POLICY REFORM: THE SOCIAL DIMENSION

WEEK 1: DAY 4

POLICY REFORM PROGRAMS AND THE SOCIAL DIMENSION

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1. INTRODUCTION AND OVERVIEW: AGRICULTURE, STRUCTURAL ADJUSTMENT AND POVERTY

In the early 80s, many sub-Saharan countries were facing dramatic balance-of-payments crises due to a world-wide economic recession, the collapse of commercial lending to developing countries and misguided national economic policies. Changes in economic policy were necessary and, often under the pressure of the IMF and the World Bank, structural adjustment programs were introduced. However, Africa’s unsatisfactory development process in recent years has stimulated an intensive debate concerning to what extent economic failure is due to or in spite of the economic adjustments. The World Bank notes that although some improvements in macroeconomic and sectoral policies have been attained, none of the countries surveyed has what it regards as a ‘good’ overall macroeconomic stance (World Bank 1994; Mosley/Substat/Weeks 1995). Especially for African countries, poor implementation of structural adjustment programs and the globalisation of the international economy are factors that must be taken into account in measuring the impact of policies. While it is difficult to measure the policy impact at the macro level, it is even more difficult to quantify the effects of policies on welfare at the micro-level, particularly since the population stratum is complex and depends on the economic and social situation.

The social dimension of structural adjustment, or the effect structural adjustment has had on poverty alleviation or aggravation, must therefore be differentiated according to several characteristics: the structure of the economy, the level of urbanisation, or other characteristics at the national level.

In Africa, the economic crisis is most evident in the urban areas, where virtually all classes face problems due to a drastic decline in their standard of living. It is not clear to what extent structural adjustment policies have adversely affected the poor population, since they often rely on parallel markets. Due to the removal of food subsidies and drastic reductions in commodity imports, the prices of consumer goods climbed, thus favouring the terms of trade towards the rural areas. The biggest losers from adjustment policies were the urban elite, who had access to official markets and prices, and former public sector employees. (Sahn/Dorosh/Younger 1996).

However, despite being able to arrive at general conclusions regarding the economic adjustment process, there remains the fundamental problem of not knowing what would have happened in their absence. The evaluation of the effects of structural adjustment policies on the welfare of the poor requires special conceptual and methodological attention. First, adjustment programs often are partially implemented with regard to scope, sequencing, and speed. In this sense, almost no program be considered a failure, since few programs have been implemented in their original form (Johnson 1994). Second, it is not always possible to clearly distinguish between the effects of the economic crisis following the implementation of the adjustment policies, and the flow of foreign resources after their adoption. Third, it is difficult to control for other external influences, such as climatic shocks, effects of war, or changing terms of trade conditions on international markets. Fourth, empirical data at the micro-level are only available for the relatively short period during which the policies have been in effect, thus limited time series have to be analysed in statistical equations. Fifth, analysis is made more complex because of the combination, interdependence, and sequence of specific policies (Haddad et al. 1995). Pairing adjusting countries with "homogeneous" non-adjusting countries as a reference is one attempt to cope with the "with and without" problem, and implicitly doing so by using regression analysis. The "before and after approach" has
been widely used, but the conclusions concerning what has happened are closely related to the two time periods as well as the indicators chosen (Sahn/Dorosh/Younger 1996).

The success or failure of any policy measure depends critically on an individual’s access to and control of resources, as well as the ability to move productive economic resources between sectors, and is therefore gender-differentiated. The gender bias lies not only in the macro policies per se, but also in the socio-economic environment within which the policies are applied, which determines the ability to respond and/or to bear the costs of potential consumption, income, or employment effects of adjustment (Haddad et al. 1995). Any examination of the role of adjustment policies in promoting poverty reduction should begin with an understanding of the characteristics and the behaviour of the poor within their social environment, thus providing the basis for constructing appropriate models to explore the differential effects, as well as providing an insight into the mechanisms of individual, inter- and intrahousehold resource allocation (Sahn/Dorosh/Younger 1996).

This conceptual framework that stresses vulnerability as well as the resource allocation of individuals and/or households in the process of poverty alleviation, is shown in figure 1.

Figure 1. Resource allocation and the individual living standard

(Haddad et al. 1995)

The following section will examine the main macro and sectoral policies and discuss the social dimension of these policies, or how and to what extent they influence living conditions at the micro-level.
2. INSTRUMENTS OF POLICY REFORM WITH SPECIAL EMPHASIS ON THEIR SOCIAL DIMENSION

2.1. Introduction
The expression "Structural Adjustment Programs (SAP)" describes the economic policy reforms adopted by developing countries to respond to the world recession and the "debt-crisis" of the late 1970s and early 1980s. The Programs involved two broad complementary strategies. The first strategy, the International Monetary Fund (IMF) Stabilisation Policies, was designed to reduce both fiscal and external deficits through a combination of austere fiscal and monetary policies and exchange rate liberalisation. The second strategy, a complement to the IMF-recommended economic reforms, was a series of Structural Adjustment Policies recommended by the World Bank (WB) to change the supply-side, i.e. to shift the structure of the economy and output in order to improve international competitiveness and efficiency in resource use, with an underlying but key objective of increasing economic efficiency by allowing market forces to play a greater role in determining prices and hence guide the allocation of resources (H.de Haen, T. Aldington and R. Saigal, 1992).

