Structural Adjustment Lending

An Evaluation of Program Design

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ABSTRACT

Structural adjustment lending (SAL) is a comparatively new instrument. Although the Bank has substantially improved the design and implementation of these operations, there are areas which need further improvement. This paper attempts to identify these areas and indicate the issues to be explicitly addressed in the design of future SALs.

Special emphasis is given to the development of an analytical framework for SAL design. An analytical framework is defined as a set of concepts, issues, techniques and guidelines for policy analysis. Recommendations are also made to specify some of the components of the suggested framework.
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# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>2. A SURVEY OF ADJUSTMENT ISSUES</td>
<td>5</td>
</tr>
<tr>
<td>Introduction</td>
<td>5</td>
</tr>
<tr>
<td>Sources of Internal and External Imbalance</td>
<td>5</td>
</tr>
<tr>
<td>Modes of Adjustment to External Disequilibrium</td>
<td>6</td>
</tr>
<tr>
<td>Impact of Stabilization and Structural Adjustment Policies</td>
<td>7</td>
</tr>
<tr>
<td>Expenditure-Reduction Policy</td>
<td>9</td>
</tr>
<tr>
<td>Expenditure Switching</td>
<td>11</td>
</tr>
<tr>
<td>The Design of Consistent Structural Adjustment Programs</td>
<td>14</td>
</tr>
<tr>
<td>Income Distribution Effects of Adjustment Policies</td>
<td>17</td>
</tr>
<tr>
<td>Global Consistency of Adjustment Policies</td>
<td>18</td>
</tr>
<tr>
<td>3. AN EVALUATION OF THE ANALYTICAL FRAMEWORK OF SALs</td>
<td>20</td>
</tr>
<tr>
<td>Introduction</td>
<td>20</td>
</tr>
<tr>
<td>Consistency in Objectives</td>
<td>21</td>
</tr>
<tr>
<td>Relationship Between Objectives and Instruments</td>
<td>29</td>
</tr>
<tr>
<td>Partial vs. General Equilibrium Analysis</td>
<td>31</td>
</tr>
<tr>
<td>Lack of a Clear Medium-Term Perspective</td>
<td>32</td>
</tr>
<tr>
<td>4. RECOMMENDATIONS TO IMPROVE THE ANALYTICAL FRAMEWORK OF SALs</td>
<td>34</td>
</tr>
<tr>
<td>Introduction</td>
<td>34</td>
</tr>
<tr>
<td>Monitorable Medium-Term Action Program</td>
<td>35</td>
</tr>
<tr>
<td>Adjustment Dynamics</td>
<td>36</td>
</tr>
<tr>
<td>Explicit Analysis of Conflicts and Trade-offs</td>
<td>38</td>
</tr>
<tr>
<td>Guidelines for Monitoring and Evaluating SAL Programs</td>
<td>39</td>
</tr>
<tr>
<td>Research Requirements of an Analytical Framework for SAL Design</td>
<td>40</td>
</tr>
<tr>
<td>Issue-Oriented Research</td>
<td>41</td>
</tr>
<tr>
<td>Policy Modelling</td>
<td>43</td>
</tr>
<tr>
<td>Main Features of the Suggested Modelling Framework</td>
<td>46</td>
</tr>
</tbody>
</table>
# TABLE OF CONTENTS (cont'd)

<table>
<thead>
<tr>
<th>Appendix</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>APPENDIX</td>
<td>50</td>
</tr>
<tr>
<td>A. Country Experiences of Structural Adjustment</td>
<td>51</td>
</tr>
<tr>
<td>Turkey</td>
<td>51</td>
</tr>
<tr>
<td>Malawi</td>
<td>67</td>
</tr>
<tr>
<td>Philippines</td>
<td>79</td>
</tr>
<tr>
<td>B. Survey of Adjustment Issues</td>
<td>97</td>
</tr>
<tr>
<td>C. References</td>
<td>134</td>
</tr>
</tbody>
</table>
1. **INTRODUCTION**

This study purposes to evaluate the design of the Bank's Structural Adjustment Loan program. A variety of other evaluations of the SAL program have been written since its inception in 1980, but these have largely concentrated upon the recipient countries' success in implementing the programs. By contrast, this study brings a more analytic perspective to bear upon developing a unified conceptual framework and designing consistent adjustment programs.

The purpose of SALs has been to support the implementation of policies and institutional changes necessary to modify the structure of an economy so that it can maintain both its growth rate and the viability of its balance of payments in the medium-term. Some 28 SAL operations have been approved to date in 16 countries, and these have met with varying degree of success. 1/

SALs are comparatively new instruments, and the Bank is still gaining experience in their design and implementation. Despite this, SALs have had considerable success in a number of countries, both in design and implementation. However, some issues have been identified in this study that need further attention in SAL design. These issues can be summarized as follows: (1) Lack of a well-elaborated medium-term perspective is a common issue observed in a large number of SAL programs. (2) There are potential conflicts among some of SAL objectives and policy instruments. They are not sufficiently elaborated

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1/ See "Structural Adjustment Lending Progress Report", June 6, 1984 (R 84-150).
and the trade-offs are not carefully explored in SAL programs. (3) SALs are multiple objective and multiple instrument programs. The multidirectional links and interactions are only informally and loosely established. (4) Partial analysis dominates SALs' policy design. This does not allow one to trace the general equilibrium interactions in the economy that would be initiated by the recommended policies. 

These issues indicate that an articulated analytical framework has not yet been developed in the Bank for the policy analysis of the SAL operations which is comparable to those that support project lending of the Bank or the stand-by arrangements of the Fund. By an analytical framework, we mean an integrated set of concepts, issues, techniques and guidelines for policy analysis. The benefit of developing such a framework is clear. By providing a unified set of tools and concepts and a shared vocabulary to analyze adjustment issues, a well thought-out framework would help organize our views and facilitate clear and systematic thinking, leading to better SAL programs.

To help develop such a framework and to improve the design of SALs, recommendations are also made. These recommendations (a) stress the need for a policy-focussed medium-term perspective as a guide for monitorable actions; (b) provide a list of areas of further research needed to improve our understanding of adjustment dynamics; (c) present a checklist of possible conflicts among objectives and instruments that need further attention in SAL policy design; (d) point to the need for a set of guidelines regarding the monitoring and evaluation of SAL programs; (e) indicate the need for researching of specific issues and key relationships; and (f) draw attention to the usefulness of
simulating the impact of suggested policies with an economy-wide policy model.

These recommendations are naturally not sufficient to define in detail the type of analytical framework the Bank needs for SAL design. However, they would constitute some of the main components of such a framework and indicate the types of features it would contain. In the recommendations, special emphasis was placed upon researching key issues, relationships and trade-offs and analyzing the short-term and medium-term response coefficients of the main macroeconomic variables and targets. It is also suggested that policy modelling would serve as a unifying element in defining an analytical framework by providing a basis for linking policy instruments to performance indicators, estimating trade-offs, and simulating the effects of the recommended policies in an economy-wide context. It is stressed, however, that the role of modelling and its expected benefits should not be overstated. The concept of an analytical framework, the main theme of this study, is much wider than a modelling framework. The latter is expected to assist those engaged in a policy dialogue in testing the consistency of their judgments in an economy-wide framework and exploring the implications of alternative policy packages being considered.

Our evaluation is based on (a) an in-depth study of a number of SALs; and (b) a survey of adjustment issues. Initially, our intention was to study all SAL programs prepared in the Bank. This proved infeasible within the time constraint we worked. After reviewing a number of SALs we had to reduce the sample size to three countries (Philippines, Turkey and Malawi) for more detailed evaluation. Our
observations therefore apply mainly to the three SALs we have studied in depth, but are also appropriate to others we have examined less closely.

We have also done a literature survey of adjustment issues. The purpose of this survey is to identify the major discussions and controversies on adjustment policies and to help establish criteria to evaluate the SAL programs. This survey is far from being exhaustive. It includes only the adjustment issues which are particularly relevant for the SAL programs.

One limitation of the study should also be mentioned. The evaluation we present in this paper focuses largely upon the policy design of the SAL programs and only touches upon the negotiation, implementation, supervision and other aspects of these operations.

The plan of the paper is as follows. Section 2 summarizes a variety of the issues in the literature most relevant to the design of structural adjustment policies. Section 3 evaluates a number of SAL operations from a technical and analytical point of view, while Section 4 makes recommendations to improve the construction of structural adjustment policy packages. The appendix includes three country-specific case studies of SAL design which formed the core of our evaluation effort; this was, however, supplemented by less detailed studies of a variety of other SALs. This is followed by a longer, more detailed version of the survey of adjustment issues.
2. **SURVEY OF ADJUSTMENT ISSUES**

**Introduction**

The past decade has seen the development of persistent, unviable balance of payments deficits on the part of many developing countries. There is a growing belief that these problems are not amenable to narrow demand management policies; interest has shifted from the application of short-term stabilization policies to more gradual structural adjustment programs. Little academic research has been focused upon the proper design of structural adjustment programs per se. The following pages are intended to highlight those issues currently being discussed which are especially pertinent to the construction of structural adjustment programs. A discussion of the sources of internal and external imbalance is followed by a summary of the different broad modes of adjustment identified in the literature. Next, the potential impacts of specific adjustment and stabilization policies are focused upon, while the following section discusses the overall design of consistent, effective structural adjustment programs. Finally, potential distributional impacts of these programs and their consistency with global economic trends are touched upon.

**Sources of Internal and External Imbalance**

Considerable controversy attaches to whether the past decade's marked payments problems are attributable to external shocks or

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1/ This section is a summary of the detailed survey presented in the appendix.
inappropriate domestic policies. The former include adverse terms of trade changes, declines in export volume demanded, and more recently, rises in the interest rate (Mitra 1983). The latter encompass overly-expansionary fiscal and monetary policy, policies reducing microeconomic efficiency through introduction of various distortions, and policies producing disincentives for the export sector, notably overvalued exchange rates and high cost protection policies. There appears to be some consensus in the literature that the weight of external shocks has been more important in payments imbalances, though internal factors have been especially important in the adjustment response to external shocks. As structural adjustment programs are country-specific, it is not clear how useful an aggregate characterization will be to SAL design. In any event, care should be taken in SAL design to identify the specific causes of imbalances - the internal/external distinction per se may be less crucial.

Modes of Adjustment to External Disequilibrium

Three broad adjustment modes have been identified in the literature. (1) Expenditure -reduction involves reducing domestic absorption in relation to aggregate supply. While in principle this could be achieved through either increases in output or increases in savings (at constant output), in practice expenditure-reduction policies are usually associated with decreases in output, investment, and hence future growth. (2) Expenditure-switching policies attempt to shift output from the home goods to the tradeable goods sector by promoting exports and import - substitutes. While entailing less costs than the
expenditure-reduction strategy, it is likely to take longer to achieve results. (3) The final adjustment mode, external financing, is considered appropriate for transitory payments imbalances and in conjunction with other adjustment modes, but not for persistent, fundamental disequilibria.

Research on the incidence of adjustment modes across different countries indicates that while outward-looking countries suffered greater external shocks, they were better able to implement expenditure-switching policies with less reliance on external financing or economic traction (Balassa 1983). This stemmed from the outward-looking country's less active discrimination against the tradeables sectors, so that they could more strongly demonstrate the flexibility needed to respond to severe external shocks.

