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Adjustment from Within

Lessons from the Structural Adjustment Participatory Review Initiative

A contribution from the World Bank to the Second Global SAPRI Forum

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1. INTRODUCTION

By structural adjustment, we in this report mean a program of economic changes implemented by a government in order to generate medium- and long-term economic benefits for its population. These changes are often contentious, and carry social and political costs.

In 1996, the World Bank took up a challenge from certain NGOs to review 15 years of structural adjustment operations and explore new economic options in conjunction with civil society organizations. The Structural Adjustment Participatory Review Initiative (SAPRI) was developed through consultations between World Bank country teams and a network of non-governmental (NGOs) and civil society organizations (SAPRIN). The objective was for them to review together the impact of adjustment lending and policy advice in countries where governments were willing to participate: Bangladesh, Ecuador, Ghana, Hungary, Mali and Uganda. The aim was to improve understanding about the impact of adjustment policies and how the participation of civil society can enhance economic policy-making. It was to be both a review of past experience and a forward-looking exercise designed to identify practical changes in policy-making that could lead to significant improvements in people's lives.

The review consisted of public forums, field investigations and reviews of the existing literature on adjustment in each of the six countries. The project opened in July, 1997, at the First Global Forum in Washington, D.C., followed by a First National Forum held in each country. In each of the six countries, a national steering committee selected the two or three major concerns they wanted to focus on, based on suggestions received from local civil society organizations. Field investigation and participatory analysis were then carried out and all findings and conclusions presented at a Second National Forum held in each country between June, 2000, and May, 2001. Findings from all the country studies and recommendations for policy changes are to be presented at the Second Global Forum in Washington in July, 2001. This report summarizes the lessons of the SAPRI exercise, as seen from the perspective of the World Bank.

1.1. Structural adjustment and structural adjustment lending

Assessing the impact of structural adjustment on vulnerable groups is vital. Balancing long-run gains and short-run costs is a common challenge for governments embarking on adjustment programs. Long-run gains are projected—but never certain. Short-run costs are often not identified but rapidly become visible: people may lose their jobs, see prices increase for products they buy, or see prices decrease for products they sell. In short, they may find their lives becoming more difficult.

Opposition to reform can mount when it is not clear whether this price is worth the uncertain long-run gains. An added complexity is that it is impossible to observe the counterfactual, or the outcome in the absence of reform. Neglecting this issue can distort the way adjustment is interpreted as declining growth and increasing poverty are often underlying characteristics of countries undertaking adjustment.

Finally, there are differences between adjustment policies directed at structural reforms and those directed at macroeconomic stabilization, often as part of a bail-out package overseen by the International Monetary Fund. Many concerns about the impact of "adjustment" in the past have been focused on stabilization policies, where external and internal shocks on top of existing imbalances have made harsh measures necessary. Over time, the more effective structural reforms that are carried out, the less harsh the macroeconomic adjustment will prove to be. In fact, the World Bank's adjustment loans are often provided to countries to reduce the impact of tough stabilization programs on society, and on the poor in particular.

Three types of situations may prompt a structural adjustment program. The first is a necessary response to an economic crisis. A second type deals with the transition from a centrally controlled economy to a market economy. The third is adjustment in a non-crisis situation. This type is done to spur economic growth and poverty reduction through structural reforms aimed at increasing the efficiency of the economy

Adjustment to crisis

When a country experiences an economic crisis, as Ecuador did, external financing can help to avoid a long-run decrease in growth, rising inflation or an increase in unemployment, and smooth the return to more secure and steady growth. The reasons for a crisis may involve many factors that interact in ways specific to a country's own situation. Among them may be:

- External shocks, such as a rise in oil prices, falling commodity prices, or high international interest rates.
- Internal conditions, such as mounting deficits, overvalued exchange rates, inefficiencies and inequities in public spending, or poor private-sector incentives.

International financial institutions stand ready to assist in the process of adjustment after a crisis. The IMF, in particular, may lend money to a country that does not have enough because tax revenues are falling while government expenditures rise, or because earnings from exports are dropping while the cost of imports increases. (The IMF is concerned with the macroeconomic conditions of a country and may provide loans to improve them. The World Bank focuses on support for long-run structural and social development, with a focus on reducing poverty.)

Transition

A second type of adjustment is the introduction of a market economy in countries that were previously centrally controlled. This typically comes about for two reasons. First, the centrally controlled system proves unable to satisfy its people's expectations for prosperity. Second, the citizens of a country make a choice in favor of individual freedom and democracy, which is constrained by central control. Among the six SAPRI countries, Hungary offers an example of such a transition.

Promoting growth

To move toward a more efficient economy often requires modernizing institutions and policies that are a constraint on achieving better growth rates and more rapid rates of poverty reduction. Typical structural adjustments include two broad categories of reforms. First-generation reforms include trade liberalization, financial liberalization, and privatization of state enterprises. Second-generation reforms include the development of an independent judiciary, instilling professionalism in the public sector, promoting transparency in government, better governance, and greater financial sector soundness.

1.2. Contents

Whether structural adjustment achieved its goals in the past is a vast question, which goes beyond the scope of this exercise. Each country is considered individually. The experiences of the six countries involved in the SAPRI exercise provide insights into their adjustment processes. But despite all the attention given to research design and implementation, the studies do not cover all aspects of adjustment. They provide a particular and fresh perspective, rather than a comprehensive view on adjustment.

The specific policies that SAPRI assessed through its country studies are:

- Financial liberalization (Bangladesh, Ecuador);
- Privatization (Bangladesh, Hungary, Uganda);
- Agricultural liberalization (Bangladesh, Ghana, Uganda);
- Labor market deregulation (Ecuador);
- Trade liberalization (Bangladesh, Ecuador, Ghana, Hungary);
- Public expenditure reform (Hungary, Ecuador).

This report follows a parallel structure. It analyzes the lessons from SAPRI on each of the policies and compares them to the global experience that the World Bank has gained over the past 15 years. The World Bank and the NGOs involved share a common commitment to poverty reduction. The most central lesson from the SAPRI exercise is that taking into account "people's experiences"—that is how they experience structural adjustment in their lives—is vital for a government to design and build consensus around reform and to ensure the greatest positive impact of adjustment programs.

This shift in development thinking, i.e. the centrality that "country ownership" has taken in the approach to development, is what the title of this report *Adjustment from Within* aims to reflect.

2. CIVIL SOCIETY ORGANIZATIONS AND LEARNING FROM EXPERIENCES

The past decade has seen a major shift in thinking about how to implement economic reform programs in a wide range of countries. The issue is "ownership"—how to make sure that governments and civil society groups in the countries themselves buy into the reforms and develop a broad consensus on the actions that must be taken. There is growing understanding that there are powerful practical and philosophical reasons to put countries in charge of their own reform. The practical reasons are well documented. If the groups most affect by a reform process do not feel that they "own" it, generally it will not succeed. At the same time, reform cannot be "bought" through donor support alone (World Bank, 1999).

Civil society has played a substantial role in bringing about this paradigm shift. One example is the pressure exerted by non-governmental organizations (NGOs) and the global Jubilee 2000 movement to recognize the burden that debt has placed on human development in many low- and middle-income countries. SAPRI is one of the contributions of civil society to the work of the World Bank. During the SAPRI process, this change in thinking became more widely reflected in the Bank's operations. This shift is highlighted today in the approach to development cooperation embodied in the Poverty Reduction Strategy Papers. These documents are developed and "owned" by the countries affected, and lay out countries' own intentions for policies to promote growth and reduce poverty, which in turn become the basis for donor involvement and coordination.

2.1. The World Bank, civil society, and SAPRI

The World Bank has been working to strengthen collaboration with groups in civil society since 1981, when the Board of Directors approved its first operational directive on relations with NGOs. However, over the past five years this interaction has been taken to a higher level. It has moved beyond simply working with development and advocacy NGOs to include trade unions, faith-based organizations, community-based organizations, foundations and other groups that shape local and global society. The Bank has also shifted from focusing mainly on dialogue with NGOs about *projects* to broader discussion of *policies.*

The World Bank engages civil society on a variety of levels. First, the Bank facilitates dialogue and partnerships between civil society and governments by convening key stakeholders and providing resources through training and technical support. Second, the Bank consults civil society groups on various policies and programs, listening to their perspectives and soliciting advice. Third, the Bank partners directly with civil society groups by jointly engaging these organizations in initiatives of common concern.

The World Bank has recognized that civil society can be an effective partner in many ways:

- Acting as intermediaries between the government, the Bank and those who benefit from or are affected by development; bringing to the table insights, perspectives, and voices of the poor and the excluded (especially when they have exceptional proximity and credibility with local, remote or diverse communities)[1];
- Offering professional expertise to improve the quality of World Bank-financed operations and national-level policy and strategy formulation, implementation, and monitoring; transferring knowledge from the local to the national and global levels;
- Highlighting the positive aspects of operational collaboration and policy dialogue; encouraging constructive engagement of the various parties involved in development processes;
- Improving or complementing service delivery to reduce costs and improve outreach.

As a result, the Bank's approach to engaging civil society has evolved from:

- Simply involving or contracting civil society in projects to deliver services, to a more substantive participation and dialogue in development programs and policies;
- Project implementation to formulation and review of policies and strategies;
- "Fire-fighting" and defensive responses to more pro-active inclusion, strategic discussions and joint planning;
- *Ad hoc* interactions to thematic alliances;
- Consulting for validation to engaging in an informed dialogue to improve the process and the substance of programs, policies and strategies.

In the case of SAPRI, the civil society network has contributed substantially to increasing the capacity of its members by creating cross-support mechanisms, developing economic literacy, and stimulating and helping to get the SAPRI process organized in countries. The international NGOs present within SAPRIN, and in particular the SAPRIN Secretariat, also deserve credit for the success of the process.

SAPRI has been a valuable partnership experience for the World Bank and a transnational network of international and national NGOs. Like any pioneer experience, it has faced difficulties and imperfect outcomes. We hope that the lessons we draw from it will contribute to future partnerships between civil society, governments and multilateral financial institutions

[1] The Country Assistance Strategy (CAS), Comprehensive Development Framework (CDF), and the Poverty Reduction Strategy Papers (PRSP) experience shows that strategic consultations with and the involvement of civil society have helped to promote consensus on the national development framework and the agenda for development and poverty reduction.

2.2. Experience, research, and capacity enhancement

Part of the SAPRI concept required civil society organizations, governments and the World Bank to focus jointly on the design of the structural adjustment review and to seek local research institutes to carry out this research project. This has proven to be very innovative and fruitful.

Research institutions in each country were empowered through their involvement in the program and the associated financial resources. Without exception, they have taken this task seriously. In this way SAPRI has contributed to capacity development. It also helped local civil society organizations team up with research institutions in their own country and to explore synergies that had not been fully utilized until then.