Recent World Bank evaluation studies concluded that Structural Adjustment Programs have achieved positive results in many developing countries. The studies showed that economic growth rates have been higher with SAP in place than they would otherwise have been, and that a significantly higher proportion of investment projects succeeded in countries with good structural adjustment programs under implementation. This is in agreement with Cleaver’s (1988) studies on Africa. He compared the agricultural growth rates of Sub-Saharan African countries under adjustment with those not under adjustment and found that, while there was no difference between the two groups in the 1970s, a slight difference began to emerge in the early 1980s when adjustment programs were initiated. The annual agricultural growth in countries under adjustment was about 1 percentage point higher than that in countries without adjustment programs and 2.6 percentage points higher in 1987, a bad year for agriculture throughout in Africa. The striking difference between the two groups clearly increases over time, showing the responsiveness of African agriculture to policy changes.

Despite these encouraging results showing that developing countries may gain from well-implemented adjustment policies in the medium term, several common features related to SAP economic instruments clearly negatively affect the distribution of social welfare. A fall in per capita income, a decline in social expenditures benefitting to the poor, rising unemployment and a drop in real wages suggest that SAPs have not succeeded in reducing the adverse consequences of the economic recession and debt-crisis and that, in many countries under SAP, not only poverty and vulnerability persist, but the social conditions of the poor have even worsened. Therefore, it is crucial to carefully analyse the lessons that can be learned from the first generation of SAPs, as a basis for making recommendations for modifications or alternatives to future economic reforms.

This chapter of the module examines the social impact of Structural Adjustment Programs. The first part is a review of the social effects of different types of structural adjustment policies, with particular reference to their impact on income changes and social structures (health, education, and food security). The second part focuses on policies recommended to render the effects of SAP on development more positive, i.e. what kind of recommendations could help SAPs achieve economic stabilisation, increase the efficiency of the economy and increase supply, as well as enhance socio-economic transformation and equity.
2.2. The social impacts of SAP instruments

2.2.1. Public sector policy

Public sector policy measures are among the most important macroeconomic instruments in SAPs. Their objectives are to bring fiscal deficits under control so as to attain stability in the fiscal account, restore the equilibria of the budget and current account, lower the level of the country’s external debt to a bearable level, and rationalise public investment.

These policies measures include: the reduction of the fiscal deficit; the reduction of public sector employment, the increase in capital investment, and wage control; the reform of public sector enterprises; the reduction of subsidies and price policy reform.

The reduction of fiscal deficits, (i.e. the reduction or rationalisation of public expenditures), associated with tax reforms, is one of the most important economic instruments used by the IMF in its policies to stabilise developing country economies. The long-run positive influence of public expenditure cuts in providing macroeconomic stability is well recognised. However, this is often achieved through drastic cuts especially of expenditures on social services and other essential goods offered to the people, hence undermining the social conditions for the poor (health, education, social security and other social services). All income groups may be hit by such measures, but especially the poor, who lack savings and therefore cannot afford alternative services in the private sectors. Sheshamani (1988) reported that following SAP implementation Zambia faced a sharp rise in its mortality rate, especially among the infant population because hospitals could not afford to import the essential drugs and other requisites necessary for life-support. The country faced a situation in which social conditions were disintegrating, resulting in social unrest in 1990. Public expenditure cuts can hinder agriculture development. Indeed, it may affect not only expenditures on health, education and rural amenities, which are important requirements for sustainable increases in agricultural productivity, but also lead to reductions in some essential investments in agriculture, including investment in physical infrastructure and supporting services such as agricultural extension.

Among other important measures recommended in SAPs to reduce heavy and costly public expenditure, the reform of public sector employment, wage control, and reform of public enterprises occupies a prominent place. In many developing countries wages have been controlled through the labour code which fixes minimum wage rates for all categories of workers according to their formal training, regional location and sector of the economy.

The existing policy framework has been characterised by direct state intervention in the production and distribution of goods and services. Most of the time, these government-owned enterprises and monopoly marketing boards were extremely inefficient and unprofitable. Citing the case of Cameroon as an example, Ntansgi (1992) showed that between 1960 and 1990, a total of 200 public enterprises were created by the Cameroonian government. He stressed that the performances of these public enterprises has been unsatisfactory due essentially to their politisation and use of patronage, a lack of autonomy and accountability in management and an environment that did not encourage productivity. As a consequence, they have contributed to the public finance crisis, either directly through state operating and investment subsidies they needed to survive, servicing of external guaranteed debt by the government for public enterprises in difficulty, and indirectly through defaults in the payment of taxes. They had become a burden to the rest of the economy also through their debt to banks and suppliers. The resulting need to reduce public sector staffing and cut public sector salaries hit particularly the urban wage earners such as civil servants and public enterprise
employees who found themselves out of work and income as a result of the reform or liquidation of public enterprises.

Expenditure cuts particularly constrain operation and maintenance budgets, which implies most of the time the removal of production and food subsidies. The removal of food subsidies can particularly hit the urban poor who have to buy their food. The impact of these measures on the urban poor can be made more severe by additional cuts in subsidies on public transport, energy, water, or other goods they consume. Since most farmers, particularly in Africa, are in subsistence conditions, and since a large proportion of the rural population are food buyers (like landless labourers) rather than food sellers, they are affected by increases in food prices following the removal of food subsidies. The removal of other subsidies, such as those on gasoline or middle class housing, affect the non-poor more than the poor.