Impact of Stabilization and Structural Adjustment Policies

In the preceding pages, the terms stabilization and structural adjustment have been used recurrently, but no clear distinction has been drawn between them. We would like to draw this distinction more closely in order to use it to organize our thinking about the issues and our discussion of adjustment policies. In this sense, "stabilization" and "structural adjustment" should be thought of as abstract concepts defining opposite poles on a range of different policy approaches, rather than specific policy packages per se. While the Fund programs are traditionally referred to as "stabilization programs" and Bank SALs as "structural adjustment programs", this organizational distinction does not correspond to the conceptual distinction we are making here.
The Fund programs provide for a variety of measures effecting output, employment and resource re-allocation which might be thought of as "structural adjustment" measures. 1/ Moreover, while stabilization and structural adjustment are highly dissimilar in some respects, they complement each other in the design of complete policy packages, and this complementarity has resulted in the emphasis on effective Bank/Fund collaboration in designing SAL and standby arrangements. In this organizational collaboration the boundaries between stabilization and structural adjustment become blurred.

The conceptual distinction between stabilization and structural adjustment is composed of two related elements. The first relates to the objective of the actions: the purpose of a stabilization program is to correct a balance of payments deficit, while structural adjustment works simultaneously toward payments deficit reduction, the resumption of output growth, and the achievement of structural changes needed to prevent future payments and stabilization problems. Secondly, to this distinction in objectives corresponds a crucial distinction in methodologies. Stabilization programs take the parameters determining an economy's response to policy instruments as given, and attempts to manipulate these policy instruments exclusively to achieve its stabilization objectives within relatively short time horizons. Conversely, a structural adjustment program not only manipulates primary policy instruments, but exploits a longer time frame to increase the

responsiveness of the stabilization objectives to those instruments. For example, a stabilization program may depend largely upon an exchange rate devaluation to correct a BOP problem, relying exclusively upon exporter response to higher export prices (in domestic currency) to turn around the trade deficit. By contrast, a structural adjustment program might combine a devaluation with decreased tariffs, the elimination of price/wage controls, and an export credit facility, all of which would enhance the export sector's response to the original devaluation.

Expenditure-Reduction Policy

Within this mode, the major stabilization tool is a decrease in domestic credit creation to reduce the current account deficit and also to contain inflation. Those adhering to the pure absorption approach would see this policy leading to declines in final demand but not in output, leading to an improved current account with relatively little cost in terms of income and growth (Sharpley 1984). Dell (1983) points out that this presumption of easy flexible expenditure-switching (as declining domestic demand is automatically offset by increased sales for export) must underlie any exclusively demand-focused approach to stabilization. On the other hand, those of a more structuralist inclination stress the inflexibility of derived demands for imports, as well as the short run inability to produce domestic substitutes; they would expect import declines and trade balance improvement only after considerably greater output contraction (Schydlowsky's comments on Cline, in Cline and Weintraub 1981).

Another strand of criticism in the literature focuses upon the inflationary side-effects of these stabilization policies, their
effectiveness aside. Taylor (1981) and Bruno (1979) both present models of monetary contractions which raise interest costs on working capital, lever up prices, and reduce output. Dervis' comments on Taylor (1981), however, point out that these inflationary effects will usually be short-term phenomena; in general, empirical evidence does not support an actual negative correlation between the money supply and inflation (Cline 1983).

Perhaps a more problematic aspect of conventional absorption reduction measures is their focus upon investment reduction; this limits future output growth and hinders attempts to drift relative sectoral capacities toward tradeable goods.

There are varieties of structural rigidities which force attempts to reduce the output/absorption gap to rely exclusively upon costly output and investment reduction: bottlenecks and rigidities inhibiting sectoral shifts, ineffective taxation systems and public sector operations which limit public savings, and underdeveloped capital markets and financial regulations limiting private savings mobilization. Structural adjustment policies addressing bottlenecks and sectoral rigidities are discussed below, while those associated with public sector efficiency and resource mobilization are of a rather technical nature and have received less attention in the stabilization literature.

Regarding the capital market rigidities, a widely recommended strategy for increasing private savings has been liberalization of the financial sector (McKinnon 1973, Shaw 1973). This is hoped not only to raise real interest rates, encourage savings, and better select for high
return investments, but also to reduce intermediation costs in the banking sector by introducing increased competition. Foxley (1980), however, points out that large lending rate increases may increase working capital costs, raise prices, and decrease some sectoral outputs in the short term. Whether or not increases in deposit rates increase private savings rates, they are also likely to divert savings from informal to more formal credit markets, at least temporarily disrupting the flow of working capital to sectors traditionally dependent upon the curb markets for financing and hence causing transitory output losses (Taylor 1981, Wijnbergen 1982).

**Expenditure Switching**

The most prominent stabilization tool for expenditure switching has been the devaluation of the exchange rate. This action is intended to raise the domestic currency price of tradeables vis-a-vis home goods and hence shift production toward the former (and to lesser degree, demand towards the latter).

One of the most controversial impacts of a devaluation is its potential, depending upon a variety of conditions in the economy, to raise domestic prices and hence undermine the real effects of the nominal exchange rate change. Bird (1984) notes the possibility that in addition to a direct inflationary impact through increased import prices, the improved trade balance caused by a devaluation could induce reserve inflows which would expand the money supply and thereby raise prices. This could be sterilized through a corresponding credit contraction, however; and in any event, the full real devaluation can be
protected by adoption of a "crawling peg" which depreciates the exchange rate at the rate of inflation.

A key determinant of the effectiveness of the devaluation will be the supply response of exports. While evidence points to fairly high responsiveness (Cline 1983), this will depend upon the capacity utilization of the country's export sector and the gestation periods associated with additional investments or crop expansion. The response of import demand and import-substitution supply is not expected to be as important to trade deficit reduction. First, the effect of a currency devaluation in the context of widespread QRs is to lower the profits of import licensees more than to raise import prices for consumers (Krueger 1981). Secondly, decades of tariff protection have already suppressed the importation of most easily producible goods, so that little leeway exists for further substitution in the short-term.

The thrust of the most recent criticism of exchange rate devaluation focuses less upon its medium-term effectiveness than upon possible stagflationary side effects. In addition to its inflationary potential, a variety of hypotheses suggest that while devaluation is considered expansionary, it may achieve offsetting contractionary impacts. It could do this by (1) raising the price level, thus lowering real balances, credit, and activity (Dornbusch 1973), (2) lowering aggregate real income when the trade balance is initially in deficit and income gains to exporters are offset by income losses of import consumers (Krugman and Taylor 1978), and (3) raising profits as prices increase relative to nominal wages and hence diverting incomes from high-consuming workers to low-consuming capitalists (Taylor 1981).
These are theories of short-run effect, however, and should be viewed more as factors which could cause overkill through credit contraction than as important independent factors in themselves.

The structural adjustment policies associated with expenditure-switching are intended to enlarge the elasticities of export supply, import demand, and import substituting supply with respect to devaluation, as well as to more directly shift resources into the tradeable goods sector. Among the most important of these is trade liberalization to remove the import barriers raising costs, lowering productivity, and producing incentive biases against exports (Krueger 1981). While likely to be highly beneficial in the long run, Krueger notes that a decrease in protection may cause transitory losses of activity if newly profitable industries need time to expand output while others lose their viability. Moreover, if no strong export response is forthcoming, increases in imports could offset the intended trade balance benefits of devaluation. Finally, the unification of the tariff rates in liberalization schemes may involve raising tariffs on imported capital and intermediate goods, with according adverse impacts on costs in some sectors.

A second major structural adjustment strategy associated with expenditure-switching is price control liberalization to remove distortions, increase efficiency, and eliminate sectoral discrimination. Again, certain transition problems may result. Foxley (1981) notes that after prices have been frozen for some time, unstable expectations may generate price overshooting, declines in the real wage, and fluctuations in output - oligopolistic elements in the markets would delay the adjustment period.
The importance of liberalizing markets notwithstanding, more interventionist tools such as export subsidies and/or multiple exchange rates may be appropriate when certain distortions cannot be readily reduced, or when response elasticities differ across sectors (Bird 1984). For example, it may be desirable to devalue the exchange rate for export earnings more than that for import payments if import demand is highly inelastic and would promote contractionary expenditure leakages. While lacking the destabilizing potential of liberalizing measures, however, these policies are subject to potentially high administration costs and difficulties in implementation. They tend to develop vested interests opposed to their eventual removal, and in the case of export subsidies on value-added, are likely to violate GATT rulings and invite hostile reciprocation.

Another interventionist strategy would be the specific targeting of investment to the export and import-substituting sectors. This may be justified by the need to break bottlenecks preventing expenditure-switching sectoral shifts, as well as by the failure of poorly developed capital markets in many developing countries to guide resources to the most profitable areas. As a long term strategy, however, it may conflict with the goals of privatization and market liberalization embodied in many structural adjustment programs.

The Design of Consistent Structural Adjustment Programs

While analyses of specific stabilization and adjustment policies abound, few guidelines exist to help design a structural adjustment program per se, i.e., a set of consistent mutually
reinforcing policies. One recent example of this has been the "real economy" approach proposed by Killik, Bird, Sharpley, and Sutton (1984). As they point out in their article, this approach is very similar in spirit to World Bank SALs: the application of a multiplicity of different policy tools to enhance efficiency, build up institutions, promote resource mobilization and correct payments imbalances. However, they do not propose a formal framework to determine objectives, appropriate time phasing, and construct/evaluate optimal, consistent policies.

Turning to the objectives of structural adjustment programs, most discussions include the following elements: (1) the correction of balance of payments imbalances, (2) the elimination of distortions and promotion of microeconomic efficiency, (3) the reduction of high inflation rates, (4) the protection or resumption of output growth, and (5) minimization of the cost of adjustment to the poorest (Killik, Bird, Sharpley and Sutton 1984; various World Bank documents; Williamson 1983). However, little attention in the literature has been focused upon the assigning of relative weights to those potentially conflicting objectives, nor ways of adjusting these weights to specific country circumstances.

There appears to be substantial controversy regarding the relative appropriateness of "shock treatments" and gradualist approaches to adjustment. Analysts of a structuralist orientation such as Killik maintain that gradualism is to be preferred because it allows rigid structural parameters time to adjust, as well as because it avoids the welfare losses of harsh, rapid dislocation. Conversely, Krueger and
others recommend a non-gradualist approach because it limits opportunities for the development of political resistance to program policies. Moreover, Nowzad (1984) points out that a series of shorter term programs may provide more flexibility over time than a single longer term program. Clearly, the appropriate point on this trade-off must be determined on a country by country basis.

A related issue is the optimal degree of external financing of a deficit: the longer the adjustment period, the greater the role for financing. Conversely, factors specific to the cost and availability of external financing will contribute to the determination of the optimal adjustment period. Relatively little in the literature focuses specifically upon optimal financing levels for structural adjustment (except Selowsky and Martin 1984). However, recent theoretical work on the determination of solvency and liquidity constraints for developing countries may provide rough guidelines in this area (Sachs 1983, Simeonson 1984).

An implementation-oriented issue in the design of structural adjustment programs is the number of policy actions to be undertaken. While it is considered desirable to take action in as many different areas as possible, too large a "wish list" may overly burden administrative and monitoring capacities - the appropriate point on this tradeoff will vary across countries.

The core of a formal framework for SAL design should be a framework to evaluate the impacts of different adjustment policies - such a framework would incorporate the elasticities of response of policy variables to policy actions, and would also account for
interaction effects between policies in a consistent, simultaneous manner. The real/financial model developed by Lal (1984) to analyze structural adjustment issues represents an effort along these lines. Furthermore, this framework must take response lags into account so that a dynamically consistent set of policies may be devised. Cline (1983) points out that the time path of optimal adjustment is a high priority for future research. Khan and Knight (1981) developed a highly aggregate simulation model to study dynamic adjustment paths, and this is a step in the right direction.