NGOs, social movements and research institutions have often been isolated from each other, in both the North and the South. The absence of dialogue among them partly explains the fact that local academic knowledge rarely penetrated the economic policy debate in developing countries and does not optimize their reach to citizens. Macroeconomic policy analysis and formulation have suffered from the same shortcoming. Bridging the gap between research centers, policy formulation teams, and civil society organizations is a positive step toward demystifying macroeconomics and building the consensus that is critical for the success of reform.

The SAPRI country studies have brought to light the ongoing debate about the relative value of quantitative, qualitative and participatory data and collection methods—all of which come from very different research traditions. The SAPRI research was organized to use a common framework to be adapted at the country level, made use of existing poverty statistics and relied extensively on key stakeholder groups reporting their experiences. While there were general guidelines on the methodological approach, diverse sampling and data collection methods were used including household surveys, group interviews, participatory rural appraisals, and workshop discussions to generate numbers and non-numerical data. Since the rules for household surveys are well established, this section explores the value added of focusing on consultations with those affected, using more open-ended qualitative or participatory methods.

What is the contribution of the experiences of a range of stakeholders, particularly poor women and men, with development reforms?

- First, poverty is multi-dimensional, underlining the findings of the World Development Report 2000/2001 *Attacking Poverty* (World Bank, 2000);
- Second, the different data collection methods have different strengths and are appropriate for different purposes;
- Third, qualitative and participatory data collection methods often reveal unexpected findings, and lend themselves to understanding intra-household dynamics more easily than can be anticipated by survey questionnaires;
- Fourth, open-ended methods lend themselves to making causal linkages that may not be part of the expert models or thinking. They also lend themselves to

diagramming institutional processes that eventually affect the implementation of structural adjustment;

- Fifth, particularly when there are many unknowns, great strength is derived from converging sampling frameworks for qualitative, participatory and quantitative data;
- Finally, participatory methods can build local ownership, leading to consensus and capacity for action and giving national policy makers the support they need to implement extremely difficult reform measures.

Building consensus, ownership and capacity

Our experience shows that consultation between stakeholders—including poor women, men and children—and policy-makers is crucial to building social consensus for reforms that clearly have short-term losers. Policy-makers learn about the expectations and fears of reform held by stakeholder groups, and are able to mitigate demystify macroeconomic policy. Stakeholder groups, in turn, learn about the constraints and choices facing policy-makers. Such public debate over public policy options is crucial to creating alliances and designing policies which are robust enough to withstand the early shocks that adjustment often brings and to optimize the subsequent benefits.

SAPRI has contributed to this process by running "economic literacy" programs for local organizations in several countries. This is an important step to increase participation. If consultations are held to fulfill requirements and do not lead to well-designed policy changes understood and endorsed by society at large, government actions will only heighten perceptions of failed expectations, increase distrust, and encourage less than optimal policy choices for poor people.

3. EXPERIENCES IN KEY AREAS OF POLICY REFORM

What follows is an overview of the conclusions from the SAPRI country studies on the impact that six common structural adjustment policies can have on social and economic conditions, and more generally on the impact that structural adjustment can have on poverty. These studies complement an extensive body of literature on the international experience with structural change. We will draw on this literature to compare its findings with SAPRI experiences and to shed light on further possible improvements to structural adjustment programs.

3.1. Impact on Poverty

When SAPRI was launched in 1996, several studies analyzing the impact of structural adjustment programs on poverty had been published. These studies came to diverging conclusions.

Study	*Conclusion*
RAL-I, 1988*	On average, no significant change in social indicators
UNECA, 1989	Increase in poverty and income inequality
RAL-II, 1990	Short-run indicators of living conditions did not worsen; long-run indicators improved
RAL-III, 1992	Poverty decreased in countries that adjusted effectively
Khan, 1993	Social conditions worsened in 13 percent of adjusting countries
Adjustment in Africa, 1994	Poor better off in countries that adjusted with growth (especially rural poor)
Oxfam, 1995	Adjustment lending failed to create a framework for growth and poverty reduction
Christian Aid, 1995	Adjustment lending programs hurt poor
OED, 1995	Countries that implemented right policies reduced poverty
Stewart, 1995	Adverse effect of deflationary macro policies on poor
Demery & Squire, 1995	Effective macroeconomic reform programs in Africa associated with reduced overall poverty; inadequate reform programs with a worsening of poverty

** RAL stands for Report on Adjustment Lending (World Bank)*

Experience in SAPRI countries

All the national steering committees reviewed the impact of structural adjustment in their countries. Some reports analyzed the microeconomic impact of specific policy reforms, such as trade liberalization or privatization, and identified population groups most likely to be affected. Others focused more on the overall trend in poverty.

The following is an overview of trends in poverty and social indicators in the six SAPRI countries, based on available data from the country studies and other sources. The overall conclusion is that, in most countries, poverty was reduced and social indicators improved during adjustment periods. While country reports mention that consequences of structural adjustment on income distribution are a concern, none of the reports demonstrates a causal link between a specific policy aspect of structural adjustment and the poverty trend in a country. The text below is therefore mostly descriptive and does not attribute the outcomes in poverty and inequity directly to structural adjustment.

a) Ghana

- Between 1992/1993 and 1998/99, the proportion of people living on less than $1 a day fell from 52 percent to 40 percent (data from World Bank, based on the Ghana Living Standards Surveys);
- Poverty reduction during the 1990s was greatest among export farmers and employees in both the private and public sectors. Food crop farmers experienced smaller reductions. Poverty reduction was also uneven geographically (Ghana Statistical Services, 2000).
- Job creation increased by 51 percent in the sampled manufacturing firms since the structural adjustment program began in 1983 (SAPRI Ghana, p. 39). Elsewhere, the country report describes the experience of the Tarkwa mining region. The mining industry did not create enough jobs to absorb people laid off from agriculture or attracted by possible jobs on mining sites, and the cost of living increased in those regions (SAPRI Ghana, p.49). Those areas also experienced a deterioration in the quality of life due to prostitution, drug abuse, inadequate housing and environmental damage.
- Social indicators improved across the board throughout the 1990s. Primary school enrollment increased by 10 percent, while secondary school enrollment also increased, though by a smaller amount (Ghana Statistical Services, 2000). Life expectancy increased, and access to safe water improved (World Bank, 2001b).

b) Bangladesh

- Poverty was reduced between 1983/84 and 1995/96, from 58.5 percent to 53.1 per cent (headcount ratio). Based on the periodic household surveys conducted by the Bangladesh Bureau of Statistics, a noticeable reduction in poverty, as measured by the "cost of basic needs," took place between 1991/92 and 1995/96. An alternative poverty measure based on "direct calorie intake" suggests that this reduction occurred between 1983/84 and 1988/89 (SAPRI Bangladesh, p. 96).
- The government strategy of allocating an increasing share of budgetary resources to high priority programs in health and education had the desired effect. The overall Human Poverty Index declined sharply between 1981/83 and 1995/97, from 61.3 to 40.1 (SAPRI Bangladesh, p. 98). Primary school enrollment rates, immunization rates, life expectancy, and mortality also improved (World Bank, 2001b).
- The SAPRI report identifies, without providing much supporting evidence, some groups that may have been at greater risk for poverty. Little employment was created that directly benefited the poor (p. 100). Rural real wages declined between 1989 and

1995 (p. 101). And 55 per cent of workers laid off from state-owned enterprises were older than 50 and had little chance to find other employment, although they left their jobs with reasonable pensions.

c) Uganda

- While proceedings of the Second National Forum refer to an increase in poverty and inequality (SAPRI Uganda, pp. 14 and 25), periodic household surveys from the Ugandan Bureau of Statistics show that poverty declined sharply and inequality was also reduced. The proportion of Ugandans living in absolute poverty declined from 56 percent in 1992 to 44 percent in 1998 (Appleton, 2001). This study concludes that strong economic growth accounted for 95 percent of poverty reduction.
- Spending on health and education rose in real terms during the structural adjustment period (SAPRI Uganda, p. 40). The enrollment rate in primary schools increased more rapidly than the number of teachers, leading to teacher/pupil ratios as high as 1:100, which affected the quality of education. While spending on health services increased, the report identified problems relating to the quality of delivery and a bias towards curative rather than preventive programs.

d) Mali[2]

- With a per capita GNP of U.S.$250 in 1998, Mali is among the ten least-developed countries in the world. Its social indicators are significantly weaker than the average for Sub-Saharan Africa.
- It is estimated that 64 percent of the population lived below the poverty line in 1999. Poverty in Mali tends to be concentrated in rural areas, where food shortages can become particularly acute during periods of drought. Malnutrition is a serious problem: in 1996, 30 percent of Malian children under the age of three were chronically malnourished and 23 percent suffered from acute malnutrition.

e) Hungary

- Following the liberalization of the economy in 1989, unemployment went from being officially non-existent to a high of 14 percent in three to four years (SAPRI Hungary, p. 50). Since then, unemployment dropped to 6.4 percent by the end of 2000 (CSO 2000), a level somewhat lower than in western Europe. Some regions and population groups (in particular the Roma) are affected more than others.
- Poverty, like unemployment, also peaked in 1995 and decreased subsequently.
- Income inequality increased: the difference between the lowest and highest decimal class per head income increased from 4-4.5 times before 1990, to 8-9 times in 1999 (SAPRI Hungary, p. 51).

f) Ecuador

- Available evidence shows that poverty increased in urban areas between 1982 and 1992, a period characterized by economic crisis and adjustment; fell between 1993 and 1995, a period of relative economic stability; and deepened during the following

[2] Few time series data are available and it is therefore not possible to draw any trend in poverty over the structural adjustment period in Mali.

years. Studies concluded that economic policies adopted in the past quarter century did not contribute to overcoming the structural determinants of poverty in Ecuador.
- The UNDP's Human Development Index shows favorable changes in Ecuador over the past 25 years: it rose from 0.485 in 1970 to 0.775 in 1996. This means that despite an increase in poverty and a reduction in social spending in recent years, there were some achievements in health and education.

Summary of the lessons learned

Like all studies on structural adjustment, the six country studies and face a major methodological limitation in linking a structural adjustment program with poverty reduction. While it is possible to observe the evolution of poverty during an adjustment program, we cannot compare these trends with what poverty would have been if no program had been implemented.

In particular, researchers face three challenges in measuring the impact of an adjustment program. First, an adjustment program aims to have long-term benefits and it is difficult to evaluate the time period over which all effects will have played out. Second, the depth with which an adjustment program is been implemented is critical to its effectiveness. We usually measure a structural adjustment by using the loan as a proxy variable, and this "loan" variable unfortunately does not give any indication on the implementation of programs. These factors and the lack of counterfactual should, however, not stop us from drawing conclusions and lessons on how to increase the contribution of structural adjustment programs to poverty reduction.

