to a redistribution of income away from labour to capital, while wage differential between skilled and unskilled workers rose with liberalisation. Growing inequality of incomes was also found for Jamaica and Trinidad and Tobago under structural adjustment. On the other hand, World Bank Economist, Easterly (2001) finds no evidence that IMF/WB programmes have a direct effect on poverty. He argues that adjustment lending in fact lowers the growth elasticity of poverty.

The new growth theories and the empirical evidence suggest that the traditional argument that inequality is good for growth has outlived it usefulness. In fact, according to the new growth theory, excessive inequality can retard growth. Additionally, empirical evidence reveals that countries with relatively egalitarian initial conditions tend to grow faster than those with high initial inequality. The IMF itself has put forward evidence that inequality may hinder growth and that equitable adjustment may be more sustainable.

3. How Have Specific Adjustment Measures Impacted Poverty?

Domestic market liberalisation in the form of removal of price and exchange rate distortions has had a disproportionate effect on the poor. Particularly the removal of subsidies such as those on basic food items and other goods and services utilised by the poor since these goods comprise a higher percentage of their consumption basket.

Devaluation to correct overvalued exchange rate: The results are not clear cut. The overall impact depends on the share of tradeables and non-tradeables in the income and expenditure of the poor as well as their level of expenditure and the movement in relative prices. Clearly the outcome will depend on the relative concentration of the poor in the traded or nontraded sector, as well as, the prospects for said sectors in terms of external realities, a critical point for the OECS. Agenor (2002:49) notes that if the tradeable goods sector is labour intensive, the poor will gain from the relative price shifts associated with a real exchange rate depreciation. On the other hand, the goods produced by the poor may not be responsive to lower export prices (supply inelastic) or depends on market access under special arrangements rather than prices competitiveness. Hence devaluation will not benefit the poor. If the consumption basket of the poor consists of a large percentage of imports, devaluation will impact them negatively.

Not only do pricing policies under adjustment programs redistribute incomes across industries (from nontraded to traded sectors) but they also redistribute incomes within the labour force, typically from the unskilled to the skilled. To the extent that the poor are usually unskilled, they can be expected to lose out from this shift. This effect may be worsened by pricing policies that erode or remove food subsidies. Further, to the extent that many are in the informal sector (either as street vendors or service providers, such as household helpers) they may also suffer indirectly as middle class public servants are shed as the public sector contracts under adjustment.

Trade Liberalisation, Growth and Poverty: The evidence is again mixed. There are claims that globalsiers have grown faster (Dollar and Kraay; 2001); while others find no convincing evidence as to the benefits of liberalisation and growth. In fact, evidence produced shows widening disparity between countries. There is growing concern that the greater integration of developing countries in the international economy has not resulted in the expected convergence. Rather it has been argued that globalisation has led to slower growth and rising inter- and intra-country inequality and poverty (UNCTAD, 1997; Stewart and Berry, 2000). Stewart and Berry argue that the growth in inequality has been pronounced because policy reforms adversely affected those areas that are good for social equity. Kaplinsky (1999) alerts us to the phenomenon of immiserising growth and the fallacy of composition as a number of manufactured goods become commoditised. Anwar (2002) citing evidence for Pakistan argues that when trade reform was intensively implemented, the incidence of poverty increased substantially.

Tax and Labour Market Reforms: Overall labour market adjustments tend to weaken the position of labors through the elimination of minimum wages, changes in legislation to make hiring and firing easier, and the general dilution of trade union power and the increasing mobility of capital. The simplification of the tax system often affects benefits to the poor such as the elimination of basic food subsidies; changes in the level and composition of government expenditure tend to preclude spending on infrastructure projects that provide short term relief to the poor, and the move to indirect taxation is regressive.

EVIDENCE FROM THE CARIBBEAN REGION

A study of the 1981-86 period in Jamaica painted a very bleak picture of the human dimension of the adjustment. The study by Paul Cheng Young and Associates found:

- Declines in the share and value of Government expenditure going to social and community services.