**Income Distribution Effects of Adjustment Policies**

The role of distributional considerations in structural adjustment objectives is ambiguous, but it would seem desirable to at the least attempt to avoid large movements toward greater inequality. While little consensus on the net effect of adjustment programs exists, the following summarizes some of the potential distributional impacts noted in the literature.

Much of the work in this vein focuses upon the functional income distribution. Ahluwalia and Lysy (1981) point out that the impact of contractionary stabilization policy will depend partly upon the elasticity of substitution of capital and labor, with low elasticities increasing labor's share as output decreases. Using a less neo-classically oriented approach, Taylor's models often assume a shift of income toward capitalists as increases in prices (caused by a devaluation, largely) combine with fixed nominal wage to lower real worker incomes. However, as Omataunde and Salop (1980) point out, a
successful devaluation may result in a decrease of the wage relative to tradeables' prices, but an increase relative to non-tradeables. Moreover, a lowered real wage will increase employment and potentially improve the functional distribution; this will be more true, depending upon the labor-intensiveness of the stimulated export sector. Wage and tariff liberalization policies which reduce capital-intensive biases in investment may have long run beneficial effects on distributions.

In developing countries, the key inequality may not be between capital and labor so much as between different categories of capitalists and workers. Omatunde and Salop (1980) note that credit restraint programs may hurt small informal sector firms and the rural sector. Increased taxation is likely to fall heaviest upon importers, exporters, and public/formal sector workers. On the other hand, widely recommended actions to cut consumption subsidies and raise government charges may be detrimental to the poor, regardless of income source.

Global Consistency of Adjustment Policies

In addition to ensuring the internal consistency of structural adjustment policies, SALs should ensure the consistency of their policy recommendations with trends in world export and capital markets. Traditional analyses often regard individual countries as price takers in world markets (see Ahluwalia and Lysy 1981, for a notable exception), but some countries will inevitably have substantial market shares in some commodities. SAL design should include an assessment of those export categories with the greatest expansion potential. Moreover, the policies of SAL programs across countries should be made mutually
consistent, so that markets for particular commodities are not accidentally saturated by too many expanded supply sources, or so that simultaneous absorption-reduction policies in too many countries do not depress world import demands. The global analysis and projections associated with the WDR may provide a useful point of departure for this approach. There is as yet little written on these issues, partly because they are inherently difficult to treat, but with increasing numbers of countries undertaking adjustment policies, it should attract research interest.
3. AN EVALUATION OF THE ANALYTICAL FRAMEWORK OF SALs

Introduction

Section 2 summarized a variety of issues currently being discussed in the literature which are especially pertinent to structural adjustment policies. In the light of these discussions and on the basis of our in-depth examination of a number of SALs, this section presents an evaluation of the design of SAL programs.

SALs are a creative and innovative lending instrument. Experience indicates that they have contributed substantially to structural adjustment in a number of developing countries. The strength of the SAL operations lies in their comprehensive approach to structural adjustment and their emphasis on medium-term, supply-side, micro, and real issues of the adjustment process as opposed to the relatively sharper short-term, demand-side, macro, and financial focus of the traditional stabilization programs.

In the last four years, some experience has been accumulated in the Bank in the design and implementation of adjustment programs. This experience enables us to make an evaluation of these operations. The evaluation presented here will be limited in scope: it will be related only to the technical and analytical aspects of a number of SALs. Neither the suitability of the suggested policy changes in the specific cases, nor the effectiveness of these measures are included in the evaluation. The general aim is to indicate where the Bank can improve the policy analysis of the SAL operations.
In examining the analytical structure of the SAL documents for Turkey, Philippines and Malawi in-depth and for some other countries less closely, we identified some issues that need further attention in policy analysis. These issues are certainly known to those who were involved in the SAL operations. Lack of an established policy framework and the time constraint under which the programs are completed, are important elements which contributed to the insufficiency of attention these issues have received. The purpose of this evaluation is to highlight these issues and make some recommendations.

Consistency in Objectives

SAL operations are multiple-objective operations. They are formulated around various economic, institutional and social objectives both at the macro and micro level. This makes interdependence between objectives an important issue. Some objectives are complementary, but others are partially conflicting. Explicit trade-offs between partially conflicting objectives and the degree of complementarity between others are not always made clear in the documents, leading to recommendations of policies which might fail to meet some of the objectives to the extent originally envisioned.

In the case of conflicting objectives, the question is whether the conflict is a transitory one and could be resolved through time without many medium-term costs, or it persists for a longer period with significant costs attached to sub-optimal policy choices. How long would the conflict last? What is the cost in terms of foregone objectives? Would the severity of the foregone objectives impair the
credibility of the package of adjustment policies and lead to the breakdown of the program. Some conflicting objectives could be reconciled at a lower level of income. What is the level of income which would reconcile them? Would it be politically acceptable?

These questions need to be explicitly addressed in a multi-objective program and interdependence and trade-offs need to be quantified as far as possible.

The treatment of these issues in SAL documents requires more attention and rigour. In some cases they are not directly addressed. In others they are only casually and superficially treated.

The areas of potential conflict in the three SAL operations we have examined, are the following.

(1) **Trade liberalization vs. reduction in balance of payments deficit/reduction in budget deficit.** Trade liberalization is a significant part of the Turkey and Philippines SALs (not important in Malawi, where QRs are negligible and tariffs are low). This involves reduction in tariffs as well as the elimination of QRs (average tariff reduction was also suggested in the case of Kenya, Korea and Thailand). If not supported by appropriate supplementary policies, tariff reduction reduces government revenue and increases imports, which, in turn, increases both the budget deficit and the balance of payment deficit, indicating short-run inconsistency among three objectives set in the SAL documents of two countries. 1/

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1/ If trade liberalization involves replacement of QRs with tariffs (Kenya, Panama, Pakistan, Ivory Coast) such a conflict would naturally not arise.
The inconsistency can be partially reconciled in several ways. (a) Exports and government revenue from non-tariff sources could be increased to such an extent that balance of payments deficit and budget deficit are reduced despite the adverse effects of tariff reduction. 1/ (b) A compensating exchange rate adjustment may be undertaken to accompany tariff reduction. This would eliminate the cheapening of imported goods created by tariff reduction and discourage imports made available by lifting of QRs. Although tariff rates are reduced, exchange rate adjustment would increase the domestic currency price of imports and the tariff revenue. (c) Reconciliation could be achieved at a lower level of income brought about by reducing domestic absorption.

The potential conflict between trade liberalization and balance in budget and payments could be partially or totally reconciled by one or a combination of (a) - (c). There is not a clear discussion of these issues in the SAL documents. Although a combination of (a) - (c) is adopted in SALs, the issue was not explicitly addressed and the relative merits of the choices do not appear to have been carefully considered.

(2) Stabilization vs. growth. In all three countries structural adjustment is combined with stabilization. SAL operations are prepared in conjunction with standby arrangements. Stabilization programs are designed to deal mainly, but not exclusively, with imbalance between aggregate demand and supply created by internal mismanagement or external shocks or both. Such an imbalance can be

1/ In the case of Philippines, the conflict was carefully considered and increase in indirect taxes were recommended to compensate the potential loss of revenue.
corrected by adjusting demand or supply or both. Supply adjustment, which is the focal points of SALs, typically takes time. In the short-run, under standby arrangements, the main burden of adjustment may fall on the side of demand, implemented through reducing the growth rate of money supply by controlling the Central Bank's domestic assets. 1/

With the contraction of demand, capacity utilization and output tend to decrease if not compensated by an autonomous increase in production such as an increase in agricultural output due to favorable weather conditions. In addition, the availability of credit for both working and fixed capital would decrease. This increases costs which may discourage new investment. Supply adjustment in a contracting economy with decreasing new investment would be severely limited.

The conflict is evident in the case of Turkey. The manufacturing value added and GDP declined in 1980, the first year of the adjustment, but began growing thereafter (Table 3). Investment also declined in both 1980 and 1981. However, growth in investment resumed in 1982.

The conflict between stabilization and growth is naturally a transitory one. After a while, positive effects of stabilization would emerge and both production and investment would resume positive growth rates. Efficiency in production and productivity of investment would improve. The long-term benefits would exceed short-term costs. But the length of the contradictory period and the economic and social costs of

1/ The changes in the traditional Standby and SAL programs and the growth of effective collaboration between the Bank and the Fund in recent years make the distinction between stabilization and adjustment more difficult.
stabilization in that period are of utmost economic and political importance.

The SAL documents do not provide an explicit analysis of the reconciliation of the need for long-term development with reasonable stability. They do not explore the trade-offs and alternatives. An explicit treatment of these issues would not only improve policy analysis of the Bank, but also forewarn the governments about the difficulties involved in the implementation of the programs. This, in turn, would avoid the possible disillusionment with the results and consequent breakdown of the programs.

The relationship between stabilization and growth receive little analysis in SAL documents mainly because the stabilization falls under the organizational jurisdiction of the Fund. The staff of the Bank and the Fund, however, occasionally differ on the speed of stabilization and adjustment. A policy modelling framework which is capable of simulating the policies and estimating the trade-offs would be very useful in the dialogue between the Bank and the Fund staff.

(3) **Privatization vs. liberalization of interest rates/increase in tax revenue.** Privatization of the economy is another common objective in the SALs under study. This involves an increase in the share of private sector in production through a substantial increase in private investment. 1/ This objective is set simultaneously with liberalization of interest rates and an increase in tax revenue, which both tend to curb private investment. Liberalization of interest rates

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1/ Privatization often means selling off some public firms to the private sector (Panama).
takes for granted that a sufficient array of investment opportunities promising high rates of return will always exist; if it does not, interest rate reform can result in a seriously reduced investment rate in the short-run (the medium-term effect of the reform would, obviously, be favorable). An increase in the tax revenue also reduces investment in the private sector by reducing the investable funds.

The conflict between objectives is again evident. In the case of Turkey, the conflict was tried to be solved by recommending a revaluation of physical assets. By reducing the taxable income through an increase in nominal depreciation allowances, asset revaluation would raise the after-tax profits and the funds to be invested in the private sector. However, this recommendation contradicts with the objective of increasing tax revenue.

Another policy recommended for Turkey is a reduction in the intermediation cost of the banking sector by eliminating the transaction tax of 25 percent on credits. The transaction tax was reduced to 15 percent in 1981 and 3 percent in 1984. But the oligopolistic conditions in the financial sector prevented the gains in the intermediation cost from being passed on the borrowers. This policy recommendation also contradicts with the objective of increasing tax revenue.

The conflict among privatization, liberalization of interest rates and an increase in tax revenue is reflected in the economic performance of Turkey in the SAL period. Interest rates were decontrolled in 1981. The share of private investment in total investment declined from 48.8 percent in 1979 to 40.9 percent in 1983. The tax/GNP ratio also declined from 20 percent to 17 percent in the same period.
The analysis of these issues in the SAL documents is not formal. The trade-offs and the possible means of reconciliation are not addressed directly and rigorously.

(4) **Increasing/decreasing subsidies vs. increasing public sector surplus.** Direct export subsidies in various forms have been recommended for Turkey and the Philippines to complement a realistic exchange rate policy. 

1/ They were suggested, however, on a temporary basis to soften or eliminate the anti-export bias inherent in the system of import protection. Following decreases in import protection, export subsidies need to be lifted gradually.

Granting direct export subsidies is in conflict with achieving higher public sector surplus. Eliminating some subsidies may also conflict with increasing public sector surplus. Decontrolling interest rates in Turkey is one such case. Public firms are the main beneficiary of interest subsidies in Turkey (92 percent of all interest subsidies were granted to public firms in 1981). 