If we focus on long-term structural reforms, we can identify three conditions that increase the likelihood of success of a structural adjustment program in terms of poverty reduction:

- The design of the program should be geared towards generating economic growth and ensuring that this growth is shared equitably across the population. Such programs would facilitate income-generating opportunities for poor people, expand or at least preserve public expenditures and contribute to the effective delivery of basic services to the poor, and provide social safety nets for the most vulnerable groups. This approach to poverty reduction reflects the findings from the World Development Report 2000/2001 *Attacking Poverty*, which recommended increasing opportunity and security for the poor.
- The program will be more effective if it is supported by a dialogue within the population. Such consensus is built through broad consultations with parliamentarians, public administrations and civil society. This again is in line with the WDR 2000/2001 recommendation, corroborated by *Voices of the Poor*, to better empower poor people and to give them a voice in development programs.
- Finally, a structural adjustment program should be adapted to the government's capacity to implement it and to the country's level of institutional development.

As the SAPRI Uganda report concludes: “Poverty must be conceived as an economic, political and social process whereby the three aspects reinforce each other to defy conventional approaches to poverty alleviation. Assumptions that only a small percentage of people are adversely affected by adjustment policies and can therefore be provided with safety nets masks the need for structural changes that go beyond financial provisions.” (SAPRI Uganda, p. 29)

These lessons are being increasingly integrated into World Bank practices. They are at the core of new development instruments such as the Poverty Reduction Strategy Papers and Poverty Reduction Support Credits. This approach to Bank assistance is based on a country’s own vision and strategy for poverty reduction. It is also underpinned by extensive economic analysis, including an assessment of the country’s development policies and its public financial accountability arrangements. These are developed within better-defined Country Assistance Strategies.

Finally, the SAPRI studies also confirmed that there are gaps in our knowledge on the effects of structural adjustment policies on poverty and social indicators. The World Bank has since started further research on macro-micro linkages, i.e. how a broad macroeconomic program such as public expenditure reform trickles down into poverty reduction, and on the notion of empowerment.

3.2. Impact of Financial Liberalization

In many developing countries, financial liberalization is a deliberate attempt to move away from using financial controls to fund fiscal imbalances and subsidize priority sectors. Financial controls reduce private financial savings, limiting the resources available to finance capital accumulation. From this perspective, financial liberalization enables developing countries to stimulate domestic savings and growth and reduce excessive dependence on foreign capital flows. Worldwide experience suggests that financial liberalization—in order to be effective—must be linked to strong institutions, characterized by effective law enforcement, an efficient bureaucracy, and measure to control corruption. These factors underline the importance of emphasizing institutional development early in the liberalization process.

Pre-liberalization

Before reform policies were implemented, all SAPRI countries imposed controls over interest rates as well as a variety of lending directives, rediscount facilities or special lending schemes designed to increase the volume of bank credit extended to priority sectors such as agriculture. Government ownership of banks was important in all six countries; the private sector had a minimal role, or no role at all.

The SAPRI countries, like other developing countries, suffered from weakness in their financial infrastructure. A well-functioning financial system requires a range of supporting institutions—such as enforcement of property rights, prompt disclosure of accurate information, and good quality supervision—which provide incentives and enable market participants to limit excessive risk-taking and fraudulent behavior.

In Hungary, government-owned financial institutions had a monopoly of formal sector financial markets and new bank entry from the private sector was not allowed. Banking provided a form of quasi-government financing for state-owned enterprises, rather than genuine financial intermediation. The other five countries had mixed banking systems comprising government and private sector banks, or joint ventures between government and the private sector. Government-owned banks were expected to pursue non-commercial objectives, such as lending to state enterprises and non-profitable small farmers.

There are typically several causes of banking crises[3], and many of these factors were found in the SAPRI countries: macroeconomic shocks; poor management and microeconomic deficiencies; and deficiencies in the infrastructure of legal, regulatory and supervisory arrangements (SAPRI Bangladesh, p. 53). It appears that the distress of most government commercial banks in all SAPRI countries were as a result of non-commercial principles that undermined their solvency, while macroeconomic shocks seem to have severely affected Ecuador's financial system.

Liberalization: what financial sector reforms were implemented in SAPRI countries?

The SAPRI countries began their reforms from different starting points, mainly because they experienced different levels of financial repression or financial sector inefficiency. In most of these programs liberalization began alongside institutional reforms to the prudential systems and the distressed banks, but the institutional reforms, and in particular the reform of distressed banks, took much longer to implement than removal of administrative controls.

The reforms were designed to build more efficient, robust and deeper financial systems. Interest rates were liberalized in all SAPRI countries. This took place in a phased manner over several years, beginning with administered interest rates being raised before partial and then full liberalization. Only in Hungary were entry restrictions liberalized under adjustment policies. Bangladesh, Ghana and Uganda all licensed private sector banks and financial institutions during the 1980s before their reform programs began, at a time when prudential requirements on new entrants were low.

New banking legislation, including stronger prudential regulations, was enacted in all six countries and was accompanied by institutional reforms to strengthen the supervisory capacity of central banks. All the SAPRI countries implemented measures to tackle financial distress in their government-owned banks, including recapitalization and reforms to the management and operations of these banks.

[3] See Demirguc-Kunt and Detragiache (1998) and Honohan (1997).

Post-liberalization: achievements and questions

a) Have reforms enhanced the efficiency of financial intermediation?
One of the objectives of financial sector reforms is to boost financial depth, and therefore increase the resources available for financial intermediation. The impact of the financial sector reforms on financial depth, as measured by liquid liabilities of the financial system as a percentage of GDP, varied between countries. As can be seen in Table 1 (see annex), financial deepening did take place in Bangladesh, Ecuador, Ghana, and Uganda. In contrast, Hungary and Mali did not experience an increase in financial depth.

In all SAPRI countries the reforms facilitated new entry, mainly by the private sector, into banking markets. The number of banks and financial institutions increased and the dominant market share of the major banks eroded, although it remained large. There was significant bank privatization in countries like Ecuador and Hungary.

b) Impact of the reforms on lending
An objective assessment of whether the financial sector reforms have actually brought about a more efficient allocation of credit is very difficult.[4] Examining the volume of bank credit to the private sector on the grounds that the private sector is assumed to use resources more efficiently than the public sector might be a good indicator of improvements. Figures in Table 1 indicate that bank credit to the private sector as a share of GDP increased in all countries except Mali.

The financial sector reform programs have led to substantial improvements in the regulation and supervision of the financial system in all SAPRI countries. Legislation and supervisory capacities were strengthened, and while deficiencies remain, prudential supervision is now taken seriously in all the LDCs. Direct controls on bank credit have been eliminated and market-determined interest rates established.

The institutional characteristics of most SAPRI countries created a number of specific issues. For example, while adjustment reforms require interest rate liberalization and increases in government borrowing as opposed to monetizing the deficits, this created a situation in which the government and the private sector compete for scarce funds in the oligopolistic banking sector, and resulted in sharply higher interest rates (see SAPRI Bangladesh, pp. 55-56). Higher interest rates, coupled with instability, devaluation, government spending cuts, and trade liberalization, had a negative effect on investment.

Some observers have also argued that the revised prudential legislation in SAPRI countries, as in other developing countries, incorporates regulations modeled on those of the industrialized countries. These may not necessarily be adequate for developing countries where accounting standards are weaker and economic conditions are less stable (Dziobeck, Frecault and Nieto, 1995). Most important, however, is the implementation of these rules, not simply their adoption.

[4] Ideally one would need data on private and social rates of return earned by borrowers, plus a counterfactual with which to make a comparison. Such data are not available.

c) Has financial liberalization contributed to financial crisis?
Some observers have argued that financial liberalization, specifically liberal licensing criteria and the decontrol of interest rates, may contribute to financial crises if undertaken too abruptly or if poorly sequenced with other reforms (Alawode and Ikhide, 1997). Liberalization of interest rates probably contributed to distress in private sector banks, where nominal lending rates rose to more than 100 percent following liberalization and undoubtedly made lending much riskier. In Bangladesh, Ecuador, Ghana, Mali and Uganda, private banks were licensed at a time when prudential criteria for entry, such as minimum capital requirements, were low, other prudential regulations were deficient and supervisory capacities were weak (SAPRI Bangladesh, pp. 59, 68).

Financial liberalization itself was not a significant contributor to the distress afflicting the government-owned banks. Their distress was chronic and pre-dated financial liberalization in all SAPRI countries. Nevertheless, operating alongside undercapitalized banks subject to lax prudential regulations undermines incentives for all banks in the system, and liberalization provides new risk-taking opportunities. High respect for the rule of law, low corruption, and good contract enforcement are found to be especially important institutional characteristics.

Summary of the lessons learned

The impact of the financial sector reforms implemented in SAPRI countries has been generally positive, but less impressive than expected. Progress has been limited because some of the reforms, such as the restructuring of governance systems, proved very difficult to implement and the supporting legal and regulatory institutions necessary for a well-functioning financial system remained underdeveloped.

Most countries—except Mali—experienced some financial deepening and greater amounts of credit were allocated to the private sector. Privatization progressed slowly in most countries although there has been some new entry that brought benefits in terms of improved services and wider access to credit. Nevertheless, financial liberalization coupled with unstable macroeconomic conditions and poor financial infrastructure led to crises in a number of countries. A period of instability in financial markets appears to be inevitable during the transition to financial deregulation, which then makes the management of monetary policy during financial sector reforms extremely difficult, especially in poor countries such as those represented in the SAPRI exercise.

Nevertheless, progress has been made on reforms to the prudential system in SAPRI countries, where legislation has been brought up to the standards of international best practice and supervisory capacities and procedures considerably strengthened. Still, much remains to be accomplished in improving enforcement (SAPRI Bangladesh, p. 68).

Research and international experience suggest the following lessons:

- Well-functioning markets need a legal and regulatory underpinning and a strategy based on providing the right incentives for all parties;

- Governments are not good at providing financial services, particularly when institutional quality is weak;
- Most developing countries are too small to afford to do without the benefits of access to global finance, including accessing financial services from foreign banks. Of course, bringing national banking to the international banking standards is an equally important learning experience;
- Even in the most developed financial systems, information problems and relatively high fixed costs limit the access of small or micro-enterprises. Market-friendly measures are often the best way to improve access for these small borrowers. For example, registries for land and credit could help them greatly to establish collateral in obtaining small loans;
- Good safety nets require good institutions to function well, and developing countries with poor institutions should resist the urge to imitate mature systems when considering deposit insurance.

In addition to these global lessons, the experience in the SAPRI countries also bring to light some challenges that must be confronted in implementing a financial liberalization program:

- If groups were privileged under the previous financial system—for example, certain firms or people could obtain credit without proper verification—they are likely to oppose any reform, since that would likely mean a loss of privileged access for them.
- Financial liberalization is never easy and can be discredited by incidents of corruption and favoritism;
- Financial liberalization can increase vulnerability to external macroeconomic shocks and therefore, it is important to ensure that it is accompanied by regulatory and macroeconomic reforms.

3.3. The impact of privatization

Privatization, or the transfer of state assets to the private sector, has often been a part of structural adjustment. Privatization sometimes has multiple objectives, including reducing public expenditure, re-focusing government on its core role of providing public goods, increasing the level and efficiency of investment in the economy, and providing income for the treasury to help cope with short-term budget deficits.