Inappropriate pricing policies, especially for agricultural products, is considered one of the most important domestic policy deficiencies responsible for the economic crisis facing developing countries, especially in Africa; hence the need for pricing policy reforms. As price controls are usually implemented through a marketing board, the reforms consist in either reducing or eliminating the operation of the board to allow private trade to become the dominant marketing channel and let prices reflect more closely world market levels. These reforms are intended to encourage greater aggregate agricultural production, especially of trade crops for export, and to shift sectoral terms of trade in favour of agriculture. Gittinger (1991) stressed the inter-related nature of SAP measures and pointed out that these pricing adjustments are unlikely to result in increased production in circumstances of high inflation. "Getting prices right", whether for goods or for services, interest rates, or exchange rates, has proven to be all but impossible in conditions of high inflation. Relative prices vary more than proportionally as inflation increases, adding to uncertainty and making price signals ambiguous and inadequate for agricultural producers. He concluded that when inflation is high, the priority should be given to restoring financial stability, particularly by controlling public sector spending.

The social impact of pricing policy derives from the fact that real prices for agricultural products may improve the welfare of farmers provided that the price increases reach them. However, these price increases reduce the real income of consumers in the cities, especially if they apply to food crops. Poor farmers can only benefit from increased producer prices to the extent that they are engaged in the production of tradable agricultural products and not merely in subsistence agriculture. Increased producer prices are important but not the only way of providing incentives for increases in cash crop production. Price policy must be part of a package of measures in which price incentives take their place alongside infrastructure, credit and related institutions, research and development, extension services and efficient government investment in improvements of transport, irrigation, etc. Without these complementary investments, agricultural policies focusing only on higher producer prices will have limited positive effects on alleviating poverty among small farmers and could even have detrimental effects (Singer, 1991, P. Pinstrup-Andersen and R. Pandya-Lorch, 1992).

2.2.2. Monetary policy

The two main monetary policy instruments in IMF agreements are credit ceilings and raised interest rates. These aim to reduce the growth of domestic credit supply, and thus inflation, increasing real savings and rationalise the use of domestic savings by switching these savings from the government to productive sectors. These measures are usually associated with financial system reforms intended to improve financial sector policy, i.e. to achieve competitive returns on financial assets, increase the marginal productivity of capital and boost
the saving rate. These measures are not socially harmful as fiscal measures. Basically, they tend to have an adverse impact on borrowers and therefore on industrialists (and large farmers to the extent that they are borrowers), while they have a favourable impact on savers like urban wages earners and more particularly urban professionals.

2.2.3. Balance of payment policies.
Balance of payments policies recommended in SAPs include mainly exchange rate reforms, restructuring of tariff systems, import substitution and export promotion measures, but among these measures, exchange rate reforms have a particularly severe impact on the social conditions of people. In most developing countries, and particularly in Africa, balance of payments deficits have traditionally been associated with over-valued exchange rates. Therefore, one of the most important instruments used in SAPs is the establishment of a market exchange rate that reflects more closely the true value of the currency (usually by devaluation), so that exports become more profitable and imports more expensive. This reduces the volume of imports, encourages producers to use more labour-intensive methods and more domestic raw materials, and increases the production of tradable goods, all of which positively affect the balance of payment of the country.

Abalu (1992) reported that while devaluation is likely to raise the volume of agricultural exports, its effect on non-tradable agricultural products is, at best, doubtful. Even in the case of export products, volatile commodity markets, international competition, low demand growth due in part to low price elasticities in developed countries, can lead to real difficulties in predicting the effects of devaluation. Reviewing the Zambian experience and the severe effects that followed several currency devaluations, he pointed out how a generalised currency devaluation, especially in the context of African economies, can lead to socially unbearable increases in the price of critical goods and services. It is also associated with increases in the domestic cost of imported inputs which can undermine capacity utilisation, raise the general inflation level if not properly supported by a tight domestic monetary and fiscal policy, divert scarce foreign exchange to speculative activities and capital flight, and worsen income distribution patterns. Thus devaluation is not a panacea for stimulating economic growth: it requires proper support by domestic and monetary supply-side policies.

The Zambian case shows how the social impact of currency devaluation can be very severe. In general, devaluation increases the price of tradable goods relative to non-tradable goods and initially benefits exporters including farmers, processors, and manufacturers. Consumers, particularly those of imported goods, are also affected by higher prices for food and other goods. Overall, devaluation improves the welfare of export-oriented producers (that is those who export more than they import) but negatively affects the consumers of import products particularly urban wage earners. Normally these are not the poor.

Other balance of payments measures like trade liberalisation (the abolition of licenses and quantitative restrictions), tariff policy (the move towards low and uniform tariff rates, the removal of imports restrictions) etc., do not affect directly the poor. The removal of import restrictions can, however, reduce the protection accorded to industrialists manufacturing for the home market and lower the cost of imports. Liberalisation of imports associated with currency devaluation can lead to greater and more entrenched external competitiveness encouraging economic growth and employment and thus benefiting the labour force.