2/ Elimination of interest subsidies would increase the cost and reduce the public sector surplus. In some situations, for example Turkey, subsidy reductions might be more important and it overrides the second objective.

(5) **Stabilization vs. employment and income distribution.** Although the programs frequently include measures which directly affect employment and income distribution, SALs do not take explicit account of

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1/ Direct export subsidies were also recommended for Ivory Coast, Kenya, Mauritius, Senegal, Pakistan, Thailand, Panama and Yugoslavia.

2/ See Yagci (1984), Chapter 3.
distributional consequences of their policy measures. Transitory conflict may exist between employment/income distribution and other objectives of the SALs in the following areas. All three programs aim to increase exports mainly by exchange rate depreciation. This policy shifts resources from non-tradables to tradables. Since non-tradables are more labor-intensive, export-promotion tends to reduce employment. This may be compensated if exportables are more labor intensive than importables.

While decreases in output and investment adversely affect employment, the effects of shifting investment to more labor-intensive sectors and restructuring factor prices are favorable.

Removal of subsidies and liberalization of prices which are included in three SALs may also create adverse effects on income distribution because they are sometimes directly related to the low income producers and consumers.

The conflict is evident in Turkey's adjustment experience. During the four years of structural adjustment in Turkey, inflation fell from 103 percent in 1980 to 32 percent in 1983 and exports increased from $2.3 billion to $5.7 billion in the same period, but unemployment increased from 19.6 percent to 23.2 percent and real wages fell more than 10 percent in 1980-83.

Distributional impact of SAL operations is complex and a priori indeterminate. There might not exist a large number of possibilities to improve employment and income distribution in the process of stabilization and structural adjustment. But the issue deserves explicit treatment in the SAL analysis. The costs and benefits of alternative adjustment paths should be brought out explicitly.
Relationship Between Objectives and Instruments

Policy design in the case of multiple objectives is not an easy task. If policy objectives were positively correlated in response to any given instrument, so that the attainment of any objective necessarily implied progress toward achieving the remainder, little difficulty would be encountered in the formulation of policy. But certain objectives are negatively correlated. In addition, the effect of each instrument on all objectives is not positive. This requires the use of multiple instruments, some being particularly assigned to eliminate the negative effects of the others. All the multi-directional links and effects should be explicitly considered in a coherent program. The questions which need to be particularly addressed include the following:

(1) How large will the response of the objective variables be to a given change in an individual or in a package of instruments? The values of the short-term and the long-term elasticities of (a) imports and exports with respect to the exchange rate; (b) inflation with respect to money stock and exchange rate; and (c) savings and investment with respect to interest rate, have important implications for policy recommendations. If the short-term elasticities are too low because of structural rigidities in the economy, moderation is needed in the use of these instruments and the continuation of some of the interventionist measures (multiple exchange rates, import restrictions, drawback schemes, tax and interest preferences for exports and investment, selective credit policy, etc.) can be justified until the structural constraints are eased. (a) - (c) are discussed extensively in the literature, but receive less attention in the SAL documents.
(2) What indirect effects would the policy instruments create on other objectives? Will they be positive or negative? A good example to illustrate this point is the cost-push effects of public firms' output prices and exchange rate adjustment on inflation in Turkey. In the stabilization programs, inflation has been seen mainly as a monetary phenomenon and the effects of the cost-push factors have not received due consideration. The reversal in the rate of inflation in 1983 after substantial decreases in 1981 and 1982, is explained mainly by the cost-push effects of continuous exchange rate adjustment and particularly by the increases in the public sector's output prices. The output prices of the public enterprises were liberalized in 1980, but little has been done to improve their efficiency. They can now pass their inefficiencies on their prices and contribute importantly to general price level through the basic intermediate and capital goods they produce.

(3) Could the negative side effects be eliminated with specially introduced policy instruments? Would these new instruments themselves produce negative side effects? How could they be taken care of? Liberalization of interest rates in Turkey substantially increased the cost of borrowing for both working capital and fixed capital (lending rates increased as high as 70 percent yielding 25-30 percent real interest rate) and negatively affected investment in the private sector. To counteract this negative effect of interest rate liberalization, the government tried to reduce the intermediation cost of the banking sector by reducing the transaction tax on credit gradually from 25 percent in 1980 to 3 percent in 1984. This policy resulted in a reduction in government revenue only. The oligopolistic
conditions in the banking sector prevented the cost reduction to be passed on to borrowers.

(4) What will be the sequence of policy measures? Will they be introduced simultaneously or sequencially? Good examples of inappropriate sequencing are the ones discussed in (2) and (3) above. Delays and inability in improving the efficiency in the public sector and banking sector substantially reduced the positive effects of liberalization in these sectors. Public sector prices were liberalized in 1980, but no action was taken to rationalize the public sector until 1983. Besides, the measures taken were not radical enough to create sufficient improvement in efficiency. In the financial sector, interest rates were liberalized in 1981, but little has been done to introduce competition in the banking sector. The Capital Law, enacted in 1982, regulates the capital market and is not directly related to the market structure in the banking sector. Some competition could have been imposed on the private sector through large public banks such as the Agricultural Bank.

(5) What is the time lag of the response of the key macro variables and targets to policy variables? How would the policy variables be time-phased? These questions have important bearing on the speed of adjustment. However, they are not sufficiently elaborated in the SAL documents.

Partial vs. General Equilibrium Analysis

SAL operations are formulated around various economic, institutional and social objectives which are linked to a multitude of policy instruments. Contemporaneous and inter-temporal interdependence
is one of the key features of these programs. This necessitates an efficient integration of partial and general equilibrium analyses. Partial analyses focus on certain sectoral issues and recommend detailed sectoral policy measures. They should, however, be integrated in a general equilibrium framework to take account of all interactions and to ensure contemporaneous and intertemporal consistency.

The three SALs we have studied, are dominated by partial analysis, based on various macro, sector or other policy-focused studies undertaken under the economic and sector work programs of the divisions. These studies yielded numerous objectives and policy recommendations, particularly in the case of Turkey and Philippines. However, these objectives and recommendations were not integrated in a general equilibrium framework to analyze the interactions, trade-offs and consistency.

Lack of a Clear Medium-Term Perspective

The objectives and policy instruments of SALs need to be placed in a well-elaborated medium-term perspective in order to guide the policy actions and institutional improvements toward the desired medium-term goals. However, most of the SAL programs lack a clear medium-term outlook.

What is needed is a clear analysis of the growth potential of the economy and the main structural and institutional constraints and policy-induced distortions that hinder the full use of this potential. On the basis of such an analysis, alternative growth paths can be projected in terms of a set of chosen macro performance indicators and time-phased policy instruments consistent with them.
All SALs examined in this study include medium- and long-term projections which are very useful to see the range of likely changes in the economy. These projections are often obtained from RMSM on the basis of assumed growth rates and elasticities of some key variables. The policy analysis behind these assumptions and projections are, however, not always clear.
Introduction

In the previous section we have identified various key issues that need further attention in the policy analysis of a number of SALs. These observations apply mainly to the three SALs we have studied in depth, but are also appropriate to others we have examined less closely.

These issues indicate that SALs lack an articulated analytical framework for policy analysis comparable to the one for project evaluation. Project lending is the traditional means of lending in the Bank. Through the years, the Bank has accumulated experience, expertise, and procedures in the design, implementation and supervision of projects and established a comparative advantage in project lending. SAL is a new instrument. It is related to the design, negotiation, implementation and supervision of overall adjustment policies, both at the macro and the micro level. The Bank staff has less experience in designing comprehensive policy packages.

An analytical framework involves an integrated set of concepts, issues, procedures, techniques and guidelines for policy analysis. The advantage of having such a framework is clear. It provides a unified set of tools and concepts and a common language to analyze adjustment issues. It also helps organize our views and facilitates clear and systematic thinking.

Although the analytical base of the policy measures of SALs is not yet well developed, there is a strong learning-by-doing involved in
the SAL operations. As experience accumulates the technical and analytical scaffolding of these operations will naturally improve. However, we feel this incremental progress can be augmented by more immediate and concerted action. On the basis of the evaluation presented in the previous section, we shall make some recommendations to help improve the analytical framework of the SAL operations.

These recommendations are naturally not sufficient to define a full-fledged framework. Specifying a full-fledged analytical framework is a challenging task and is beyond the boundaries of this study. However, these recommendations would address some of the main components of such a framework and indicate the type of features it would contain. These components are closely interrelated and somewhat overlapping. They should not be seen as mutually exclusive building blocks which are mechanically added together to specify an analytical framework. Rather, an analytical framework could be thought as an integrated whole consisting of interrelated concepts, issues, procedures, techniques and guidelines derived from the constituent parts.

Monitorable Medium-Term Action Program

An analytical framework for SALs should include a clear and well-defined medium-term growth perspective in terms of the main macroeconomic performance indicators and policy instruments. The SAL programs need to be envisioned in such a perspective to orchestrate the policy actions so as to lead the economy towards a desired growth path.

Defining a medium-term growth perspective requires a clear analysis of the growth potential of the economy and of the main
structural and institutional rigidities and policy-induced distortions that hinder the full use of this potential. On the basis of this analysis combined with consideration of past trends, global considerations and the possible changes in the policy environment, alternative growth paths can be defined in terms of the identified macroeconomic performance indicators. These indicators then need to be linked to the main policy instruments in order to estimate the time-phased values of these instruments consistent with the projected growth paths.

The identification of a set of monitorable performance indicators and policy instruments is a major task. Some work has already been done in the Bank. This set should include the main performance indicators and policy instruments that affect the medium-term growth and structural adjustment of an economy, the monitoring of which would fall under the organizational jurisdiction of the Bank.

In SALs, the closest thing to the growth perspective we have just outlined is the macro projections obtained from RMSM. RMSM ensures the consistency in macro projections in the sense that all macroeconomic identities are satisfied. But there is a second kind of consistency to be secured: the consistency between the projections and the policy instruments. RMSM is not suitable for this second type of consistency and should be supplemented with a medium-term framework described above.

**Adjustment Dynamics**

Once identified, the performance indicators need to be linked to the policy instruments in order to estimate the time-phased values of
these instruments consistent with the projected indicators. As already noted in this report, the timing of different policy actions and the response lags of the performance indicators to these actions may be highly important to the success of SAL programs. Different instruments take different amounts of time to work, and adjustment paths in response to them may determine whether or not certain policies conflict.

SAL policies in part work through changing prices. The responsiveness in terms of the magnitude and speed of adjustment of objectives to price changes is conditioned by structural, institutional and social rigidities in the economy. Relaxation of these rigidities is an important part of the adjustment process. However, our current knowledge of adjustment paths is not sufficient, both in general and for a particular SAL country.

If SAL programs are to be correctly time-phased, our understanding of the adjustment path of an economy's response to SAL policies must be considerably improved. This will require further research, in a general level and on country specific basis, into the dynamics of adjustment. The experience and information accumulated in the Bank on adjustment issues would be a significant data source for such research.

While one might desire to predict the dynamics of adjustment in all areas of the economy receiving a SAL, certain issues stand out as being especially important. The following is a tentative list of these areas where adjustment dynamics might be especially worthy of further research: the likely magnitude and the lag of response of (1) output to decrease in overall credit to economy and its allocation; (2) exports,
imports and payments balance to a devaluation and export incentives; (3) wages, prices and output to a devaluation; (4) output mix to import liberalization; 1/ (5) savings, investment and output to financial liberalization; (6) total factor productivity to trade liberalization and the opening-up of the economy; (7) efficiency of investment to financial liberalization; (8) relative prices within and between the key sectors to price liberalization; and (9) tax revenues and fiscal deficit to changes in output and prices.