Some of these objectives directly contribute to fiscal stability, a central component of any structural adjustment program, by either reducing government expenditures in the form of subsidies to state-owned enterprises or increasing government revenues through the sales receipts and future tax contributions of the privatized firms. Privatization can also be part of a longer-term strategy to increase economic efficiency and reduce the role of the state.

Privatization policies

It is virtually impossible to lay out a single set of proposals that would work for all countries. However, worldwide experience suggests some broad lessons that can make it more likely that privatization is implemented successfully:

- Privatization is a means to an end, not an end in itself. That is, the purpose of privatization is to encourage the economically rational use of resources;
- To achieve this an economy will need to ensure that economic actors have the correct incentives. Ownership structure alone may be insufficient to ensure improved performance if other distortions (such as market or price restrictions, and poor banking policies) are maintained;
- Other measures such as macroeconomic reforms, liberalization of trade, effective regulation of the financial sector (to ensure a hard budget constraint for all firms), improvement of infrastructure services and improvement of the business environment are necessary complements to any privatization strategy;
- Whenever possible privatization should seek to establish a competitive market structure;
- When competition or the threat of competition is not possible, arrangements for appropriate regulation must be put in place;
- Privatization should be carried out in a transparent manner, with policies and procedures clearly stated, widely publicized and scrupulously followed;
- Like any significant economic change, privatization may have social repercussions, especially for current employees of state-owned enterprises, at least in the short run. It is important to recognize this and design ways, both organizational and financial, to lessen the potential negative impact on employees and their families, particularly when no public safety net exists.

Privatization outcomes

The outcome of privatization was uneven in the SAPRI countries, with some successes and some disappointments. In telecommunications, the most commonly liberalized or privatized infrastructure sector, all the countries, with the exception of Mali, have either privatized or allowed private sector entry and reaped substantial investments (see Table 2, annex). The effect of the investments have been dramatic, with those countries that opened the sector to significant foreign ownership and a competitive structure in the sector (Hungary, Ghana and Uganda) gaining the most (see Figure 1, annex).

The transfer of state enterprises has been done in several ways and with varying levels of transparency. Transparent sale techniques include open auction, competitive sale of shares or assets, public flotations and (usually) liquidations. Less transparent techniques have included direct negotiation or placement of shares or assets, loans for shares and management buyouts. Voucher privatization, a technique unique to the transition economies, promised great transparency but in practice often allowed for concentration of ownership by insiders and state-owned banks. Public perception of the results of privatization has been heavily influenced by perceptions of its transparency.

In the SAPRI countries where privatization has been more successful, governments have divested more, especially in competitive sectors. Privatization has allowed for increased competition in sectors where state enterprises used to enjoy protection and monopoly powers. It has opened the market for more firms to compete, reduced protection from imports, and reduced formal and informal barriers to entry.

Issues raised in SAPRI assessments

a) Privatization and market structure

Many enterprises that were privatized in the 1990s in the SAPRI countries operated in monopolistic or quasi-monopolistic markets and produced goods and services with a strong implication for welfare—electricity, telecommunications, water, post, railways and energy. The fear expressed was that public welfare might be negatively affected if governments are concerned only about efficiency and reducing costs. Since many of these enterprises are monopolies, the new private owners may raise prices substantially above the marginal costs and reap monopoly profits. This would affect customers, especially the poor. The Hungary SAPRI study notes that after privatization and the associated commercialization of products, prices increased continually. For example, the price of household consumption of electric energy in 1998 was ten times higher than in 1989, which caused profound difficulties for families living on or below the subsistence minimum. (SAPRI Hungary, p. 32)

However, this has not been the case in most SAPRI countries. Only Hungary privatized substantial portions of its infrastructure, other than telecommunications. In the other five countries, infrastructure other than telecommunications is still state-owned, although there are current efforts to privatize some sectors. These countries are now finding that these are exactly the areas (particularly electricity and transport) constraining investment and growth. Bangladesh faced a power crisis in 2000; Ghana, a former exporter of energy, has had to import from Cote d'Ivoire to avoid power outages; Uganda put its state power company under a private management contract to avoid large commercial losses.

In assessing the effects on the poor, it must also be realized that, apart from Hungary, the SAPRI countries also have some of the lowest levels of infrastructure services in the world. Power was available to just 28 percent of the population in Ghana (1993), 25 percent in Bangladesh (1997), 7.6 percent in Mali (1996) and 6.9 percent in Uganda (1995) (World Bank 2000b). Since the poor do not have access to many of these services at all now, it is difficult to argue that privatization would worsen their situation.

b) Improvement of performance

In some SAPRI countries the level of efficiency has not improved even after privatization**.** Civil society organizations in Hungary and Bangladesh, for example, believe that privatization has not created an internationally competitive group of domestic entrepreneurs (SAPRI Hungary, p.29; SAPRI Bangladesh, p. 77). They also maintain that foreign owners have too big a role, and the share of employee or cooperative ownership is too low (SAPRI Hungary, p. 29).

c) Privatization and labor

The SAPRI assessments report a high level of concern over the reduction of employment under privatization as new managers seek to restructure, minimize costs and change the terms of employment from permanent tenure to one based on performance and profitability. This concern is understandable, as many of the affected workers in these economies have never faced the possibility of unemployment before. Combined with a period of economic contraction, which is usual in most countries undergoing adjustment, the lack of alternative employment becomes even more stressful.

While it is rarely any consolation to the affected workers, it is important to understand that, in most of these situations, job loss was inevitable regardless of the identity of the owner. As the Ghana report notes, more than 150,000 workers lost their jobs in the 42 largest state enterprises between 1984 and 1991—before any of the firms were privatized (Bangura, 2000). Continuing the very high levels of employment in the firms was simply unsustainable.

In some of the SAPRI countries, privatization has also been associated with job insecurity and loss of social benefits. There is no question that the shift from secure, state-sector employment to a more dynamic, productivity-dependent system has lowered job security, particularly for poorly performing workers. Permanent workers are sometimes also replaced by short-term contract labor. Generally this occurs when labor regulations are overly generous, making it very difficult to dismiss workers and seriously undermining the flexibility of firms to respond to market conditions. When it is extremely difficult or costly to dismiss workers, managements may not hire more people or do so only on short-term contracts even when the market is strong and the company could usefully employ more workers, as a way to protect the firm when market conditions change. The role of the state is to help ensure a balance between the need of firms to vary their employment and reasonable job security (or severance payments) for employees.

d) Transparency and corruption

Some of the SAPRI reports argue that the sale of public enterprises was not done in a transparent manner (SAPRI Uganda, p. 5; SAPRI Bangladesh, p. 78). In more than one country the failure to carry out privatization through open tender led to public suspicion that the valuation of the firms was not done properly due to corrupt practices. There are two issues here which need to be dealt with separately: the valuation of enterprises before privatization and the possibility of corruption in the process.

Valuation of an enterprise is difficult because the value of the firm must be estimated in a number of scenarios, including book value, liquidation value of the assets and the value of the firm as an ongoing business (the discounted value of future cash flow).

We must also recognize that corruption can be, and has been, a significant problem in some privatizations. The potential personal gains, and thus the temptation, from corruption in privatization can be very large—but clear, transparent processes which include all important steps taking place in public can mitigate this problem. It is not impossible to ensure transparency even in countries that have had difficulties with corruption in the past. Uganda's sale of its telecommunications company is a case in point. Despite allegations of corruption in other parts of its privatization program, the Ugandan government implemented a very transparent process in difficult circumstances and finally privatized the company without any claims of corruption.

e) Effects on equality and foreign ownership

Some of the country reports also associated privatization with negative social impacts such as inequality, ethnic and regional imbalance and loss of a strategic resource to foreign interests. The Hungarian report argues that privatization increased polarization between rich and poor and failed to engender a strong middle class (SAPRI Hungary, p. 26). To some degree the highlighting of differences was bound to result from any movement to a market economy as returns to skills and effort begin to dominate the economy. However it is interesting that one of the best-known Hungarian economists, Janos Kornai, has argued, contrary to the SAPRI report, that the great success of Hungarian reforms has been the creation of a middle class through the growth of a strong and vibrant small and medium-size sector (Kornai, 2000).

The Hungarian report, in particular, also raises the issue of foreign ownership following privatization. Specifically, it argues (SAPRI Hungary, p. 28) that the ratio of foreign ownership in Hungary is very high by international standards, with the proportion of foreign capital exceeding 50 per cent in almost all industrial sectors. That noted, Hungary is one of the few countries that has been able to attract very high levels of foreign investment due to its proximity to western Europe, high level of education and relatively good economic policies. The country seems to have benefited from large amounts of investment, and as the report states, growth has improved in areas in which foreign firms have concentrated.

Summary

The SAPRI country reports have raised a number of important issues dealing with privatization. For example, privatization clearly has the downside of causing lay-offs, with the consequent pain of the employees involved. Lay-offs in some firms also contribute to insecurity throughout the labor force. Clearly, privatization is in this respect far more than a technical, economic measure. It often changes the rules that have governed society in a profound manner with all the accompanying social costs. More broadly, concerns center on market structure and regulation, the performance of firms after privatization, the degree of transparency and the potential for negative effects on equality and national security.

3.4. Structural Adjustment, Agriculture and Rural Livelihoods

From the early 1980s, many governments in developing countries moved to rely increasingly on markets, including in the area of agriculture. They dismantled institutions and removed interventionist mechanisms such as marketing boards that came to be viewed as impediments to growth, unworkable or unaffordable. The process of reforming markets often took place in response to economic crises.

These reforms, including the World Bank's structural adjustment lending program, often resulted in new market incentives. The new incentives no longer relied on government sponsorship, as did earlier failed policies. However, they led to a shift in the value and use of resources with social and economic consequences that were not fully anticipated or planned. At the same time, the removal of one set of obstacles to growth revealed other, more deep-seated obstacles.

Pre-liberalization

When the Bank's structural adjustment program in the SAPRI countries began, several types of interventions were common that had important implications for agriculture and rural families. At the macro level, exchange rates were over-valued in a number of developing countries, to the disadvantage of export crops. In some instances, central banks operated multiple exchange rates that encouraged food imports at the expense of local producers. Trade monopolies were common for exported crops and frequently for imported food as well. Prices for key consumer and producer goods were often set by government mandate. Transportation costs were sometimes ignored and one price fixed for an entire region or country. Some inputs (for example, imported seeds or farm equipment) were restricted or heavily taxed, while other inputs (such as water and fertilizer) were often subsidized.

Liberalization

Reforms usually began when sudden and often unpredicted political and economic events led to fiscal crises so severe that external funding was needed to keep the economy functioning. In turn, policy-makers emphasized structural reform rather than stabilization, in part because of the mounting evidence that past policies had been ineffective and could not be sustained. It also resulted from an evolution in development economists' thinking about the importance of agriculture to economic development and the capacity of government institutions. Further, declining world commodity prices during the 1980s and 1990s, generated by changing production, transportation and information technologies, brought increasing pressure to bear on marketing boards, international agreements and related interventionist instruments.