- Real expenditure on education, training and cultural activities, housing, and water, was lower than in the preadjustment period.

- A decline in the nutritional status of children.

- Employee share of real GDP declined.

- Falling per capita disposable incomes.

- Significant cuts in primary schools expenditure leading to temporary closure.

- Increase in inflation.

Melville (1996) investigating the Trinidad and Tobago experience over the period 1986-1993 observed the following:

- Government's approach to reigning in its expenditure, attempted to minimise the social impact. Mass public sector retrenchment was avoided and employment was reduced through the introduction of voluntary separation employment packages (VSEP) and by natural attrition; the wage bill was lowered by a freeze on salaries and actual salary cuts. Nevertheless, many workers suffered a decline in real incomes through decreases in nominal income and rises in prices and many fell below the poverty line.

- Domestic prices, especially food prices, escalated under adjustment.

- Government workers, service workers and others employed in labour intensive activities in the manufacturing sector were most severely hit by the decline in income. Real minimum wages in these activities dropped and the labour share of GDP diminished considerably. The share of GDP going to profits also rose.

- Employment in the agricultural sector and the informal sector expanded.

- Poverty rose over the period of adjustment. The incidence of poverty was found to be greater among the urban poor and particularly high for government workers. Rural workers who had access to garden plots or were less dependent on wage income fared better.

- Spending on the social sector declined and this adversely affected their operations.

- There was an expansion of job opportunities for women in the public and private sector.

- Social programmes up to 1993 were ad hoc and not focussed on providing immediate relief to the dislocated persons.

EVOLUTION OF STRUCTURAL ADJUSTMENT PROGRAMMES AND POVERTY

While the debate is still ongoing as to the reasons for these results, and in particular the role of structural adjustment measures, there now seems to be a growing consensus that adjustment without an explicit focus on social outcomes is likely to aggravate poverty and inequality. Experience has shown that adjustment policies could result in significant social costs for some groups, particularly persons that are hovering just above the poverty line and those subsisting below the poverty line. More importantly, there is acknowledgment that growth alone is insufficient to remove persons from poverty as the poor may lack the capacity to take advantage of growth opportunities, and/or the type of growth strategy pursued may further disadvantage persons/groups/communities that have been traditionally bypassed by growth episodes. As poverty and its many dimensions have become better understood, and the limitations of an exclusive focus on growth have become apparent, this has been reflected in a change in the policy dialogue and prescriptions flowing from the IFIs. The evolution of IMF/WB policies have shifted from an exclusive focus on economic objectives to explicitly embrace poverty reduction as one of the outcome challenges for structural adjustment. While still embracing the private sector led growth within the context of a globalised free market as the key to development, greater attention is now paid to social outcomes. At the same time, it is now acknowledged that the existence of large pockets of poverty is not good for development. The IFIs now directly target poverty reduction through specific measures, rather than relying on growth to effect a reduction of poverty. This is reflected in a shift in their policy prescriptions and in their lending portfolio in favour of the social sectors.

The IFIs now advocate the following as central to poverty reduction.

(1) Broad based-growth that promotes the productive use of the labour of the poor.

(2) Provision of basic social services to the poor through a focus on primary health care, family planning, nutrition and education.

(3) Programme of well targetted transfers and safety nets to support those that may be temporarily adversely affected by economic reforms.

(4) Programmes aimed at improving the poor earning capacity. The approach assumes that persons are poor because of the lack of human capital, i.e., they lack the skills and other capabilities to take advantage of growth opportunities. Hence an element of the approach concentrates on equipping the poor with the wherewithal to accumulate human capital through investment in health, education.

(5) The employment of Poverty Reduction Strategy Papers crafted by countries to guide the IFIs and Governments in the adjustment process.