In SAL policy design, an explicit analysis of the adjustment dynamics in these areas would constitute an important component of the suggested analytical framework.

Explicit Analysis of Conflicts and Trade-offs

The evaluation of the design of SALs in the preceding section focused closely upon a variety of potentially conflicting objectives and policies in the SAL programs studied. Many others were noted in the survey of adjustment issues as well. It was indicated that the treatment of conflicts and trade-offs in SAL analysis and presentation requires more attention and rigour. An explicit analysis of the conflicts and the trade-offs might be another significant component of an analytical framework for SAL operations.

While in a fully integrated economy, all policies and objectives will interact with each other (either positively or negatively), it is possible to single out a set of potential conflicts

1/ "The Timing and Sequencing of a Trade Liberalization Policy" (Ref. No. 673-31) and "Liberalization with Stabilization in the Southern Cone" (Ref. No. 672-85) are two important research projects the Bank has launched in addressing the trade liberalization issue.
which are most likely to condition the outcome of a SAL program. The following is a (less than wholly exhaustive) checklist of potential conflicts that need further consideration in SAL policy analysis. (a) trade liberalization vs. reduction in the trade deficit; (b) tariff reduction vs. increase in public tax revenue; (c) devaluation vs. reduction in inflation; (d) devaluation vs. output expansion; (e) credit contraction vs. capacity utilization; (f) credit contraction vs. investment and growth; (g) financial liberalization vs. output expansion; (h) financial liberalization vs. investment and growth; (i) export/investment subsidies vs. reduction in public deficit; and (j) elimination of subsidies vs. income distribution.

The conflicts listed above are sometimes transitory. But the length of the conflict period and the economic and social costs attached to them are of utmost economic and political importance. This is why additional attention is needed in SAL policy analysis to address them explicitly.

**Guidelines for Monitoring and Evaluating SAL Programs**

While this paper has for the most part focused upon the prior design of SAL programs, it is apparent that a framework for SAL analysis should also contribute to program monitoring and evaluation. The evaluation of past SAL performance represents the basis for improved SAL design. Moreover, the progress of performance indicators must be monitored over time to determine whether further policy changes are required.

Currently, the most common form of SAL monitoring and evaluation does not actually gauge the economic impact of a SAL program,
but rather focuses upon the degree to which SAL policies are implemented and conditions are met. This is only the first step in the evaluation of SAL programs, and reveals little about the effectiveness of the policies themselves in achieving SAL goals. A framework for SAL analysis can contribute to the evaluation and monitoring process by specifying the standard of comparison against which policy outcomes may be gauged. The literature currently recognizes three broad comparison standards: (1) the state of the performance indicators prior to implementation of the SAL; (2) the target values of the performance indicators specified in the SAL; and (3) the values of the performance indicators that would have prevailed in the absence of a SAL. It should be noted that the third comparator, which tends to be the preferred one, represents a counterfactual scenario requiring a well-developed analytical framework.

Research Requirements of an Analytical Framework for SAL Design

Some of the recommendations made thus far have pointed to the need for more information about the economic structure of the SAL receiving countries, as well as to the need for closer integration and synthesis of existing information. An analytical framework for SAL design, in fact, provides a set of guidelines to direct research to a specific set of issues. In general, we feel these issues will be best addressed by a combination of two essentially complementary research approaches. In the context of SAL design, the first of these approaches is composed by specific, issue-oriented analyses of direct, partial-equilibrium relationships linking policy instruments to performance indicators. The second approach is the use of a policy-oriented
economy-wide modelling framework to study the interactions of instruments and indicators in a general equilibrium context.

The extent to which either approach is fully implemented, of course, will depend upon the data endowments of the countries receiving SALs, as well as the nature of different countries' problems. SAL design for a country poor in data may have to rely upon relatively simple, non-quantitative analyses of the economy's individual problems, linked by a merely implicit macro framework. A data rich country may support considerably more sophisticated policy studies, as well as a detailed, economy-wide policy model integrating the results of partial equilibrium analyses into a consistent macroeconomic framework. Viewed from another perspective, an economy with largely sectoral problems, but reasonable fiscal and trade performance, may benefit most from partial equilibrium policy studies. An economy suffering from fiscal deficits, external payments imbalances, severe inflation, and distortion in the financial sector, on the other hand, must be studied within an explicitly macroeconomic framework; this framework need not be an actual policy simulation model, though as pointed out below, such a model possesses significant advantages. Issue-oriented studies are also suitable for applying cross-country data to establish stylized facts about adjustment dynamics and regularities regarding the relationship between indicators and policy instruments.

Issue-Oriented Research

Issue-oriented or partial equilibrium research has two distinct but highly important roles to play in SAL design. The first of these, as suggested above, is to analyze the structural features and the
relationships linking policy instruments to performance indicators. The results of this type of research feed directly into macroeconomic analyses, as well as being important for their own sake. An example of this would be a study of a SAL recipient's export sector and the response of that sector to different types of incentives. Depending upon factors such as market share and world demand elasticities, a devaluation could raise or lower export revenues, while tariff unification could have similarly ambiguous effects, depending on the sector's import requirements. These issues must be well researched before the macroeconomic effects of export sector policies can be assessed. The same applies to analyses of agricultural production, the manufacturing sector, or the financial sector.

The second role for partial equilibrium analysis is to address one of the broad objectives of all SAL programs, the raising of output and total factor productivity. As pointed out earlier in this paper, the promotion of efficiency in all economic sectors is one of the key distinctions between structural adjustment and stabilization. The response of output and productivity in individual sectors to changes in relative prices improved marketing practices, revised regulations, and other features of a policy package cannot be evaluated through purely macroeconomic analyses, but must be addressed through in-depth microeconomic, industry-specific research. A partial list of key topics for research along these lines would include: (1) the response of crop outputs to changes in producer prices, and of agricultural productivity to changes in fertilizer subsidies, extension programs, etc.; (2) the response of labor and capital productivity to changes in industrial incentives, credit policy, and wage/price regulations; (3) the response
of lending/deposit rates, savings trends, and bank loans to revised financial sector regulations; (4) the response of the efficiency of investment to financial liberalization; and (5) methods of improving the productivity and financial performance of government agencies and parastatals. These research areas have figured prominently in most SAL design efforts to date, and will continue to do so in the future.

Policy Modelling

Estimating the trade-offs and interactions, simulating the effects of proposed policies, and projecting the future performance of the economy under various policy scenarios are important components in an analytical framework. Policy-focused, economy-wide models are very useful tools to perform these tasks. In doing so, policy modelling may serve as a basis for unifying and integrating some of the components in an analytical framework. However, this does not imply that an analytical framework cannot be defined without a policy modelling component. All other components are significant in their own right and sufficient to specify the required framework without a modelling dimension. What policy modelling can do is support a formal integration of some of the components within an economy-wide context and adds new features such as consistency, quantification and cohesion to the suggested analytical framework.

Several models have been developed in the Bank and successfully used in some SAL and non-SAL operations, including the RMSM used in the three countries under study and a CGE used in the case of Turkey. RMSM is a projection model, which does not provide for response of performance indicators to any key policy instruments. It is not
suitable for policy analysis. The policy-oriented models, on the other hand, are (a) highly personalized, poorly documented and hardly accessible to wider audience; (b) limited in the number of objectives, policy instruments and closure rules; (c) designed mainly for research purposes; (d) suitable for addressing only a limited number of issues; and (e) not formulated as user-oriented packages. The CGE models represent an important sub-class of policy models, and they have two additional weaknesses. First, they are real-side, long-run models which are not suitable for the analysis of the shorter term financial movements of interest to SAL designers. Second, they tend to be very large, complex, sectorally disaggregated with longer preparation requirements than may be permissible in SAL policy design. Consequently, the use of policy models for operational purposes has been limited. The suggested framework should draw on these studies but try to avoid their limitations.

If appropriately constructed and responsibly used, the main contribution of the modelling capability to the policy analysis of the SAL and non-SAL operations would include the following.

(1) It would help working out contemporaneously and intertemporally consistent macro policy packages. SALs are multiple-objective and multiple-instrument operations. Some of these objectives are complementary, but others are partially conflicting. The multidirectional links among objectives and instruments are not always satisfactorily formed in the policy analysis of SALs. The suggested framework would help to check the consistency and feasibility of the objectives, estimate the trade-offs between conflicting objectives, and simulate the static and dynamic effects of policy instruments on
objectives. It would introduce formally the principles such as "coherence", "compatibility", "consistency", and "time-phasing" into the policy analysis and facilitate tracing of the general equilibrium consequences of alternative policies, avoiding potentially misleading partial equilibrium conclusions. It would also aid in the evaluation of SAL programs by helping assess what would have occurred in an economy in the absence of the SAL and by facilitating the identification of specific causes of program shortfalls.

(2) It would bring discipline to policy analysis. SALs tend to be too comprehensive and too general. This is done at the expense of in-depth analysis of major issues. The proliferation of objectives and instruments spreads the limited implementation capacity of the member countries too thinly. By restricting the analysis to the key macro objectives and instruments, a formal policy simulations framework would facilitate in-depth analysis of the major problem areas in the economy. It would force the analysts to shift the attention from "enumerating objectives and instruments" to "analyzing major issues", and from loose policy statements and intuition to refined policy advice. Policy objectives on major issues would then serve as the core for further extension of the policy set to the sector/micro level, subject to administrative and resource constraints in implementation. The model would also help identify which policies would have significant impact on the objectives and which would not in a particular country, so the most attention should be focused on the former.

(3) It would serve as a vehicle for dialogue on the diagnosis of problems, on the types of instruments and the speed of adjustment, since differences of opinion may exist within the Bank, between the Bank
and the Fund and between the Bank and the member countries. The suggested framework can provide a common base for policy discussion within which the differences of opinion can be reduced to testable forms such as equation specifications, coefficient values and closure rules.

(4) It would help to institutionalize, discipline and coordinate the policy making process in the member countries. The policy making process is fragmented in some of the member countries. Various ministries are responsible for different parts of economic policy with little coordination among them. If the policy modelling framework was transferred to the member country with technical assistance and training, policy making process would be substantially improved in some countries.

(5) It would help to bring to surface the implicit assumption made in policy analysis. All policy recommendations involve some implicit modelling. With the suggested framework, decisions with regard to structures, parameters and closure rules can be made explicit. This would bring clarity and transparency in the policy analysis.

(6) It would enable one to gain insight into the behavior of the economy. There are important learning effects involved in model development and implementation. The process of modelling often sheds considerable light on the workings of the economy. A policy-modelling framework could also be seen as a bridge between research and actual policy making.

Main Features of the Suggested Modelling Framework

Most of the models developed in the Bank are research-oriented. They have been developed for specific tasks and their
computer software is not yet well documented. The framework suggested in this paper should be an operational tool, supported by research and located in a user-oriented environment in a standardized format accessible to a wider range of users. The software should include appropriate outputting subroutines to facilitate quick and easy use of results for reporting.

A single all-purpose policy model would not be meaningful. A general flexible policy-modelling system with many choices with regard to the number of sectors, objectives, policy instruments, equation specification, adjustment mechanism and closure rules from which various model structures could be derived depending on data availability, institutional constraints, time frame and policy focus, would serve the purpose better. The choices could be increased and improved. Such a flexible system would provide the possibility of constructing a menu of models ranging from very simple (one sector with no behavioral equation) to more sophisticated structures.

The main purpose of the suggested framework is policy analysis rather than projections. In that respect, it would be complementary to RMSM. RMSM is not suitable for policy analysis, concentrating instead on formulating consistent projections of the main macroeconomic and balance of payments accounts without explicit linkages with instruments to achieve them.