2.2.4. External borrowing
Lyakura (1989) reported that in many cases, IMF economic reforms and associated conditionalities could only be sustained through recourse to additional external borrowing.
Even if temporary relief can be obtained by way of rescheduling agreements with creditors, rescheduling is itself costly, in that it postpones and increases the debt. The case of Tanzania is cited as an example. In 1988, the Tanzanian government faced problems in implementing the SAP-recommended exchange rate policy due to the non-availability of sufficient external funds to support the objectives of the program. Two years after the agreement concerning the economic recovery program (established in 1986), only half of the credit agreed to under the program with the IMF, the WB and joint financing arrangements had been disbursed. This was principally due to the non-fulfilment of the performance criteria and other disbursement delays. This delay of foreign resource inflows affected the performance of the ERP particularly in the areas of physical and social infrastructure and in the maintenance of social services. This example shows clearly that external finance and contingency arrangements are essential to bear the sacrifices and risks often involved in SAPs. In fact, there is the danger of a vicious circle in that external finance is conditional upon strict adherence to the adjustment program, while the adjustment programs depend on the maintenance of external finance. There is a risk that temporary and perhaps unavoidable lapses from original adjustment targets may result in a cessation of external support and the collapse of the whole program, with severe economic and social consequences for the country.

2.2.5. Institutional reform
These crucial measures of SAPs cover the reform of institutions, legal and regulatory frameworks and the necessary rationalisation of the role of the State. The objective is to reduce the role of the public sector in the direct production process and distribution of goods and services that are non-strategic or do not have a public good character, and to increase reliance on the private sector. These reforms are needed to match the growing complexity of the modern economy which makes overly centralised decision-making inefficient. Reformed institutions, especially public procurement, marketing boards, public and private service enterprises become more responsive to market forces, more accountable and more cost effective. To attain this objective it is necessary to eliminate many functions that the State has performed in the past while strengthening a number of other functions. Two key functions of the State are generally reinforced. One is the creation of an enabling environment that promotes economic activity through the provision of a fair and transparent institutional, legal and regulatory framework (liberalisation policies, privatisation and liquidation of private enterprises, the simplification of laws and procedures for contracts, new investment code, laws governing commercial activity, new labour law, the accessibility of information to investors and consumers). The second is the development of the state’s capacity for analysing and managing macroeconomic and sectoral policies.

2.2.6. Conclusion
The analysis of the socio-economic effects of SAP instruments shows that the income-distribution effects of structural adjustment do not cut in one direction, so one cannot say that SAP policies make income distribution "worse" or "better". For the very poorest like landless people and subsistence farmers, the effects of SAP are complex. For example, devaluation will hurt those who buy imports, while increases in crop prices will help them if they are net sellers of these crops. Broadly speaking, the heaviest losses resulting from SAP measures fall on those just below the middle level of income distribution, i.e. urban wage earners. The very poor or the very rich are more favoured by these measures, especially producers in the export sector (Mosley, 1991; P. Mosley, J. Harrigan and J. Toye, 1991)

Mosley (1991) pointed out that these conclusions are somewhat hypothetical since while there are estimates of what would happen if SAP were carried out in full, very few of them have been fully implemented. Examining 40 countries where structural and sectoral adjustment
programs had been designed by the WB, he found that only about 20% had been fully implemented; about 60% incompletely implemented, and 20% not implemented at all. This was reflected in an enormous gap between what had been intended through SAPs and what SAPs really achieved. He related this to the fact that implementation of SAPs inevitably aroused opposition on the part of those enjoying the benefits that the reforms were trying to remove (industrialists protected by import quotas, license holders protected by licenses, farmers protected by subsidies, etc.). Since a large part of the loan is disbursed before the SAP measures are implemented, it is tempting to keep the money while avoiding antagonising the vested interests threatened by the SAP. Malawi is a case in point reflecting how SAPs have been implemented differently than they were intended. Public expenditure cuts were totally implemented and devaluation measures were partially implemented. Of the recommended increases in agricultural prices, the government chose to raise the prices of food crops rather than that of cash crops, such as tea, tobacco and sugar. However, fertiliser subsidies were not cut at all. Thus the Government managed to avoid the part of the SAP that would have involved the elimination of the specific benefits enjoyed by influential farmers. Consequently, the urban consumers were hurt even more than intended by the original WB measures.

This example was chosen, among many others, to stress that the politically easiest measures (i.e., those that can be carried out quickly by government officials without recourse to the legislature or mass political debate) tend to be carried out first and generally completely. These tend to be measures aimed at deflating demand such as public expenditure cuts and exchange rate changes. On the other hand, measures intended to increase supply, which tend to take a long time, involve mass consultation and are politically the hardest. These measures were often carried out late or not at all. This suggests the need for an appropriate timing and sequencing of these measures. Stabilisation measures tend to come first and have an immediate effect. Structural adjustment measures which are growth-oriented take much more time to show their effectiveness. To avoid the cumulative pressure of the reforms that could prevent the country from achieving economic growth, and to avoid the danger of these measures becoming politically and socially insupportable (I. Husain and R. Faruqee, 1996, S. Commander, 1989) it is essential that SAP measures be implemented at an appropriate pace and with the proper sequencing according to each country’s specific circumstances.