Post-liberalization

Structural adjustment loans are not necessarily intended to spur growth in agriculture, but rather to improve overall economic performance. In its own evaluation process, the World Bank rarely considered sector growth as a measure of success for adjustment loans. However, in some specific cases, loans were expected to lead to increased agricultural output by removing constraints. Meerman (1997) reviews specific agricultural adjustment lending that was expected to improve conditions for smallholder producers and result in expanded production.

In a book that focuses on commodity market reforms (Akiyama, Baffes, Larson and Varangis, 2001), the authors consider the effect of reforms on the share of export price received by smallholders. For coffee and cocoa, they find that the share of the world prices that farmers received improved dramatically following reform. This was in part due to the removal of explicit export taxes and partly to increased competition among exports following the end of marketing board monopolies. Because coffee and cocoa are exported, gains in farm incomes do not imply an equivalent loss by domestic consumers. Experiences for sugar and food grains were more complicated and the results less clear, due in part to the nature of the interventions. The authors do find cases where both producers and consumers appear to have gained from reduced marketing costs (Kenya, Mali, Zambia and Zimbabwe). Often, however, reforms resulted in shifts between consumers and producers (Jayne, Negassa and Myers, 1998 report a similar finding for Ethiopia). The authors point out that this tradeoff is not necessarily between urban and rural households, as many poor rural households are net consumers of food grains.

SAPRI issues

Even though liberalization in the agricultural sector was long overdue, some of the policy decisions in the SAPRI countries might have been too abrupt and the benefits might have been higher if they had been more gradual. For example, fertilizer reforms involved the full removal of subsidies in nearly all countries. In Ghana, while the Cocoa Board found that agro-chemicals are economically viable, farmers had a strong case when they claimed they could not afford them. Swift (1998) argues that a two-year increase in cocoa prices of 107 percent in Ghana was outstripped by an increase in the price of insecticides of 657 percent, fungicides of 250 percent and spraying machines of 400 percent. The removal of subsidies and devaluation of the *cedi* made these inputs unaffordable for most farmers (Swift, 1998). A more gradual abolition of subsidies might have been preferable.

Agricultural liberalization in Mali had many of the effects it was designed for: production and investment decisions were decentralized to the level of production units; production of cotton and cereals increased and became more diversified; production returns and investment rose. In social terms, decentralization strengthened local organizations. In some cases this led to greater social tensions: empowered local leaders of "technical" associations clashed with traditional village leaders or employed favoritism to allocate credit. Two additional negative aspects were observed. Although access to credit has been made easier, this led some farmers to accumulate excessive debt. Second, environmental degradation has not been halted. As a whole, the program can be considered very satisfactory. It created greater opportunities and also empowered people through decentralization and educational programs (SAPRI Mali, pp. 32-39).

Overall, these issues suggest three directions:
- A step-by-step approach to adjustment that focuses on institutions;
- A continuing support for agricultural infrastructure;
- Safety nets for poor farmers, and a recognition that small farmers may experience short-term problems, as was the case in Bangladesh.

Other factors

Even though recent reforms in SAPRI countries have improved agricultural price incentives, the effect has been undermined by the failure of some governments to address other structural and institutional constraints. These include rural infrastructure (irrigation, roads, power and telecommunications), agricultural research and extension services, the decline in human capital formation in the countryside (because of decreasing school enrolment ratios) and farmer education and health (see Binswanger 1993; SAPRI Uganda, p. 47). All these make the turnaround in agriculture a distant prospect (see also SAPRI Bangladesh, pp. 93-94). More specifically, the Uganda SAPRI study (p. 7) points out that liberalization can stimulate production but it can have its full effect only if it is accompanied by other factors, such as good infrastructure, free flow of market information, and security of land tenure

Nonetheless, Appleton (2001) uses survey evidence from Uganda to show that poverty levels dropped significantly following reforms. Moreover, in rural households poverty fell most sharply among smallholder producers of export crops–primarily coffee— following liberalization of this subsector. Appleton notes that while the household and sector data were consistent, the result differed from perceptions registered in participatory surveys. Using the same survey, Deininger and Okidi (2001) found that changing price signals did bring about changes in household production and input use. They also stressed the gains to education as well as the accumulation of physical capital from liberalization of the agricultural sector.

Factors that limited the benefits of reform

Economic theory, as well as a large body of empirical work (see Binswanger, 1992), indicate that on the whole, agricultural output tends to respond to changes in prices, although the time frame of the response matters a great deal. There is a time lag before the accumulated effects of reforms that successfully encourage investments in people and physical capital take effect. Thus, for a number of the adjustment programs attempting to operate through aggregate price levels, the limited supply response observed is compatible with the short time horizon over which impact has been evaluated.

Other factors have weakened or derailed even a longer-term supply response. One is the lack of credibility of government commitment to sustain the reform. In the absence of credibility, entrepreneurs and farmers will not fully adjust their decisions on investment and planting to the new prices, in anticipation of reversals (Aymo and Weder, 1994, Pinstrup-Andersen and Pandya-Lorch, 1994).

Another important set of factors is related to the mutual dependence between price-responsiveness and the extent of physical infrastructure (roads, communications, power, irrigation), human resource infrastructure (level of farmers' knowledge, quality of agricultural extension, quality of agricultural research system), and the institutional support apparatus (credit system, marketing and input supply system). If many of these infrastructure and institutional factors are deficient, the response to changes in the relative prices is bound to be weak. The abrupt dismantling of parastatal marketing organizations could imply a prolonged period of vacuum, as private sector marketing services emerge slowly. Akiyama, Baffes, Larson and Varangis (2001) provide a positive example from Uganda, where the regulatory and quality control functions of the existing marketing board were separated from its marketing function. The newly formed marketing company maintained a continued presence in the market, but without monopoly status. Private traders emerge quickly, and by the third year the former state organization had lost its market share.

Summary of the lessons learned

The SAPRI experiences highlight some of the difficulties of agricultural liberalization:

- Higher food prices, while benefiting many producers, also affected consumers, particularly low-income groups;
- Market forces were quickly unleashed in ways that may have hurt small farmers with low productivity or who are geographically more isolated;
- Rapid increase in input prices has led to higher debts for small farmers in some countries.

The lessons for future policies are that agricultural adjustments are complex and require a sequence of modest steps. Safety net policies must be in place for small farmers who are most affected by changes in markets and who have neither the flexibility nor the financial security to quickly adjust to changes in commodity market prices. Finally, the infrastructure for agriculture needs greater attention during liberalization.

3.5. Impact of labor deregulation

Labor deregulation has not been a major component of structural adjustment and is not even mentioned in some of the SAPRI reports. This was not due to a perception that labor markets were highly efficient in developing countries and transition economies. For many in the development community, labor markets were rigid and distorted, and could undermine the outcome of other structural reforms. High unemployment, and especially the rising level and continuous presence of informal employment, were often attributed to excessive and inappropriate labor market regulation.

Labor market distortions, many of them induced by government regulations, were blamed for making labor too costly and risky relative to its abundance in the economy. If labor costs cannot vary freely in response to changes in demand, reforms in other areas of the economy could lead to a decline in output, at least temporarily. In times of negative shocks, a flexible labor market minimizes the rise of unemployment, thus promoting a timely recovery. When the economy is booming, labor market flexibility guarantees that output growth is accompanied by full employment and rising real wages. From this perspective, labor market deregulation is supposed to make the market adjust efficiently to changes in overall demand.

Pre-liberalization

Governments intervene in the labor market in four main ways. First, they may establish minimum levels of pay and benefits. Depending on the country, minimum wages may be set at the national level, or for specific industries and categories of workers. The level of minimum wages may also be unilaterally decided by government, or through negotiation or consultation with employers associations and labor unions.

A second set of regulations has to do with movement in and out of jobs. Before labor market reforms, the SAPRI countries had legislation that imposed constraints on hiring and firing. Collective bargaining is a third set of issues that can be affected by government regulations. Some countries lack appropriate mechanisms for the peaceful resolution of labor disputes, and some even seem to encourage them. In Ecuador, legislation required that workers be paid even when they were on strike. Such legislation could have induced labor stoppages by making one party bear most of the costs.

Finally, governments may affect the labor market equilibrium through their own employment and pay policies. While public sector employment may represent a small share of the labor force in most developing countries, it accounts for a very large share of wage employment. In some countries, the share can be overwhelming among the skilled. As a result, "queuing" for public sector jobs is common among the educated, and may lead to abnormally high unemployment rates among urban youth. The resulting wage bills became unaffordable by governments confronted with adverse external shocks. They are then forced to reduce public sector salaries or cut the workforce

Liberalization

Efforts to reform the labor market affected all four areas of government intervention. They must be judged based on indicators that involve both policy instruments and outcomes.

Many governments favored an implicit erosion of minimum wages and mandated benefits. In Bangladesh, minimum wages for many industries were not revised during the adjustment period, due to the emphasis on reducing government intervention in the labor market (SAPRI Bangladesh, p. 99). In transition economies like Hungary's, wage liberalization and deregulation was meant to ensure that the assessment of the market and competition rather than administrative regulations determine employment levels (SAPRI Hungary, p. 18). As a result, the minimum wage increased much less than average wages. Moreover, the scope and value of welfare and social benefits dropped during the adjustment process. The guiding principle was to bring the proportion of total compensation represented by family allowances, child-care benefits, subsidized daycare and similar measures in line with that in western Europe (SAPRI Hungary, p. 19). In practice, the reduction of mandated benefits was not offset by an increase in cash earnings, resulting in a fall in total compensation.

Post liberalization

Labor market reform efforts had effects on both employment and labor earnings. However, it is often difficult to disentangle those effects from those resulting from other components of structural adjustment programs, such as trade liberalization. Reductions in tariffs and non-tariff barriers may lead to job losses in the short run, much the same as public sector downsizing. On the other hand, increased economic efficiency should be associated with job creation, especially in labor-intensive activities with a high export potential. Because job destruction proceeds at a faster pace than job creation, unemployment may increase, at least temporarily. In principle, in a flexible labor market a rise in unemployment could be avoided through a temporary reduction in equilibrium wages. But even in the absence of government-induced labor market distortions, wages may not be fully flexible.

The experience of SAPRI countries reveals mixed patterns of changes in employment after liberalization. In Bangladesh, the impact was mildly negative. During the reform period, the unemployment rate increased from roughly 2 to 2.5 percent, but both figures are remarkably low by international standards (SAPRI Bangladesh, pp. 100, 109). In Ecuador, on the other hand, the unemployment rate increased steadily, from 9 percent in 1992 to more than 14 percent in 1999. The share of workers who lost their jobs (as opposed to first-time job seekers) started growing in 1991, when labor market liberalization took place. In Uganda, there is evidence of an improvement in employment levels during the privatization period. In between these two extremes, Hungary saw its unemployment rate soar at the beginning of the transition, and reach a peak in 1992. Since then, the number of registered unemployed gradually decreased. Hungary's unemployment rate is now somewhat lower than that in western Europe.

Structural adjustment has also been associated with changes in the composition of employment. The female share increased in many cases. This change may reflect deep social and demographic trends. But it may also be due in part to structural adjustment policies. In Bangladesh, female employment increased because of the growth and expansion of the export-oriented textile industry, which employs mainly women (SAPRI Bangladesh, p. 116).