The issues to be addressed in the policy modelling should include the following. 1/

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1/ Some of these issues are explicitly addressed in a number of CGE models developed in the Bank for Turkey, Thailand, Yugoslavia, and Ivory Coast.
(a) The suggested framework should incorporate a large list of policy variables which includes exchange rates, QRs, tariffs, export tax rebates, interest and tax preferences on exports and investment, money supply, credit allocation, efficiency indicators, relative prices of the key commodities in agriculture and industry, transfers, price controls and government expenditure. The effects of institutional changes could also be accounted for through exogenous changes in parameters.

(b) It should incorporate both price and quantity adjustment mechanisms and a large menu of closure rules.

(c) Apart from relative prices, the general price level needs also to be made endogenous and to be linked to excess demand, cost push factors and expectations. The suggested framework should be suitable to simulate the effects of adjusting or decontrolling major prices in the economy such as exchange rate, output prices of public firms, interest rates, wages, energy prices and agricultural support prices.

(d) Financial sector and money supply process should be explicitly modelled and linked to the real side of the economy through various transmission mechanisms (via investment, aggregate demand and cost of credit, etc.) Along with the determination of an endogenous general price level, this is a key respect in which a modelling framework for SAL design would depart from the CGE approach. Monetary and financial issues have always received less attention in modelling developing economies. These issues can be embedded in a flow-of-funds accounts framework with which financial deficits (surpluses) of various sectors (including the public sector) would be interlinked with various financial instruments and also linked to new money creation. Such a framework would enable explicit modelling of the money supply and
monetary processes and would be very useful to simulate inflationary
dynamics, output effects, crowding-out effect, and medium-term
implications of monetary programs.

(e) Trade and payments seem to be the backbone of adjustment
programs. The suggested framework should have a detailed trade and debt
block with appropriate demand and supply equations for imports and
exports capable of analyzing the effects of instruments such as QRs,
tariffs, exchange rate, export subsidies, interest rates, debt
restructuring operations, and capital transfers. The trade and debt
block would also enable the linkage of the national economy to global
trade movements through international prices, trade volume and capital
flows. It would also facilitate the analysis of different time profiles
of various debt rescheduling alternatives.

(f) There is a constant interest in the Bank and elsewhere in
the distributional effects of structural adjustment programs. The
suggested framework should have an employment and income distribution
block capable of analyzing the sources of inequality (factor prices,
skills, elasticity of substitution, sectoral allocation of investment,
taxes and subsidies, saving behavior of income groups, excess to credit
and investment opportunities by income groups, etc.) and simulating
redistributive policies compatible with adjustment.

This list of issues shows the choices that should be included
in the suggested framework. Naturally, data and time might not permit
the use of all these features in a model constructed for a particular
country. In addition, a model should be small and intelligible enough
to be explained to the policy maker.
The first part of this appendix presents the summary notes on the structural adjustment issues in Turkey, Malawi, and Philippines — the countries we have reviewed intensively in this study — to provide some of the country specific background underlying our examples, illustrations and analyses.

The second part contains a longer, more detailed version of the survey of adjustment issues.
A. COUNTRY EXPERIENCES OF STRUCTURAL ADJUSTMENT

TURKEY

Introduction

The growth of the Turkish economy has been impressive in the past, averaging 7 percent in the First Perspective Plan period (1963-77). The high growth was accompanied by substantial structural change; the share of manufacturing in GNP increased from 11.9 percent to 17.5 percent, while the share of agriculture decreased from 34.2 percent to 20.7 percent, in the same period.

With the emergence of a protracted balance of payments crisis arising mainly from Turkey's delayed adjustment to oil price increases in 1973/74 and consequent contraction in world demand, the favorable growth process has been interrupted since 1977.

Since 1980 a series of adjustment programs has been introduced to stabilize the economy and to adjust it to the new external conditions. These programs have been supported by (a) the Fund with three standby arrangements; (b) the Bank with five SALs; and (c) the OECD with debt rescheduling and consortium credits. Since then, substantial restructuring has been achieved in the Turkish economy.

Structural Characteristics of the Turkish Economy Prior to Adjustment Programs

Turkish economic development in the last two decades exhibits a number of structural characteristics which are of considerable relevance for future development policy.

(a) Industrial strategy: Industrialization in Turkey has been considered as the main instrument of rapid growth, structural change and
self-sufficiency. As such it has always been the most favored sector. Resources have been channelled into it through heavy public sector investment particularly in import-substituting basic industries and through generous financial incentives coupled with a high level of import protection for private investment.

Replacing the imports of non-durable consumer goods and their inputs did not encounter much difficulty and the first stage of import substitution was completed with success by the early 1960s. However, the second stage which involves the replacement of imports of intermediate inputs and producer and consumer durables by domestic production has created imbalances because the resource availability in the economy did not match the resource requirement of this stage.

The goods produced in the second stage are more capital-, skill-, and import-intensive. A successful second stage import substitution, therefore, requires increased efforts to generate the required resources. Turkey chose to intensify the second stage import substitution after oil price increases without adjusting her policies to new external conditions and to the resource requirements of the second stage.

(b) System of Protection and Incentives: The high emphasis and priority given to industry necessitated the erection of a system of protection and incentives to direct the economic activities in desired areas. This system, which was initiated in the early 1960s and continually enhanced, includes QRs, tariffs, export tax rebate, retention of export earnings, foreign exchange allocation and tax and interest allowances. In the last two decades, this system has created (i) high nominal and effective protection rates; (ii) large anti-export
bias; (iii) large anti-private sector bias; and (iv) wide variations in effective rates among manufacturing sub-sectors. A series of tariff and import liberalization measures introduced in recent years has partly improved the situation.

(c) **Exports:** Imports have been around 20 percent of GNP which is comparable to other middle income countries. The level of exports, however, had been very low before 1980 (4 percent of GNP, on average). The large difference which is partly closed by workers' remittances, highlights the vulnerability of the balance of payments and the importance of export development to sustain the needed flow of imports. After 1980, as a response to policy changes, export revenue has substantially increased and its structure has considerably changed.

(d) **Resource mobilization:** The rate of investment has increased considerably in the last two decades, but the mobilization of domestic savings has lagged; the saving rate has been considerably below the average for middle income countries. The growing gap led to deficit financing and domestic inflationary pressure as well as to a high level of external borrowing.

(e) **Public Sector:** The share of public sector in investment and production is very high; public firms undertake more than 50 percent of total investment and produce 30 percent of manufacturing output. Financial deficits of the public sector have been closed through Central Bank borrowings and this has created inflationary pressure (On average, 75 percent of the total Central Bank credits were given to the public sector in the last three decades. This ratio has decreased in recent years).
Response to Oil Price Increases

The impact of oil price increases on the Turkish economy has been substantial, because more than 80 percent of the required oil has been imported. The increased oil prices raised the share of oil imports to export revenue from about 25 percent in the pre-1973 period to 100 percent in 1979, which in turn substantially decreased the non-oil import capacity of the economy. The situation was aggravated by the subsequent world depression, increases in the interest rates in the international capital markets and a decline in workers' remittances.

No significant adjustment measures have been taken since 1973. In contrast, the growth rate of investment particularly in import- and capital-intensive sectors has been accelerated. Capital and import requirements sharply increased, while voluntary savings and exports were lagging. The government resorted to deficit financing and short term external borrowing at unfavorable rates. The rate of inflation increased from 15 percent in the early 1970s to 106 percent in 1980. Short term external debt rose from $216 million in 1974 to $6.6 billion in 1977. By 1978 borrowing possibilities were exhausted. Imports declined and production and investment came to a standstill by the end of 1979.

Stabilization Attempts 1978-79

By mid-1977 Turkey began taking stabilization measures. These measures were supported by the Fund with April 1978 and July 1979 Standby Arrangements. In addition, $5.5 billion external short-term debt (including commercial arrears) was rescheduled mainly through the OECD, and $1.45 billion OECD sponsored credits were arranged.
The outcome was mixed, when compared with the goals of the stabilization program. Although they helped to prevent further deterioration in the economic conditions, these measures were not sufficient to bring the economy back to stable growth. In the early 1980s, it was evident that traditional corrective measures were not sufficient to put the economy back on its feet; substantial structural adjustment was needed.

1980 Policy Measures: Prelude to Stabilization-cum-Structural Adjustment

Bold and far reaching measures taken in January 1980 represent a major turnabout in Turkish economic policies. These measures include: (a) a large devaluation followed by daily adjustment of the exchange rate; (b) higher export incentives in the form of subsidized credit, priority and duty-free access to imported inputs; (c) partial import liberalization; (d) tight monetary policy to restrain domestic demand; (e) decontrolling interest rates and State economic enterprises' (SEEs) prices, and (f) simplification of regulations and procedures.

These policies were aimed at promoting greater reliance on market forces and less on direct state intervention and control, increased export orientation and a self-reliant SEE sector.

Support of the International Financial Community

The Fund supported the Program with a three year Standby Arrangement (SDR 1,250 million) effective June 1980. On its successful implementation two new one-year standby arrangements were approved in June 1983 and April 1984.
Debt rescheduling and OECD sponsored credits continued in 1980 and 1981, which substantially improved the maturity profile of external debt and contributed to more prudent debt management.

The Bank also supported the program with the following five SALs.

Table 1: TURKEY: Structural Adjustment Loans

<table>
<thead>
<tr>
<th>Loan</th>
<th>Date of Approval</th>
<th>Amount ($m.)</th>
<th>Disbursements to December 31, 1984</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAL I</td>
<td>3/25/80</td>
<td>200.00</td>
<td>200.00</td>
</tr>
<tr>
<td></td>
<td>Supplement</td>
<td>11/18/80</td>
<td>75.00</td>
</tr>
<tr>
<td>SAL II</td>
<td>5/12/81</td>
<td>300.00</td>
<td>300.00</td>
</tr>
<tr>
<td>SAL III</td>
<td>5/27/82</td>
<td>304.50</td>
<td>304.50</td>
</tr>
<tr>
<td>SAL IV</td>
<td>5/23/83</td>
<td>300.80</td>
<td>300.80</td>
</tr>
<tr>
<td>SAL V</td>
<td>6/14/84</td>
<td>376.00</td>
<td>250.00</td>
</tr>
</tbody>
</table>

Objectives and Policies of SALs

Economic analysis and policy recommendations of the SALs were based on the economic and sector work of the Division and particularly on Public investment Review (3961-TU), Industrialization and Trade Strategy (3641-TU), Energy Assessment Report (3877-TU), Agricultural Sector Survey (4204-TU), Financial Sector Review (4459-TU), and a Country Economic Memorandum (4287-TU). A "Protection and Incentives Study" was also completed to quantify the impact of the system of incentives on manufacturing sub-sectors.
Major objectives and policy recommendations of the five SALs are summarized in Table 2.

Policy Implementation and Economic Performance

This section describes the implementation of the policies and the performance of the Turkish economy under five SALs.

Most of the policies recommended in SALs have been implemented. Further improvements are still needed particularly in liberalizing imports, reforming the SEEs, and introducing medium-term policy planning capabilities. The major policy changes under structural adjustment programs are as follows:

Fiscal and Monetary Policy: To increase the tax revenue and to reduce the tax burden on wage and salary earners, the tax system was reformed in 1981. Public investment has been constrained in line with available resources. The number of public investment projects has been reduced considerably and priority has been given to a small number of important projects to speed up their implementation. As a result of these fiscal measures, the Central Government deficit/GDP ratio has decreased from 5.3 percent in 1980 to 3.3 percent in 1983 (Table 3). This resulted in a fall in the growth of money supply from 58.4 percent in 1980 to 35.0 percent in 1983 as the public sector is the main borrower from the Central Bank.