2.3. How can SAPs more positively affect development?

2.3.1. Protecting the poor

Analysis of the social impact of SAPs shows clearly that adjustment programs take more time to be implemented and that the poverty-related aspects of these programs are not simply short-term problems. Even though SAPs are intended to spur long-term growth and improve the standard of living for the poor, it has become obvious that, in the medium term, there is a need for political solutions which aim to protect the poor and counter-balance those interests opposed to implementation. This can be achieved by using part of SAP loans to maintain investment in the high priority areas which benefit the poor. It may also be necessary to compensate poor and vulnerable groups in a way that preserves the allocative advantages of the planned policy reforms.

Suggestions made to build in compensatory measures into the adjustment process itself include short-term measures and long-term measures. These are intended to help three groups of people: the new poor or those impoverished by adjustment programs in the short term (such as retrenched civil servants, public and private enterprise employees who were laid off because of austerity measures or shifts in production); the borderline poor which includes low income, vulnerable groups that are most affected by changes in the availability
and price of major consumption items, especially food, cutbacks in social programs, and recession and adjustment; and the extreme or structural poor, known also as the chronic or ultra-poorest (V. Thomas, A. Chhibber, M. Dailami and J. de Melo, 1991).

2.3.2. Short-term measures
Temporally short-term measures are intended to ensure the continued output of subsistence crops and to protect outlays to the poor in social sectors such as primary education, health care, nutrition, since SAPs typically raise agricultural producer prices and reduce subsidies, thereby causing higher food prices that hurt the urban poor and rural landless (V. Thomas, A. Chhibber, M. Dailami and J. de Melo, 1991). This can partly be achieved by slowing down the increases in producer prices for certain food crops and carefully targeting food subsidies. Moreover, for the new and existing poor, short-term solutions can include transitory compensatory measures that provide temporary employment to ensure that the basic needs of these new poor are maintained (such as emergency public works, food-for-work programs, severance pay for retrenched workers and targeted food programs based on food stamps or rations to guarantee a minimal nutritional level).

The borderline poor and extreme poor require greater public social expenditures in both the short and the long-term, and the programs intended for them must be protected even when budgetary constraints require that total social expenditure be cut back. Three methods have been proposed (V. Thomas, A. Chhibber, M. Dailami and J. de Melo, 1991):

- Targeting available resources to the poor, based on the principle that those who can afford to pay should do so. This can be achieved by gradually recovering some of the public social services that are provided to the better-off and redirecting these resources to fund social services specifically for the poor, and shifting some service supply functions from the public to the private social services and programs, thereby enabling more public expenditures to be directed specifically to the poor (for example, privatising some hospital services while maintaining essential public health services for the needy).
- Administrative reform to make social services more efficient in order to achieve needed savings
- Progressive taxation reform designed with equity objectives to assist the poor.

2.3.3. Long-term measures
Short-term compensatory schemes are designed as temporary additions to SAPs to alleviate hardships temporarily. What is really needed to reduce poverty are long-term antipoverty measures aimed at increasing the incomes, employment and productivity of the poor. Therefore, the design of SAPs should focus on bringing the vulnerable and extremely poor into the production system as contributors (V. Thomas, A. Chhibber, M. Dailami and J. de Melo, 1991).

2.4. GENERAL CONCLUSION
Adjustment is a difficult process with serious political and social implications. Stabilisation measures, in particular; can be enacted rapidly and have an immediate impact with associated political and social repercussions. There should be more dialogue and persuasion rather than imposed conditionality in the design of SAPs to make greater allowances for shock effects and difficulties. Whereas currently, most programs reflect a "standard approach", adjustment policies should be country-specific. SAP measures need proper phasing and sequencing. Attention should be given to the "fallacy of competition", as SAP measures could lead to
increased competition between developing countries and result in declining prices. But overall, new SAPs should be more concerned with income distribution and the social impact of stabilisation and adjustment programs.

There is an increasing recognition of the need for adjustment programs to be more "growth-oriented". This objective should dominate both stabilisation and adjustment measures. However, the social dimension of adjustment should be an integral part of any program since the objective of adjustment is not only stabilisation and growth, but also a better distribution of wealth and a more equity-oriented society. In particular, food security is crucial and should be placed at the centre of adjustment programs; food security is best served by adequate incomes.

3. STRUCTURAL ADJUSTMENT POLICY, RURAL INSTITUTION BUILDING AND POVERTY

Institutions are vital for improving the socio-economic conditions of poorer population groups. The structural adjustment programs (SAPs) that predominantly rely on neo-classical economic theory presume that privatisation and economic market liberalisation lead to more efficient factor allocation and thus to economic development. Measures under SAPs consist of policy and institution reforms. However, institutional reform often just means privatisation, leaving the privatised institutions relatively unprepared to confront market forces. While neo-classical economics hypothesises that anonymous market forces will lead to the most efficient factor allocation, the New Institution Economics (NIE) proposes institutions as non-anonymous steering mechanisms to reduce risk and information asymmetries in markets.

Neo-classical economics and NIE should be considered jointly in that they both provide worthwhile theoretical concepts that can be useful when implementing development policies under a SAP in developing countries. Costs that arise when institutions are built or restructured through the privatisation policy of SAPs can be reduced through the integration of conceptual work on institutions. At the same time, the concepts provided by the NIE facilitate outreach to the traditional target groups in developing countries: the poor, and the newly created target groups in countries undergoing transformation, the newly impoverished and small private entrepreneurs.