Issues from the SAPRI process

The labor market interventions associated with structural adjustment have been questioned on several grounds. First, it has been argued that economic reforms have led to job losses and a smaller formal sector. In Ecuador, the share of workers who have a contract and are enrolled in social security reportedly declined after labor market deregulation (SAPRI Ecuador, p. 16). It is, however, more likely that this resulted from the economic crisis itself than from the labor market deregulation. In Bangladesh, despite slower growth in average wages, the manufacturing sector failed to absorb surplus labor from rural areas and the employment expansion did not keep pace with the growth of the urban population. Here again, this might have been worse without labor market regulation.

A second, frequent issue concerns the impact of public sector downsizing. Privatization and layoffs are often viewed as a source of increased poverty. Observers admit that the laid-off workers may not be counted as poor on the basis of minimum caloric requirements, because they may use severance pay to maintain their basic consumption level. Nonetheless, the sufferings and insecurity faced by these workers should not be ignored simply because they do not fall below commonly used poverty thresholds.

Finally, public sectors were also reduced without proper consideration for gender issues. Female workers may bear a disproportionate share of job losses, and they may suffer other effects as well. The gender gap in pay tends to be lower in the public sector than in the private sector, and, as a result, the drop in earnings that follows public sector downsizing is larger for women than for men. Moreover, the public sector usually offers benefits highly valued by women, such as maternity leave, flexibility in working hours, and daycare facilities. The loss in total compensation suffered by women is thus potentially larger than the more easily observable loss in earnings. In cases like Bangladesh however, the reduced pressure on government jobs has boosted the private sector, often to the advantage of female workers.

Summary of the lessons learned

The main issues emerging from the SAPRI process include:

- Some aspects of economic reform have been associated with job losses;
- Public sector downsizing in some SAPRI countries has led to under (and over) compensation, unproductive training programs, and adverse effects on female workers.

Both these lessons have been dealt with in the practice of the World Bank. The first concern, i.e. job losses, is probably well taken. However, many of the jobs lost due to economic reforms were "artificially" good and carried a cost to society as a whole. The cost was especially high for the poor, if high levels of pay and benefits were a deterrent to job creation. There are limits to the improvements to job quality that can be attained though legislation. Those limits are well addressed in the Bank's 1995 World Development Report, *Workers in an Integrating World* (World Bank, 1995).

The second issue is addressed in the present work of the donor community, including the World Bank. We have learned from past mistakes, and a more careful protocol for public sector downsizing operations has gradually emerged (Kikeri, 1997; Rama, 1999). This now includes special attention to gender considerations (Rama, 2001).

3.6. Impact of trade liberalization

Reforming trade and exchange rate policies has been a central feature of structural adjustment programs, including those introduced in the SAPRI countries. As discussed below, trade liberalization has contributed to improved trade performance, measured in terms of export growth, and to some export diversification. It has also been accompanied by increases in imports primarily driven by private consumption.

Pre-liberalization

Before trade was liberalized as part of structural adjustment, the SAPRI countries, like many other developing economies, suffered from balance-of-payments problems. Their exchange rates were overvalued, imports of goods were subject to high tariffs and most industries enjoyed strong protection.

The overvalued exchange rate policy encouraged imports, as less money was needed to buy foreign goods and discouraged exports as the margins of exporters were low. Importers in countries with overvalued currencies faced rationing of foreign exchange. The imbalance between exports and imports and the deteriorating terms of trade contributed to an increase in external indebtedness (SAPRI Ghana, p. 23).

Barriers to imports, which resulted in anti-export bias, were pervasive in the pre-adjustment era. Tariff rates were high and dispersed, partly due to governments' dependence on this source of budgetary revenue and partly to the prevalence of statutory and ad hoc exemptions, which benefited mainly individuals with political connections. Quantitative restrictions and high tariffs on consumer goods ensured that inefficient industries producing for the domestic market could pass their costs on to consumers. Pre-reform protection levels supported inefficient enterprises at enormous cost to the economy.

Trade Liberalization

Faced with a worsening balance of payments in the 1980s, the SAPRI countries, along with other developing and transition economies, initiated reforms to liberalize their international trade regimes. The goal of liberalization was to remove policies impeding export competitiveness, particularly with respect to the manufacturing sector, improve resource allocation and boost integration into the global economy (see Table 4.1, SAPRI Bangladesh, p. 36). Ultimately, the belief was that more liberal regimes would lead to faster economic growth.

Generally, the reforms have had a substantial impact on the overall availability of goods and services on the local market as well as inputs to local industry (SAPRI Ghana, p. 13; SAPRI Hungary, p. 20). Bureaucratic and cumbersome foreign exchange rationing is a thing of the past, easing availability and access to foreign exchange for local businesses. The reforms have also helped to boost exports, enhanced technology transfer and improved efficiency and quality of the products of local producers. In that context, trade policy reforms are perceived to have succeeded in exposing Ghanaian firms to greater international competition to the benefit of consumers (SAPRI Ghana, p. 13).

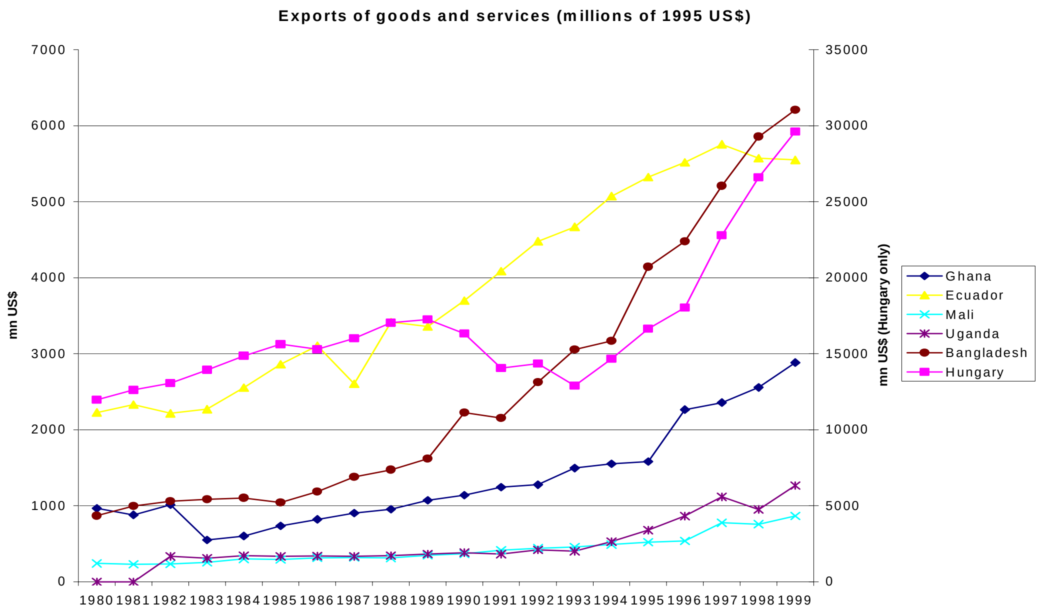
Reforms included: elimination of quantitative restrictions on imports; replacement of specific tariffs with ad valorem tariffs; removal of special concessions and exemptions; simplification of the tariff structure; reduction in effective protection and disparities in protection across sectors; removal of export taxes and subsidies; and abolishing export monopolies. These changes were to be accompanied by domestic currency depreciation combined with appropriate macroeconomic policies to eliminate foreign exchange rationing (SAPRI Ghana, p. 32).

Post liberalization

In line with the recommendations for structural reform, SAPRI countries significantly liberalized their trade regimes. The reforms improved the efficiency of the traded goods sector, facilitated the importation of inputs needed for industrial production, and encouraged growth and diversification of non-traditional exports. The chart on next page presents the export performance of the group over the past two decades. All six countries experienced a significant increase in their exports of goods and services during this period. Annual export growth rates were about 5 percent or more (the corresponding number for high-income OECD countries was 5.3 percent), due to the countries' reforms as well as improvements in the global trading system. The best performer, Bangladesh, saw its exports increase more than sevenfold with the average annual growth rate of 11 percent. All countries, except for Mali, increased the share of manufactured products in their exports. Bangladesh and Hungary were the most successful in this area with the share of manufactures accounting for 89 and 81 percent in the late 1990s, respectively. Finally, five countries experienced a growth in service exports.[5]

Mali has been the weakest performer among SAPRI countries. Nevertheless, it enjoyed an increase in exports from $243 million in 1980 to $866 million in 1999 (in constant 1995 dollars). It has, however, remained highly dependent on exports of agricultural products and raw materials (mainly cotton, gold and livestock) whose share in total merchandise exports increased from over half in the early 1980s to more than 80 percent in the late 1990s. The poor performance of manufactured exports may have been partially due to the high input and factor costs prevailing in Mali, which in all categories, except for labor, are higher than those in neighboring countries (see Table 3, annex).

[5] Note that the impressive growth rate of service exports in Uganda was partially due to a very low initial level.



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Issues

The country reports contain some concerns about trade liberalization programs undertaken by SAPRI countries. Some observers have stated that the impact of trade reform on exports has been limited. They argue that during the past decade, Africa's share of world manufacturing value added remained below one percent. In addition, they argue that export markets are more competitive today than they were when the high-performing Asian countries industrialized, making development via exports much more difficult. Further, it has been argued that trade liberalization in Africa tends to increase exports, but often only of primary products, which is especially problematic given the declining terms of trade for African products. Moreover, the gains made in the volume and value of exports have been more than offset by increases in the value of imports, leading to an increasing trade deficit (SAPRI Hungary, p. 20). According to the Ghana SAPRI study (p. 43), both macro- and micro-level information provide evidence that trade reforms initially did reverse the decline in the domestic manufacturing sector. However the study argues that the manner in which the trade reforms were implemented—“too fast and too far”—has had an adverse effect on the sustainable growth of firms in the sector.

a) Did trade liberalization have only a nominal impact on the volume and composition of exports?

Absent an in-depth analysis of each country, it is difficult to tell what share of export growth can be attributed to trade liberalization and the removal of the anti-export bias. Nonetheless, it is clear from the table above that all SAPRI countries experienced a significant growth in their exports over the past two decades. As a group, SAPRI countries increased their exports by 179 percent during this period, which compares favorably to a 163-percent change for high-income OECD countries. The best performer, Bangladesh, enjoyed a sevenfold rise in the value of its exports (see Table 4, annex).

b) Has trade liberalization led to unemployment in the manufacturing sector?

One of the most common arguments made by those questioning trade liberalization is that it creates unemployment, especially in the manufacturing sector. The argument is that the removal of trade barriers opens up the domestic market to foreign goods and domestic manufacturing firms are forced to cut employment either to reduce costs or as they acquire labor-replacing machinery in order to compete. Trade liberalization is thus often associated in the public mind with a reduction in manufacturing employment.