An undesirable development in the fiscal field is the fall in the tax/GDP ratio from 20 percent in 1980 to 17 percent in 1983. This is due primarily to the generous tax allowances granted to industrial exporters and to the reduction in the transaction tax on non-preferential credit from 25 percent to 15 percent in 1981.
<table>
<thead>
<tr>
<th>Area</th>
<th>Final Objective</th>
<th>Intermediate Objective</th>
<th>Policy Instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade and payments</td>
<td>Reduce balance of payments</td>
<td>Increase exports by eliminating disintection of export sales</td>
<td>Gradually eliminate QMs and exchange controls</td>
</tr>
<tr>
<td></td>
<td>deficit</td>
<td>and anti-export bias</td>
<td>Use tariffs and exchange rate for protection</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Decrease imports by efficient import substitution in energy</td>
<td>Reduce tariffs to 30 percent in 5 years.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Provide additional incentives to infant industries in the form of production and investment subsidies on a temporary basis and a degressive scale</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Pursue a realistic exchange rate policy. Adjust exchange rate according to the price differentials between Turkey and the trading partners</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Use export subsidies on transitory basis eliminate them over time. Rely more on exchange rate</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Grant export subsidies on value-added basis</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Ensure duty-free access to all inputs used in export production</td>
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<td></td>
<td></td>
<td></td>
<td>Encourage export-oriented investment by tax and interest allowances and by foreign exchange allocation</td>
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<td></td>
<td></td>
<td></td>
<td>Simplify administration and procedures</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Take administrative measures to improve marketing, quality control, standardization, etc. Introduce export insurance</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Encourage investment in indigenous energy sources</td>
</tr>
<tr>
<td></td>
<td>Prudent debt management</td>
<td>Improve maturity and source structure of debt</td>
<td>Allow no commercial arrears</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Try to reschedule</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Limit commercial credit</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Computerise debt statistics</td>
</tr>
<tr>
<td>Area</td>
<td>Final Objective</td>
<td>Intermediate Objective</td>
<td>Policy Instruments</td>
</tr>
<tr>
<td>-----------------</td>
<td>----------------------------------------</td>
<td>----------------------------------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Price stability</td>
<td>Reduce the rate of inflation</td>
<td>Reduce domestic demand by curbing monetary expansion through limiting Central Bank's credit to public sector</td>
<td>Reduce public investment of public projects</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Reduce the number of public projects Finance only the important projects</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Limit budgetary transfers to SEEs</td>
</tr>
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<td></td>
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<td></td>
<td>Eliminate supplementary budgetary appropriations</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Introduce tax reform Ensure efficiency in tax administration</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Liberalize SEEs' selling prices</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Ensure efficient operation of SEEs (see below)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Limit employment in the public sector</td>
</tr>
<tr>
<td>Privatization</td>
<td>Increase the private sector orientation of the economy</td>
<td>Increase the share of private Investment to its trend value of 50 percent of total investment</td>
<td>To avoid crowding out limit Central Bank credit to public sector</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Reduce cost of credit by reducing intermediation cost through eliminating transaction tax increasing interest rates on banking sector's deposits with the Central Bank and decreasing reserve requirement</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Simplify investment incentives and ensure automaticity</td>
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<td></td>
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<td></td>
<td>Encourage the availability of medium-term credit by indexed medium-term bonds</td>
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<td></td>
<td></td>
<td></td>
<td>Create a special fund to cover the exchange risks of foreign credit</td>
</tr>
<tr>
<td>Resource mobilization</td>
<td>Increase private and public savings</td>
<td></td>
<td>Ensure real positive interest rates</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Limit taxation of interest earnings and capital gains to real returns by making adjustment for inflation</td>
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<td></td>
<td></td>
<td></td>
<td>Adjust profits for inflation through revaluation of assets</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td>Reform capital market to attract financial savings</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Increase efficiency and revenue in the public sector</td>
</tr>
<tr>
<td>Area</td>
<td>Final Objective</td>
<td>Intermediate Objective</td>
<td>Policy Instrument</td>
</tr>
<tr>
<td>--------------------</td>
<td>---------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Efficiency</td>
<td>Increase efficiency in production and investment both in public and private sectors</td>
<td>Reduce protection on domestic sales</td>
<td>Liberalize trade, financial markets and prices</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Equalize protection between sectors</td>
<td>Limit the scope and extent of selective credit</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Ensure operation of SEEs according to market principles</td>
<td>Simplify administration and procedures</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Increase efficiency in economic management</td>
<td>Eliminate QMs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Reduce tariffs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Eliminate subsidized credit to SEEs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Introduce proper project evaluation principles in the public sector</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Give autonomy to SEEs for their staffing, economic and financial decisions</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Reduce direct controls, use policy instruments, rely on market forces</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Limit micro planning, rely on macro policy planning</td>
</tr>
<tr>
<td>Medium-term framework</td>
<td>Increase medium-term planning and policy making capability</td>
<td></td>
<td>Prepare master plans for key sectors (energy, iron and steel, transportation, agriculture)</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Prepare the fifth five-year plan (1985-89) on the basis of recommended policies</td>
</tr>
<tr>
<td>Income Distribution</td>
<td>Reduce inequality</td>
<td></td>
<td>Reduce the tax burden on wage and salary earners</td>
</tr>
<tr>
<td>Energy</td>
<td>Rationalize production and consumption of energy</td>
<td></td>
<td>Raise energy prices to reflect international costs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Substitute indigenous energy sources for petroleum</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Encourage greater conservation of energy</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Increase the role of private sector in energy production. Encourage foreign investment</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Improve the coordination between energy producing firms. Increase their efficiency</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Introduce medium-term planning in energy sector. Annually update energy demand and supply</td>
</tr>
</tbody>
</table>

Table 2: TURKEY: SUMMARY OF OBJECTIVES AND POLICY RECOMMENDATIONS OF FIVE SALS (cont'd)
### Table 2: TURKEY: SUMMARY OF OBJECTIVES AND POLICY RECOMMENDATIONS OF FIVE SALS (cont'd)

<table>
<thead>
<tr>
<th>Area</th>
<th>Final Objective</th>
<th>Intermediate Objective</th>
<th>Policy Instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>Increase production and exports</td>
<td>Reduce subsidies and controls</td>
<td>Let the prices adjust to the trend value of world prices with intervention limited to setting guaranteed floor prices in year of low prices and levying an export tax in years of high prices</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Rely on market forces</td>
<td>Gradually eliminate fertilizer subsidies</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Improve agricultural technology</td>
<td>Increase water charges</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Remove restrictions on exports</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Make agricultural sale cooperatives financially self-sufficient with credit obtained on commercial terms</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Establish crop insurance scheme</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Improve medium-term planning and research capabilities</td>
</tr>
</tbody>
</table>
Table 3: TURKEY: SOME ECONOMIC INDICATORS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Growth Rates (percent)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>-0.4</td>
<td>-1.1</td>
<td>4.1</td>
<td>4.6</td>
<td>3.2</td>
</tr>
<tr>
<td>Manufacturing value added</td>
<td>-5.6</td>
<td>-5.7</td>
<td>8.1</td>
<td>6.0</td>
<td>7.9</td>
</tr>
<tr>
<td>Agricultural value added</td>
<td>2.8</td>
<td>1.7</td>
<td>0.1</td>
<td>6.5</td>
<td>0.8</td>
</tr>
<tr>
<td>Total fixed investment</td>
<td>-5.9</td>
<td>-12.3</td>
<td>-0.6</td>
<td>2.5</td>
<td>4.1</td>
</tr>
<tr>
<td>Public fixed investment</td>
<td>-4.8</td>
<td>-2.4</td>
<td>5.7</td>
<td>2.2</td>
<td>3.2</td>
</tr>
<tr>
<td>Private fixed investment</td>
<td>-7.0</td>
<td>-25.0</td>
<td>-9.7</td>
<td>3.0</td>
<td>5.7</td>
</tr>
<tr>
<td><strong>Total imports (million US$)</strong></td>
<td>5,069</td>
<td>7,909</td>
<td>8,933</td>
<td>8,843</td>
<td>9,235</td>
</tr>
<tr>
<td><strong>Total exports (million US$)</strong></td>
<td>2,261</td>
<td>2,910</td>
<td>4,703</td>
<td>5,746</td>
<td>5,728</td>
</tr>
<tr>
<td>Agricultural exports (mil. US$)</td>
<td>1,344</td>
<td>1,672</td>
<td>2,219</td>
<td>2,141</td>
<td>1,880</td>
</tr>
<tr>
<td>Manufacturing exports (mil. US$)</td>
<td>785</td>
<td>1,047</td>
<td>2,290</td>
<td>3,429</td>
<td>3,658</td>
</tr>
<tr>
<td>Mining exports (mil. US$)</td>
<td>132</td>
<td>191</td>
<td>193</td>
<td>175</td>
<td>188</td>
</tr>
<tr>
<td><strong>Current account deficit/GDP (percent)</strong></td>
<td>4.6</td>
<td>5.7</td>
<td>3.5</td>
<td>1.9</td>
<td>3.5</td>
</tr>
<tr>
<td>Central government deficit/GDP (percent)</td>
<td>2.2</td>
<td>5.3</td>
<td>2.7</td>
<td>2.1</td>
<td>3.3</td>
</tr>
<tr>
<td>Private investment/total investment (percent)</td>
<td>48.8</td>
<td>43.8</td>
<td>40.2</td>
<td>40.4</td>
<td>40.9</td>
</tr>
<tr>
<td><strong>Inflation (percent)</strong></td>
<td>73.1</td>
<td>101.4</td>
<td>41.9</td>
<td>27.3</td>
<td>32.0</td>
</tr>
<tr>
<td>Real wage index (1977 = 100)</td>
<td>76.0</td>
<td>56.7</td>
<td>52.5</td>
<td>50.4</td>
<td>n.a.</td>
</tr>
<tr>
<td>Unemployment (percent)</td>
<td>17.9</td>
<td>19.6</td>
<td>21.0</td>
<td>21.7</td>
<td>22.2</td>
</tr>
<tr>
<td><strong>Real exchange rate (TL/$, 1977=100)</strong></td>
<td>84.7</td>
<td>113.8</td>
<td>132.1</td>
<td>156.8</td>
<td>164.6</td>
</tr>
</tbody>
</table>

1/ Implicit deflator of GNP
**Trade Policy:** A flexible exchange rate policy has been pursued since 1980. Daily adjustment of the exchange rate started in 1981. As a result, the real exchange rate vis-a-vis U.S. dollar was appreciated since 1980 (Table 3). Some import liberalization was introduced in 1980 and 1981: Quota List was abolished, exporters were partially exempted from duties and controls on inputs. In 1984, the Government announced major import liberalization. About 70 percent of imports were freed from QRs. Prohibition and licencing apply to only a selected number of imports. In addition, the tariff rates for 494 products were changed: more than 80 percent of them were reduced substantially. High additional levies were imposed on major consumer durables. The foreign exchange regime was also liberalized considerably: commercial banks were allowed to set their own exchange rate within the 6 percent point spread around the official exchange rate set daily by the Central Bank. Export subsidies in the form of tax and interest preferences have increased. The Government intends to reduce the average tariff rate from 32 percent to 7 percent by 1989 and to eliminate export subsidies gradually to rely more on the exchange rate policy in export promotion. However, the new tariff rates were set in an ad hoc manner. It is not known in what direction the effective rates were changed.