The justification for institution building comes from the imperfections of the neo-classically defined market, which are most evident where market support infrastructure is least developed. There is also empirical evidence that successful economic development is closely correlated with agricultural productivity and this, in turn, is strongly associated with the institutional environment such as markets, extension, research and property rights.

SAPs primarily rely on reform of economic policies and institutional infrastructure. Institutional reforms affect the public as well as the private sector (World Bank 1988). By reducing governmental intervention in all sectors, efficiency is assumed to be improved and economic development accelerated. Kahn and Knight (1985) state that without structural adjustment, today’s growth takes place at the expense of tomorrow’s growth. Economic growth in the context of neo-classically oriented development policies is hypothesised to

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accelerate when inefficiencies are reduced through structural adjustment in developing and transforming countries (Egger and Stöckli 1990).

SAPs have come to recognise the dominant role of institutions in the development process and have integrated institutional concerns in recent agreements. Frequently, however, the integration of institution building has consisted solely in privatising public institutions such as marketing agencies or research institutes. This transfer of public services (i.e. agricultural research, seed reproduction) to the private sector, however, did not always yield expected positive market effects.

Obviously, the privatisation of institutions and the reform of institutional structures is not a trivial task. This is because the assumptions of the neo-classical market model, complete information and zero-cost transactions, do not apply to real markets. If these premises do not apply, market and price mechanisms do not lead to pareto-optimal results (a.o. Hartig 1989, Hoff et all 1993). In contrast to the neo-classical theory which assumes that anonymous market forces will allocate resources in an optimal way, the NIE offers institutions as non-anonymous steering and adjustment mechanisms of risk and information asymmetries. The creation and operation of institutions, however, results in investment and operational costs. Moreover, in many developing countries, particularly in Africa, a process of institutional degeneration has been observed. This has become particularly apparent in the institutions’ decreasing capacity to exercise power and to command resources. It is in this context that the discussion in the following section must be seen (Hoff and Stiglitz 1990; Richter and Furubotn 1996; Schneider 1987).

3.1. The social dimension of structural adjustment

According to neo-liberal theory, the reduction of governmental intervention in the market should reduce economic inefficiencies. The success of such measures is, among other things, dependent on the scope of civil order as well as the socio-cultural and institutional conditions in the particular countries. In reality, SAPs overestimated the ability of private and privatised corporate bodies to assume their place in a free-market economy. These private entities have not always been able and/or ready to assume duties that have been delegated to them. Adjustment is thus not a painless exercise and this has repeatedly caused significant economic losses particularly with regard to the public welfare of certain social groups. For this reason, in 1986, SAPs began to take into account the social dimension of reform measures. The social dimension was addressed by granting poverty oriented loans that were not directly linked to adjustment or transformation measures. The social dimension loans were particularly targeted to health, food security, education, micro-enterprises and agricultural development (Egger and Stöckli 1990; Lele 1990). Also, beginning in the 1980s, a multitude of national and international non-government organisations (NGOs) began to emerge. Some of these NGOs adopted a non-profit-making legal form while others were limited companies created by former public employees and consulting firms which competed for contracts in the framework of the SAP’s social dimension. These NGOs frequently pursued socio-economic objectives thereby attempting to compensate the negative consequences of market failures and institutional inefficiencies for the poor.

Depending on the design of the adjustment package, the same adjustment goals can be achieved with more or less pain. While compensatory measures will continue to be relevant and improvements in their design and implementation are important, the focus is now on tackling the more fundamental determinants of poverty and human development within SAPs. However, this change in approach will require an increased financial and managerial capacity,

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2 This section draws partly on Jayarajah and Branson (1995), 173-182.
especially in countries undergoing structural adjustment, to analyse the social impact of alternative policy mixes and to monitor developments in social indicators. This, in turn, will require the development of databases and institutional capacities within developing countries governments.

The social impact of adjustment particularly affects primary incomes. The primary income of a household/enterprise is the income derived from the production process. It is a function of the household’s/enterprise’s stock of productive assets and the return to these assets. Adjustment measures exercise an impact on primary incomes by affecting the productive assets and the rate of return to the assets. In the short run, the rate of return to assets is usually affected the most. Thus, cuts in public expenditures may reduce employment and real wages, or, in other words, lower the rate of return to labour. A devaluation that increases the price of tradables relative to that of nontradables may increase the rate of return to assets, such as land and physical or human capital, that are involved in the production of tradables. It can equally reduce the return to assets involved in nontradable production. Some adjustment measures, such as those that lead to changes in the availability and cost of credit, may also affect the acquisition of productive assets. However, the most substantial impact of adjustment on the stock of productive assets owned by different social groups, especially the poor, usually materialises in the long run. It is now increasingly recognised that the most important way to affect the long-run incomes and human development potential of the poor is to enhance their stock of human capital. The nature of adjustment measures, especially public expenditure policies and institutional frameworks, can have a profound impact on human capital formation, and thus on the prospects of increasing the participation of the poor in the long-run growth of the economy (Jayarajah and Branson 1995).