This view is reflected in the Bangladesh SAPRI report, which observes that the country experienced an increase in unemployment as import liberalization accelerated. The report states that “while employment in the large- and medium-scale manufacturing sector may have increased, employment in the non-formal industrial sector has shrunk” (SAPRI Bangladesh, p. 52). The shift from employment in the informal to the formal sector should be, however, seen as positive. Moreover, it is worth noting that the rise in unemployment during the reform period could be due to many reasons. They include an increase in new entrants to the labor force; some of the previously under-employed or self-employment becoming unemployed; business failures for reasons unrelated to liberalization; and downsizing of privatized enterprises. The report, however, does not present any evidence to distinguish between unemployment related to liberalization and that attributable to other factors.

Moreover, the report indicates that the overall performance of the manufacturing sector in Bangladesh has improved in the 1990s, with an average annual growth rate of 6.6 percent between 1992-93 and 1998-99 (SAPRI Bangladesh, p. 39). This growth was driven mainly by large and medium-size enterprises. Bangladesh also enjoyed an impressive increase in its exports of garments, a labor-intensive sector in which women traditionally find employment (see Table 5, annex). In many countries, job losses in previously protected industries were offset by jobs created in growing export industries.

On the other hand, the SAPRI report for Ghana does not support the view that trade liberalization had strong employment effects. According to the Ministry of Trade and Industry, the decline in the growth rate of domestic manufacturing is not mainly a result of trade liberalization, but to “a highly depreciated local currency” and “inadequate knowledge and information about export market requirements” (SAPRI Ghana, p. 37). Further, the report states that “for all sizes of firms, limited access to credit stood out as the single most important problem, followed by insufficient demand of markets for their products."

c) Has trade liberalization hurt domestic industries?
The most often voiced concern in the SAPRI deliberations is that import liberalization has resulted in local markets being "flooded" by foreign goods, particularly finished consumer goods, hurting domestic industry and "deindustrializing" the country. The SAPRI Ghana report (p. 31) notes that the inflow of imports adversely affected medium-sized firms, especially the textile industry, which was overwhelmed by competition from cheap imports. This key hypothesis about excessive imports of finished goods, notably consumer goods, has not been tested as part of SAPRI assessments of the impact on industrial capacity and employment.

The poor growth performance of import substituting industries may not have been due entirely to import liberalization but rather to other structural weaknesses and inefficiencies. Some SAPRI country studies, however, appear able to establish that industrial capacity and employment declined, without addressing whether the initial conditions were optimal to begin with. Most critics of trade liberalization and the SAPRI country reports do not question whether the declining industries were operating efficiently and whether the separated workers were gainfully employed.

The SAPRI Ghana study (p. 13) argues that the sequencing of the trade reforms resulted in unnecessary damage to the local manufacturing sector in that radical import liberalization was implemented at a time when local manufacturers faced severe resource and management constraints. When these factors are combined with the exchange rate losses suffered by many firms and the increasingly high cost of credit, it is clear that local firms were unable to adjust to face external competition. The result was that many local firms, especially small and medium-sized enterprises, went out of business (SAPRI Ghana, p. 13).

d) Does trade liberalization have an adverse effect on the poor?
Many cross-country studies indicate that trade liberalization and trade openness increase the growth rate of income and output (Sachs and Warner, 1995; Edwards, 1993 and 1998; Ben David, 1993; Frankel and Romer, 1999). There is also evidence from a large number of individual country studies that "trade does seem to create, even sustain higher growth" (Bhagwati and Srinivasan, 1999). Moreover, research has shown that on average growth in incomes of the poor is related to overall growth of the economy (Dollar and Kraay, 2001). Thus, since trade liberalization promotes growth, it is also good for the poor.

While trade liberalization is expected to help the poor overall, it may have a negative impact in the short run on some vulnerable groups. As a result, policies protecting the most vulnerable groups in society should accompany trade liberalization.

e) Has trade liberalization adversely affected government revenue?
The extent to which trade reform can affect government revenue depends on whether there are large exemptions associated with high tariffs. If there are, then a reduction in

both tariffs and exemptions may keep tariff revenue unchanged. Thus the impact of tariff reform on government revenue may be less adverse than is popularly imagined. Eliminating the exemptions, preferably in the context of medium-term tax reform programs, allows for a more rapid reduction in tariffs.

f) Has trade liberalization been carried out too fast?
The SAPRI Bangladesh report (p. 38) argues that the speed of import liberalization has been faster in Bangladesh than in the rest of South Asia (see also SAPRI Ghana, p. 43; SAPRI Hungary, p. 20). The ratio of post-reform average tariff to pre-reform tariff was equal to 0.26 in Bangladesh during 1989-98 as compared to 0.40 for South Asia as a whole between 1985 and 1998. The study suggests that the content and pace of trade liberalization should be consistent with the country's stage of development, and argues that it should have been much slower in Bangladesh. Yet Bangladesh performed quite well in term of exports and GDP growth.

Moreover, the SAPRI studies do not appear to take into consideration several important points. First, the speed of reduction in customs tariffs was largely a result of the initial conditions. Second, the average customs tariff rates should be judged in the context of the dispersion of the tariff structure, including the share of zero-rated items in total imports. Third, what matters is not just customs tariffs but total nominal protection.

Many of the concerns presented in the SAPRI country reports are not supported by the country-specific data or are contrary to international experience. That does not, however, imply that there is no room for improvement in reform programs proposed by the international financial institutions.

Summary of the lessons learned

Trade liberalization provides the foundation for a more efficient, market-based resource allocation in line with a country's comparative advantage—and is therefore necessary for efficient and sustainable growth. But it is not sufficient. In particular, we have learned that:

- A comprehensive approach is crucial to the success of trade liberalization. In order to elicit a good supply response, such a reform must be accompanied not only by macroeconomic stability and appropriate exchange rate policies, but also by development or strengthening of institutions;
- In addition to increasing their access to the markets of developed countries, developing countries must also focus on removing "behind the border" obstacles to exports (such as infrastructure, transport, and customs clearance facilities);
- Efforts to stimulate growth of the private sector by improving the investment climate will boost the benefits of trade liberalization;
- Finally, the sequencing of the liberalization will ensure that previously protected firms will have the opportunity to adjust.

3. 7. The Impact of Public Expenditure Reforms

The 1990s saw more governments come under intense pressure to change their structures and functions. The World Bank's adjustment policies regarding the public sector involved: fiscal stability, public expenditure allocations, managerial efficiency, capacity building and public accountability. Reforms dealing with fiscal stability apply to all countries, although they may vary across countries. In general, fiscal reforms are the most consistently pursued and have implications for public sector employees, state capacity and social development. They involve issues of downsizing or expenditure reduction, privatization and tax reform.

Policies pertaining to public expenditure focused on reducing and restructuring capital expenditures, reducing subsidies, reforming public employment, cutting the public sector wage bill, emphasizing operations and maintenance of existing facilities, and increasing social sector spending. The ultimate objective was to make the public sector more market-friendly. There are tensions between concerns for market efficiency and deregulation, and issues of accountability, quality of services and equity.

The Pre-Adjustment Period

In the 1960s and 1970s, many governments nationalized large industries and established parastatals because the private sector either was perceived to be too slow to respond to incentives or showed little interest in investing in preferred sectors. Social services were expanded as part of nation-building efforts. Public sector growth was a function of the types of societies various governments sought to promote. For instance, there were often major commitments to the welfare state as a central institution for redistributing wealth, protecting the vulnerable and stimulating demand.

As a result, when public expenditure reform began most countries had a high level of government spending that could not be financed with public resources and a structure of public expenditure not conducive to growth and development. Whether the activities of the expanded government had a negative impact on the economy depended on how the resultant fiscal deficits were financed, and whether the economy was growing enough to support deficits. Studies in the 1970s and 1980s associated excessive fiscal deficits with high inflation, slow or negative growth, imbalances in external accounts and low domestic investment. The need to control budget deficits became a major issue in debates about how to get economies out of inflation and recession and promote the private sector.

Adjustment programs

The general goal of the World Bank was to achieve "a desirable pattern of expenditure shifts" (World Bank, 1992). This generally included an initial move away from capital expenditure, followed by strong efforts to contain the government wage bill, mainly by reducing the numbers employed, and refocusing social spending away from away from tertiary services and toward primary education and health services. A review of the historical trend in expenditure conditions indicates that the advice on capital expenditures was consistent throughout the period (1980-1999).

Social sector expenditures that were not explicitly incorporated in the original expenditure reforms of the 1980s were later addressed through adjustment lending conditions. Education spending was rarely mentioned in the 1980s, but has received greater attention since 1990. Health expenditures were subject to conditions somewhat earlier; the World Bank has argued for increases in health spending since 1986. Conditions on adjustment lending focused on three topics: the overall budget share for health and education; the share of the sectoral budgets devoted to personnel; and the intra-sectoral allocation of resources between tertiary and primary activities. The Bank used its adjustment lending to encourage shifts in spending toward human resource development in general and in particular toward the basic activities that were thought to yield the highest returns for equity and efficiency. A review of World Bank assisted programs found that loan conditions on social sector spending had on average a stimulating impact on social spending (World Bank, 2001).

Post liberalization

Most governments have been able to reduce fiscal deficits to desirable levels either by increasing their revenue base or cutting their spending. As a result, inflation in most countries has come down and the economic environment has become less volatile, developments that came as a relief to the poor who were greatly affected by skyrocketing prices. If the macroeconomic improvements expected from the reforms have occurred, it is worthwhile to also look at the developments in the delivery of two basic services that are critical for poverty reduction.

Health

Among the most notable health sector reforms were introduction of user fee charges, expansion and strengthening of district health services, reducing costs by phasing out institutional cost of feeding in hospitals, reduction of non-technical staff, implementation of essential drug policy, and improvement of drug management (SAPRI Ghana, p. 69).

The Hungary SAPRI report notes that the health sector suffers from lack of adequate funding. It claims that real spending on health has decreased by at least 15-20 percent since 1991, and the ratio of health expenditures to GDP declined from 5.5 percent in 1991 to 4.3 percent in 1998 (SAPRI Hungary, p. 38). The Uganda SAPRI report (p. 40) notes that spending on health rose in real terms during the period of structural adjustment. In Ghana, it is noted that on average the health sector has received 8-10 percent of total government spending each year, but the quality and utilization of primary health services have remained low (SAPRI Ghana, p. 68).

A common concern is the affordability of health care during and after the reform period. The Hungary SAPRI report (p. 39) argues that sick people have been the primary victims of the liberalized pharmaceutical market, reduced subsidies on therapeutic equipment, growing costs and gratuities, and forced economies of indebted hospitals. The SAPRI Uganda report (p. 40) notes that a significant number of people do not receive health services from public facilities while others do not receive them from either public or private facilities because the drugs are not there (in public hospitals) or they cannot afford the user fees. They also cannot go to private facilities because of the high cost. Maternity services are limited for the majority of rural women. The SAPRI Ghana report (p. 66) notes a serious deterioration in public health services.