SAPS AND THE OECS

The challenge of adjustment in the OECS is clear: urgent short term stabilisation to restore fiscal balance and stem the accumulation of debt and equally urgent longer term measures to shift the productive base of the economy. As indicated earlier, the dilemma is to accomplish this while minimising the social dislocation in a severely resource constrained environment and one in which recent poverty studies have revealed that the incidence of poverty in the sub-region is fairly high and that this is more protracted in the rural areas[1]. Stabilisation inevitably entails fiscal austerity including cuts in public

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[1]The level of food poverty is also higher in the rural areas and in agriculture in particular. The poor has also been found to have overall low levels of human capital with much less years of schooling than the non-poor and most have not gone beyond primary school. (The level of human capital formation in the sub-region is generally low). Whilst the unemployed had the highest incidence of poverty, a significant number of employed persons (in low paying, low skilled occupations in the private sector and in the informal sector) fell below the poverty line. The studies also revealed differential access to physical infrastructure and social services by the poor and the non-poor.

expenditure and attempts to enhance revenue collection. A tendency has been to effect across the broad cuts in public spending (including social sector spending) and to reduce the size of the wage bill through public sector retrenchment. These have the potential to create enormous social distress. Workers at the lowest end of the salary scale, who are least able to resist because they may be temporary or non-unionised, are usually the first to be displaced. Government's approach to reigning in expenditure should be to minimise the social impact. Mass public sector retrenchment should not be a first option. The lessons from Trinidad and Tobago and Barbados may prove instructive where public sector employment was reduced through VSEP and natural attrition and the nominal wage bill lowered by a freeze in increments and actual salary cuts. The conundrum for the OECS is that salary levels are already quite low. Cuts in nominal wages will have to be supported by a pact to hold the price of essential goods and services constant over the period. Declining nominal income in the face of rising prices is likely to push persons below the poverty line as happened in Jamaica and Trinidad and Tobago.

The OECS Human Development Report 2002 points to inadequate spending in the OECS on social development resulting in significant gaps in the delivery of social services and infrastructure. The poverty studies also revealed that the poor, who are largely rural, have differential access to these services. Preservation of the level and quality of social services and infrastructure in these disadvantaged communities will be another challenge. Subsidies are not pervasive in the OECS and therefore removal of these is likely to be a non-issue. Instead, the introduction of user charges for public goods and services is likely to pose more of a challenge for low income households. In cases where user charges are introduced, due consideration must be given, and mechanisms put in place, to guarantee access by vulnerable groups to critical public goods and services.

State-funded social assistance in the OECS is very limited. To alleviate the worst effect of adjustment, safety nets as short term temporary measures, will be needed to cushion those at greatest risk. An immediate problem is that of funding for these safety nets. Here donor support will be needed to supplement domestic efforts. While pursuing structural adjustment measures, great care must be taken to ensure that informal safety nets crafted by persons and communities to ensure their survival are not negatively impacted. Governments also need to be mindful of safeguarding spending on those areas that are crucial to human development lest they run the risk of seriously impairing the long term development prospects of the sub-region. The human capital base is already quite low and inadequate. This has been a constant theme throughout this development conference on the OECS. The education bar is much higher than the simple attainment of universal primary and secondary level education.

The present paradigm is grounded in private sector led development. It must be acknowledged that the private sector in the OECS is quite "thin" and at present, its ability to generate "good" jobs is extremely limited. The poverty studies have shown that the working poor are more likely to be found in the private sector and the informal sector. Unless the productivity of private sector activities can be improved substantially, the private sector may not be able to create enough "good" jobs to reduce the number of poor. Urgent attention must be given to building capacity in the private sector.

The Region can bear witness to the fall out from the move away from preferences and non-reciprocity to trade liberalisation in the context of a very narrow export base (one or two major exports) concentrated on one or two trading partners. Trade policy must be viewed as an integral part of the Region's development policy and the goal should be to try to win advantages for the tradeable sectors as well as to attain social goals.

Finally, I will conclude by observing that the issue of the chronically or structurally poor, i.e., those who suffer from social and economic exclusion (i.e., persons or communities that remain untouched by economic advances taking place in the wider society) will have to be taken on board. Special and deliberate measures will have to be developed to address this problem. The Region may have no choice but to revisit the vexing issue of redistribution although no longer in vogue.

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