3.2. New Institution Economics (NIE)
Most often, when the term "institution" is used in development aid, it signifies organisations. Frequently, the term is used for enterprises or ministries (Hartig 1989; Heidhues 1990). However, the term "institution" comprises more than this. The NIE defines an "institution" as a commonly accepted and continuous system of formal and informal rules and norms that determines the co-ordination among individuals and structures their incentives towards a joint aim or bundle of aims (Hoff et al. 1993; Richter and Furubotn 1996; Ruttan and Hayami 1984). If an institution realises its aim by applying its rules, the institution brings order into daily activities, reduces insecurities and creates societal and economic incentive structures (North 1990 and 1993). Nevertheless, institutions may encounter functional limitations. The NIE explains this through information asymmetry, imperfect foresight, incomplete contracts and the subsequent transaction costs.

Institutions in combination with the participating persons are called organisations, in so far as they are deliberately created (Heidhues 1990; North 1990). According to the definition of institutions and organisations, the following terminology applies: with regard to public and private enterprises, Richter and Furubotn (1996) talk of structured (formal) organisations and with regard to market-communities of unstructured (informal) organisations. North (1990) explains that "Institutions are like the rules of the game in a competitive team sport. Organisations, the agents of institutional change, are analogous to sports teams". Institutions, on the one hand, determine to a large extent which organisations are created and how they develop. Organisations, on the other hand, influence the development of the institutional framework.

The literature provides two explanations of how institutions come into being. The extreme historical explanation claims that institutions are formed spontaneously out of the self-interest
of individuals (Menger 1983). At the other extreme, institutions are considered the result of a purposeful plan/model. A competent authority (e.g., the Government, the World Bank etc.), that acts entirely rationally may be able to introduce a certain, conducive institutional set-up. The former can be considered as resulting from evolutionary rationalism and the latter from constructivistic rationalism (Hayek 1973).

3.3. Rural institution or organisation building?
According to the definition of an "institution", one can identify the following institutions within a rural economic system: markets, property rights, land, tree and animal tenure systems, indigenous insurance conventions, and other systems of exchange that are determined by implicit contracts, rules or social norms. (Hoff et al. 1993). The term "organisation" includes civil agencies (i.e. political parties, parliament, administrative bodies), legal personalities in business (i.e. enterprises, labour unions, co-operatives, agricultural family farms) as well as institutes of health and education (i.e. schools, universities, vocational centres, hospitals). With respect to this differentiation, the focus of this review is on institutions as the given rule-set and in as far as organisations are addressed, the focus is on their role in increasing the realisation of the rule-set.

The creation of functioning institutions is therefore a two-step process. First, the rules are stipulated in such a way that ensures a maximum level of social acceptance. In the second step, the rules must be operationalised efficiently by building the corresponding organisations. The science of public and business administration provide appropriate approaches and instruments for the realisation of congruent institution-organisation frameworks. As previously discussed, the building and adaptation of an institution is a long, stepwise, complex, sensitive process that is difficult to predict. Also, it is a process that can take a different shape depending on whether it occurs in the formal or informal sector. As a result of political or legal decisions, formal rules can be changed overnight, such as in the case of the limitations imposed on the public monopoly for grain marketing in Niger during the SAP in the mid 80s. It is more difficult to act on informal rules resulting from manners and customs, traditions and habits, such as the passage (transhumance) rights for nomadic cattle raisers that are linked to a temporary limitation of land use rights for farmers. The survival of such institutions, often complained about, and their aversion to change, can also be interpreted positively as a necessary pre-condition for stability and thus necessary for social acceptance. In Niger, institutional land tenure stability was severely interrupted in 1975. This was the result of one of President Kountché’s speeches in which he announced that the land belongs to the person who cultivates it. This announcement caused violent confrontations between traditional land owners and their tenants, the latter having been declared the new land lords. In situations concerning land tenure, which are likely to cause disputes, institutional changes should be organised in a participatory way, i.e., with the active co-operation of all persons affected. Due to its experience in the 1970s, Niger first tested via pilot projects and then implemented the new land law that was issued in 1995 by Parliament. The long term objective is to build a land registry office similar to the German model.

Altered institutional requirements resulting, for example, from the implementation of a SAP or the globalisation of markets (i.e. patent-rights for genes) demand the competence of the authorities engaged in institutional design. This expertise is crucial for the introduction of institutional innovations acceptable to society (Hartig 1989). Frequently, however, political and economic agents have to act based on incomplete information. They are expected to integrate this information into policy or economic models to increase market efficiency. The recent history of the Zimbabwean public administration gives an eloquent example on how incomplete information can cause institutional inefficiencies. During the campaign of
democratising African nations, Zimbabwe’s political leaders decided in 1982 to withdraw jurisdiction and land access control from the traditional, feudal-oriented village chiefs. The jurisdiction and control of land was transferred to newly created administrative committees. Often, this institutional change caused difficulties in the execution of development projects, particularly in cases where the collaboration between the new administrational committees and the traditional village chiefs was not achieved.