Education

Reforms included reducing spending on education and limiting the share of government education budgets devoted to post-secondary education. Other measures included cost-sharing, or requiring the direct beneficiaries of post-secondary (students and their parents) to contribute 10 percent of the cost; control of intake and enrolment by government and institutions; and implementing cost recovery mechanisms through income-generating activities (see also SAPRI Ghana, p. 58).

As in the health sector, the SAPRI reports reflect different experiences on whether the share of expenditure on education has increased or decreased. The SAPRI Hungary report (p. 39) notes that overall real value of the education expenditure dropped by one third from 1990 to 1998, and support for higher education decreased from 1.3 to 1.0 percent of GDP between 1994 and 1997. The SAPRI Uganda report notes that before 1997, only about 36 percent of public spending on primary schools reached the schools but since 1997, there has been increasing public resources going to primary schools, leading to more teachers, more textbooks, and a falling teacher/pupil ratio.

There was across-the-board concern that the cost of education increased in the 1990s, diminishing opportunities for children in poor families. The SAPRI Hungary report (p. 40) argues that despite the increasing number of pupils in secondary and higher education, the chances of continuing studies and learning a profession are bad and getting worse for children from unskilled, unemployed, poor or Roma families. The SAPRI Uganda study (p. 41) argues that the poor find it increasingly difficult to access higher education. According to the SAPRI Ghana report (p. 55), there are justifiable fears that access to education is becoming more difficult for lower-income people, and the quality of education is declining at all levels. It adds that cost-recovery policies are shifting the burden of board and lodging to parents and student beneficiaries, driving poorer students out of post-secondary institutions.

Concerns about adjustment programs

The main concerns voiced by civil society groups initially focused on reductions in social spending and increases in user fees, especially in health and education. Critics have claimed that in an effort to fulfill the required overall expenditure reductions for adjustment loans, governments reduced the non-wage spending of most line ministries, especially health, education and agriculture. The implication is that these cutbacks affected the poor most because drugs and other health equipment could not be found in government clinics, and schools lacked basic equipment. In some countries cost-sharing measures were implemented, and critics argue that the poor could not afford the minimal charges demanded for service.

In general, countries with conditions requiring capital expenditure reductions have imposed relatively large cuts in infrastructure spending. The Bank's emphasis on capital spending cuts, for example, was warranted in countries where large capital projects did not meet the basic needs of the population but may have led to such low capital expenditures in some countries that growth was retarded.

Summary of the lessons learned

The experiences with adjustment lending in support of public sector reform have shown both its limitations and potential. As the World Bank continues to incorporate lessons from its operations, the rationale for programmatic aid remains valid. Lessons from different forms of lending, and the increased recognition that reforms must be owned within countries, make new approaches to the public sector essential. In the past, donors were reluctant to acknowledge that good governance determines the success of public sector reform. Broad consensus on a comprehensive program of carefully sequenced measures is important for success. For this reason, some form of programmatic loans will be necessary if the donor community is to have a positive impact on development. This underpins the new emphasis on public sector reform programs and assistance that is to accompany Poverty Reduction Strategy Papers.

Determining the appropriate role of government is the first step in providing public expenditure guidance. Conditions could be more successful if they are derived from the appropriate role of government rather than piece-meal efforts to address specific problems. Criteria should include three considerations:

- The identification of market failures associated with the economic problem being addressed, including a justification for expenditure as the solution instead of other mechanisms such as taxation or regulation;
- The degree to which the poor benefit from expenditures relative to the non-poor;
- The degree to which governments are capable of delivering promised goods and services.

A second step is to ensure that maximum efforts are made to avoid a negative impact of adjustment programs on social spending.

A third step is to look for all possible opportunities to reduce user charges which restrict access for the poorer groups of population to healthcare and education.

4. CONCLUSIONS

Structural reform is never an easy choice for a country—but it is often a necessary one. Such reforms have been prevalent in many developing and developed countries and we do not expect them to come to a halt. The SAPRI initiative is an effort to deepen our knowledge on structural reforms and to further improve the adjustment policies, as well as the process through which they are designed.

From the World Bank's perspective, much was learned at the following levels:

- In understanding the potential role for civil society in policy-making;
- In acknowledging possible shortcomings of adjustment policies and social consequences that these programs can have for certain vulnerable groups; and,
- In identifying remaining gaps in our understanding of structural reforms.

4.1. The contribution of civil society to policy making

From the World Bank's perspective, the lessons drawn from SAPRI confirm that groups in civil society can make an important contribution to reform by acting as catalysts to spark a dialogue between governments and their citizens, a dialogue which can allow for wider views to be incorporated into policy decisions..

First, SAPRI was based in part on a partnership between civil society organizations and local research institutes. Such collaboration has proved useful in generating a greater understanding of the economic complexities and realities of structural adjustment programs. The dialogues taking place between governments, civil society organizations (in all their own diversity) and the World Bank are therefore now better informed.

Second, by gathering the experiences and concerns that local communities may have about reforms, civil society organizations can help to fill the lack of information on reforms as well as bridge the gaps that often exist between people's expectations and experiences. In doing so, civil society organizations contribute to a more open and participatory approach to the complex debates about reforms by helping to create the realistic and common understanding that is the necessary basis for both consensus and compromise among the main actors. They help communicate community concerns to their government, who can then decide how to adapt its reform policies to make them most effective and sustainable. In this sense, civil society organizations do not replace or substitute for public institutions, but rather supplement them and contribute to their effectiveness and accountability.

Third, SAPRI has contributed to the increasing interactions between civil society organizations and the World Bank in the field. In many countries, these important interactions have already expanded beyond the SAPRI exercise and will have a lasting benefit. These interactions between the World Bank and civil society are a constant source of learning for the World Bank.

4.2. Structural adjustment in balance

Governments, civil society and the World Bank are learning how to open up the complex issues and genuine disagreements that are part of the process of identifying and structuring economic reforms. Policy reforms are necessary in developing countries (as in developed countries) to give the poor better access to prosperity through wider opportunities, empowerment and security. How to make policy reforms work best for poor and vulnerable groups remains a challenge for governments, donors and civil society organizations. There are no easy formulas for structural adjustment reforms that include both short-term stabilization policies in response to acute balance-of-payment crises, as well as longer-term structural changes to improve the functioning of markets and the public sector or to move from a centrally planned economy to a market one.

In many of the SAPRI countries, the broad objectives of macroeconomic reform have been achieved. Government deficits and inflation were substantially reduced in the latter half of the 1990s. The large deficits of the 1970s and 1980s had led to high interest payments, which in some cases had crowded out sound social expenditures. The high inflation of the same period amounted to a tax on the "have-nots" who could not hedge against inflation through property holdings, foreign exchange holdings or otherwise. The overall result in the 1990s is that the people of these countries have been lifted from living in economically stagnant countries to potential emerging economies. However, for many developing (and developed) countries, the agenda of reform of markets and the public sector remains unfinished.

The reforms of markets and of the public sector of the past decades have—on balance—helped countries in their development. Yet, many lessons have been learned.

First adjustment is not an easy process, politically as well as socially. It profoundly affects people's lives. Several potentially adverse effects were apparent in some of the SAPRI countries:

- The effects of reduced government employment or spending on social services;
- The effects on employment security. These went beyond those workers who were laid off, and created uncertainty among those who kept their jobs;
- The effects on consumer prices. Reducing food subsidies decreased the purchasing power of all groups, but hit the poor especially hard.

Second, it has also become clear that adjustment has to be "owned" by the government and the society in order to be successful. Adjustment should come "from within", based on local analysis, local knowledge, local perceptions of political "room for maneuver." Outside advice and financing can help, but only if the country goes first through the consensus-building process.

In this context, the SAPRI country reports clearly show that public consultation on economic policies is an important part of the political work of adjustment. When a country faces the prospect of protracted adjustment, the government is well advised to seek broad popular support through a consultative process that helps to define realistic expectations for all parties involved.

Third, the experience of the six SAPRI countries suggests some broad lessons on designing comprehensive structural reforms that minimize the potentially adverse effects while reaping the economic benefits:

- Institutions are essential to making adjustment succeed by generating new prosperity. They include regulations that ensure competition and a proper legal environment guaranteeing their implementation. This is the theme of the *World Development Report 2002*;
- In some cases, a step-by-step approach to adjustment is appropriate to allow complex reforms to be closely linked with the development of institutions;
- It is important to provide adequate safety nets to help mitigate potentially adverse effects of adjustment on the poor;
- Special attention should be paid to safeguarding social expenditures and maintaining access to health care and education.

Looking forward, the reform agenda in the SAPRI countries is incomplete and much remains to be done. Yet effective structural reforms require a clear policy framework "*from within*", one that is developed with the people's participation and by an effective and accountable government that is committed to both promoting economic growth and furthering the human development of the people.

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ANNEX

Table 1: Financial Development After Liberalization

	Liberalization	Public bank share		M3/GDP		PRIV/GDP	
		1970	1990	Pre-lib	Post-lib	Pre-lib	Post-lib
Bangladesh		.100	.95	.186	.362	.087	.268
Ecuador	1986-87, 1992-95	.100	.41	.205	.315	.186	.252
Ghana				.147	.172	.016	.052
Hungary		.100	.37	.469	.419	.169	.235
Mali				.229	.229	.133	.125
Uganda	1991-95			.048	.091	.021	.035

Pre-liberalization figures reported are averages of 1980-82 for Bangladesh and Ghana, 1984-85 for Ecuador, 1983-84 for Hungary 1988-89 for Mali, and 1989-90 for Uganda. Post-liberalization figures are averages of 1996-97 or the last available dates. Data are from Beck, Demirguc-Kunt and Levine (2000). Public Bank Share is from La Porta, Lopez-de Silanes, and Shleifer (2000).

Table 2: Private Investment in Telecommunications (millions of US dollars)

	1994	1999
Bangladesh	$116	$472
Hungary	$1,610	$6,300
Ecuador	$14	$685
Uganda	$16	$118
Mali	$0	$0
Ghana	$20	$441

Table 3: Export performance

	Exports of goods and services	Share of Manufactures in Merchandise Exports		Exports of Services in
	annual growth 1981-99 (%)	1980-82* (%)	1997-99* (%)	1999 1980=100
Bangladesh	11.0	65.5	89.5	311
Uganda	9.2	1.0	4.2	1,282
Mali	8.3	3.6	0.7	100
Ghana	6.4	0.7	20.4	313
Hungary	5.0	63.4	81.2	711
Ecuador	4.9	3.1	9.4	158

Source: *World Development Indicators, IMF International Financial Statistics*
* average share, if data for more than one year are available

Table 4: Volume of exports in SAPRI countries

Exports of goods and services (millions of constant 1995 US$)			
	1980	1999	1980=100
Bangladesh	869	6,210	714.5
Uganda	334*	1,265	379.5
Mali	243	866	357.0
Ghana	967	2,885	298.3
Ecuador	2,227	5,550	249.2
Hungary	11,979	29,616	247.2

Source: World Development Indicators
* 1982 figure

Figure 1: Total Telephone Penetration in SAPRI countries 1990-1999 (fixed and wireless subscribers)