In the process of building and/or restructuring rural institutions as a result of a SAP, it is important to maintain access to these institutions for the traditional and new target groups of development aid. In many cases this necessitates strong collaboration between formal and informal institutions and their organisations (Zeller et all 1997). In this context, many NGOs offer valuable intermediation services. The standard example of inter-institutional co-operation, often facilitated by NGOs, is observed in the financial system of developing countries that comprises a formal and informal financial sector (see Figure 2.).
This type of financial system innovation (Schrieder and Heidhues 1995) allows the formal financial sector to shift transaction costs that arise from incomplete information and contracts, i.e. borrower selection, loan repayment incentives, and repayment monitoring to the informal financial sector. At the same time, this inter-institutional co-operation between the formal and informal financial sectors can reduce market access constraints of the target group (Heidhues, Sossoh and Schrieder 1997). In the case of the poor rural population who lack conventional credit collateral, a socially accepted and competent institution, the informal financial sector, is capable of playing the intermediary role to the formal domestic financial market.

In Asia, South America and Africa drastically increasing urbanisation, combined with a higher level of consumption of modern goods, necessitates the building of formal and informal rules regarding the supply of energy and water, waste management and recycling (Hasenritter 1995). In particular waste management presents a challenge. In order to limit the uncontrolled, hazardous waste dumps in the densely populated valley of Kathmandu in Nepal, the GTZ tried to initiate a learning process among the population regarding city-cleanliness. An important instrument were the campaigns designed to raise awareness with respect to the health risks of uncontrolled waste. At the same time, waste management rules were worked out in a participatory process. These waste management rules ought not to destroy the existing system but to complement it. In the case of Nepal this meant that the function of the street sweepers and second-hand dealers was maintained. The collection of the waste in the roads through the street sweepers was, however, extended by introducing waste removal, recycling and final waste storage facilities.

3.4. Sustainable institution building increases welfare
Politicians, practitioners and scientists are more or less unanimous in their view that a short-term and narrow sighted structural adjustment or transformation process does not suffice to put an economy on a sustainable and poverty reducing development path. Sustainable and poverty-oriented economic development is based on continuous investment in human capital, infrastructure, institutions and an effective framework for maintaining civil order (World Bank 1994). Also, it could be empirically documented that successful economic development is closely linked to higher agricultural productivity. Agricultural productivity, however, is positively correlated with the institutional environment (Heidhues 1990; North 1999).

Nevertheless, there are no generally valid recipes for quick and welfare-increasing institution building. This is shown in the brief discussion of the neo-classical and institutional economic theories above. One should always keep in mind that institutions depend on the humans that make use of them and in this respect a saying of Popper (1987) applies: it is impossible to create foolproof institutions, therefore, the architecture of the institutions must be intelligent.

As soon as the basic institutional pre-requisites in the public and private sector of rural economies are built, new public and business organisations (local political bodies, family farms, trade- and transportation enterprises) follow and existing ones become more efficient. Their economic maximisation activity results in a new productivity increase and thus contributes to economic growth. These productivity increasing effects of an institution may, of course, also induce negative external effects like any form of change. One example of this are the environmental costs resulting in the transition from farm rotation to permanent crop cultivation when soil fertility treatment is neglected. Another example is the possible deterioration of food security if public extension offices foster primarily the cultivation of export-tax creating cash crops and neglect food crop production.

In summary, the investment in sustainable institutions and the corresponding organisations benefits domestic welfare most if:

- social acceptance is reached by allowing for maximum participation of the target group and by taking into account informal rules and traditions;
- access constraints for weaker market participants are reduced (e.g., through co-operation with or adoption of informal institutions);
- information asymmetries and incomplete foresight of the market participants is reduced (e.g., through radio broadcasted market information);
- risk is diminished by producing more complete contracts (e.g., through the introduction of joint liability in group lending instead of physical collateral in individual lending) and if
- domestic welfare can be increased through a reduction of the transaction costs in the production and exchange process.

Finally, it ought to be pointed out that the willingness of the people who operationalise the rules in organisations to apply them appropriately is a necessary condition for more efficient institutions. Thus, it is necessary, apart from building an acceptable institutional framework, to foster the ethical behaviour of the market participants. The dedicated execution of ones duties in the public and private sector has to become self-evident. This is of particular importance to reduce insecurity institutionally. As long as clients (and not the organisations) have to offer work incentives to the agents, weaker market participants will continue to face a large degree of insecurity.
REFERENCES


Review Questions

1. Why is it difficult to measure the effects of the SAP, especially at the microlevel?
2. Discuss the social dimensions of different macro and sectoral policies and focus on the differences with regard to their impact on certain population groups.
3. What kind of economic measures could be implemented to counteract the adverse effects on the living conditions of the population?
4. Why are rural financial institutions important to improve the living standards of the poor?

Teacher’s Guide

1. Students are aware of the complexity of the diverse effects of structural adjustment policies on the welfare situation of the population in developing countries.
2. Students have been introduced to the main structural policies and their social dimensions with an emphasis on sub-Saharan Africa.
3. An attempt should be made to give an overview of different policies and their impact on the living conditions of the people. Two policies should be picked out and the students should discuss in depth the social dimensions.
4. Discuss the general symptoms of an economy that does not dispose of a functioning rural financial market.
5. Discuss the pros and cons, as well as the limits of some financial institutions in improving the access of the rural poor to the financial market.

Student’s Guide

This lecture give an introduction to the social dimension of structural adjustment policies. It should be seen as an overview, and it is closely linked to week 4 day 4, when the effects of different instruments are described thoroughly in two case studies.

Focusing on the role of institution building in the development process, which is one aspect of structural adjustment, the last part of the day stresses the importance of sustainable and adapted rural financial institutions to enable the rural populations to have access to productive resources.

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