**Financial sector policies:** The commercial bank interest rates were deregulated in 1981. Lending rates increased as high as 70 percent. To reduce the intermediation cost of the financial system the transaction tax on non-preferential credit was reduced from 25 percent to 15 percent in 1981 and 3 percent in 1984, but the oligopolistic
conditions in the financial sector prevented the gains in the intermediation costs to be passed on to the borrowers. Very high borrowing rates (25-30 percent in real terms) are still the main concern for firms. Legislation was introduced in 1982 to establish a legal framework for issue and trading of shares and bonds, and to regulate financial intermediaries dealing in stocks and bonds.

Although the interest rates were deregulated in 1981, credit to public firms from the publicly-owned financial institutions at heavily subsidized rates continued. While the nominal borrowing rate jumped to 70 percent after the deregulation of the interest rates, credits to the public firms ranged between 5.0 to 21.5 percent.

The government has been largely passive in regulating the interest rates. Instead of leaving the interest rates to be determined by the oligopolistic private banks, the government could have introduced some competition in the private banking sector by regulating the interest rates through the large public banks.

**Improvement in the SEEs sector:** Output prices of the SEEs were decontrolled in 1980. Their financial performance registered substantial improvements, as a situation of chronic deficits changed to one of profits. Some autonomy has been granted to the SEEs in their financial and economic management. Their privileged access to the Central Bank resources has been substantially reduced.

The liberalization of SEE prices was not accompanied by a noticeable improvement in efficiency in the operation of SEEs. SEEs can now reflect their inefficiencies on their prices. This has been an important cost-push element influencing inflation in Turkey.
Acceleration of inflation in 1983 was largely accounted for by the continuous increases in SEE prices.

**Economic performance.** Under the structural adjustment programs, the Turkish economy performed very well in a number of areas. Merchandise exports have risen from $2,910 million in 1980 to $5,728 million in 1983, with export growth led by the manufacturing exports (Table 3). The rate of inflation, as measured by the implicit price deflator of GNP, has dropped from an annual rate of 101 percent in 1980 to 31 percent in 1983.

The manufacturing value added and GDP declined in 1980, but began growing thereafter. The decline in private investment in 1980 (25 percent) continued in 1981 (9.6 percent). But the growth in private investment recovered in 1982 and accelerated in 1983. However, the share of private investment in total investment is still 40.8 percent, substantially below its trend value of 50 percent.

Some problems remain to be tackled, including in particular, rising unemployment and worsening of income distribution. The rate of unemployment increased from 19.6 percent in 1980 to 22.2 percent in 1983. Real wages declined 10.4 percent from 1980 to 1982. It is understandable that a structural adjustment program entails some transitional costs in the initial years of the program, but if the deterioration in these social indicators persists, even after the initial years of a successful adjustment process, special attention should be given to social issues.

1983 marks an interruption in the adjustment process. Turkey experienced a reversal of trends in the two major policy objectives in
1983: the rate of inflation increased from 27.3 percent in 1982 to 31.0 percent in 1983 and the export revenue declined slightly, from $5,746 million in 1982 to $5,728 million in 1983. But the new Government acted immediately to deal with the situation and introduced new measures in early 1984. These measures include (a) a substantial import liberalization; (b) a restructuring of the tariff system; (c) a centralization of import administration; (d) a substantial liberalization of the foreign exchange regime; (e) re-emphasizing the role of a flexible exchange rate policy; (f) continuation of export subsidies in the form of interest and tax allowances; (g) a gradual reduction in export tax rebate rates; (h) a reduction of the foreign exchange retention rate from 50 percent of export earnings to 20 percent; (i) a reduction in the transaction tax on non-preferential credit to the private sector from 15 percent to 3 percent; and (j) a reaffirmation that SEEs will be free to set their own prices with certain exceptions, such as sugar, coal, and fertilizer.

Economic performance in 1984 suggests a mixed picture. The available data indicate that GDP growth and exports show considerable improvement over the previous year, while inflation and fiscal deficit are expected to be considerably higher as compared to 1983. GDP growth is estimated to be 5.6 percent, favorably compared with 3.2 percent in 1983. Exports grew by over 30 percent in nominal dollar terms, exceeding the 1984 program target of 22 percent. The current account deficit is expected to be about $1.7 billion. The forecast of inflation is over 50 percent. The 1984 budget deficit is expected to be about 3.7 percent of GNP as compared to 3.3 percent in 1983.
MALAWI

Background

Malawi has pursued a relatively outward oriented development strategy. Tariff levels have been fairly low, with much less reliance on the type of import quantity restrictions imposed in most developing countries. Wages have been restrained, with according advantages to the international competitiveness of Malawi's exports. The export emphasis itself has been, with only a few exceptions, in commodities reflecting Malawi's comparative advantage: agricultural products such as tobacco and tea. This emphasis was supported by a high share of public investment devoted to agriculture and transportation.

Until the late 1970's, the results of this policy had been extremely positive. GDP grew at a rate of 5.8 percent between 1967 and 1977, with agriculture increasing at a 4.1 percent rate and industry at 6.7 percent per annum. The investment rate grew from 13.5 percent in 1967 to 24.7 percent in 1977, while the savings rate increased from 3.8 percent to 20.1 percent in that period. The budgetary deficit as a percentage of GDP averaged 6.4 percent between 1972 (the earliest available year) and 1977, a level which did not impose undue strains upon the financial system. Over the same period, (constant price) exports rose at a rate of 4.6 percent per annum. While by the late 1970s, Malawi still ranked among the poorest countries in the world, it had advanced considerably from its post-independence state.

Recent Economic Crises

In the late 1970s, a series of external shocks acted to slow Malawi's growth and increase its external debt. The severity of the
external events' impact was due not only to the shocks themselves, but to underlying structural problems in the Malawian economy which prevented rapid, flexible response.

First, Malawi's merchandise terms of trade fell 35 percent between 1977 and 1980 as an 8 percent decline in its export prices was compounded by a 40 percent rise in imported oil prices. The impact of these price movements was accentuated by the extremely concentrated nature of Malawi's exports (in 1980, tobacco, tea, and sugar made up 72% of Malawi's merchandise exports), as well as by the manufacturing sector's exclusive dependence upon imported oil.

Second, the fall in the terms of trade not only reduced Malawi's real income, but also contributed to a serious deterioration in the current account balance. Especially onerous was the deterioration in the non-factor services account: the rise in sea/air freight charges, as well as the disruption of Malawi's cheap, direct rail routes to Mozambique ports, contributed predominantly to the rise in Malawi's current account deficit.

Third, the rise in the current account deficits led to drawdowns in official reserves and substantial increases in external debt outstanding starting in the late 1970s. The increases in debt outstanding had more serious implications for the debt service burden than in the past, due to the high share of the current account deficits which were financed by commercial, non-concessionary loans.

Fourth, terms of trade changes and traffic disruptions combined with bad weather to promote a slowdown of GDP to -0.6 percent in 1980, compared with an average GDP growth rate of 5.6 percent during 1975-80;
this was followed by relatively slow growth rates of -0.3 percent in 1981 and 2.6 percent in 1982 (Table 5).

Fifth, the recent period saw a serious deterioration in the financial performance of Malawi's public enterprises. This largely resulted from the effects of the terms of trade changes and transportation disruptions in increasing costs and depressing profits; because prices charged to local consumers and paid to domestic producers were kept fairly rigid, public enterprises were unable to respond flexibly to their changed environment. These issues were compounded by more general management problems.

The factors listed above contributed to increasing government fiscal deficits towards the end of the 1970s. The ratio of the deficit to GDP rose to 11.1 percent in the 1980/81 after averaging considerably lower in the preceding decade; it then dropped to 8.1 percent by 1982/83.

**Adjustment Efforts and SALs**

The Government introduced a series of adjustment programs in consultation with the Bank and the Fund. The Bank has supported the adjustment programs with two SALs, one in June 1981 for $45 million, the other in January 1984 for $55 million. A third SAL is under consideration. The Fund also supported the program with two standby and an EFF arrangements.

The first program supported by SAL I aimed at (a) diversifying exports by developing new smallholder and estate crops, accelerating production in livestock and forestry and expanding agro-industries; (b) improving the financial performance of the Government and public
enterprises to reduce dependence on external resources, and (c) increase foreign exchange reserves. It incorporated policy changes and measures in four major areas; balance of payments, price incentives and incomes, resource management, and institutional improvements (objectives and policy actions of both programs are summarized in Table 4).

Under SAL I, the Government adjusted agricultural prices, increased some public utility tariffs, established an Investment Coordinating Committee to screen major investment projects, and allocated additional funds through the budget to agricultural sector. An energy assessment study was carried out. Steps were also taken to strengthen the management in some Press Holding’s subsidiaries. However, the implementation of the program was slow on the whole.

Implementation of the program was less than satisfactory in a number of areas particularly in reforming agricultural prices, restructuring Press, controlling financial deficits of public enterprises and adjusting charges and tariffs on public utilities. In consequence, the Government was unable to make its last two drawings in its two-year standby arrangement. The Bank also delayed releasing the second tranche of the SAL. After a series of discussions with the Bank, the Government took several steps to revitalize the adjustment program. Based on these developments, the second tranche of SAL I was released in April 1982. Also, agreement was reached with the Fund on a new standby arrangement.

The Government's difficulty in making progress in a number of politically sensitive areas, including the restructuring of Press and committing itself to a price liberalization program, delayed the
preparation of SAL II. SAL II, started in mid 1982, was finally signed in January 1984.

The second adjustment program of the Government supported by SAL II, was a continuation of the first program in some areas, but it also incorporated other areas that have emerged as crucial to a successful adjustment, including timely distribution of fertilizer to smallholder sector, elimination of fertilizer subsidy, improving the efficiency in the operation of ADMARC (public agricultural marketing agency), dismantling price controls in the industrial sector, annual review of parastatal financial accounts, and forward budgeting. With some delay in some policy actions, the program was satisfactorily implemented. The Bank is now considering a third SAL to Malawi.

Policy Implementation

This section highlights some of the policies noted in the preceding table, describes their implementation and notes their results.

Trade and Payments

In coordination with the IMF, the Malawian Kwacha was devalued in April 1982 and again in September 1983; as a result, the real effective exchange rate index (as calculated by the IMF) was restored to approximately its 1980 value by early 1984. While moving ahead with the reorganization of ADMARC, the agricultural marketing agency, authorities were relatively slow to revise the produce prices paid by smallholders. In response to a large 1981 increase in the price for maize, maize crops in 1982 and 1983 advanced strongly at the expense of
### Table 4: MALAWI: SUMMARY OF OBJECTIVES AND POLICY RECOMMENDATIONS OF TWO SALS

<table>
<thead>
<tr>
<th>Area</th>
<th>Final Objective</th>
<th>Intermediate Objective</th>
<th>Policy Instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade and Payments</td>
<td>Reduce Balance of Payments deficit</td>
<td>Increase exports by increasing relative export prices to suppliers, as well as by improved supporting services by the government</td>
<td>Periodic review of exchange rates in coordination with IMF.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Improvements in mechanism for determining agricultural producer prices, and reversal of historical discrimination in favor of prices for self-sufficiency crops such as maize and rice.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Improve the financial and operational efficiency of ADMARC, the state-run agricultural marketing organisation.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Increase public investment and recurrent budgetary support of agricultural research and extension services. Develop medium/long term financing capacity for estate sector.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Study ways to increase the productivity of the tobacco industry through improved quality and production control.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Develop new smallholder and estate crops, accelerate production in livestock and forestry industries, expand agro-industries.</td>
</tr>
<tr>
<td></td>
<td>Diversify exports</td>
<td></td>
<td>High tariffs on imported oil.</td>
</tr>
<tr>
<td></td>
<td>Decrease imports through efficient import-substitution in energy</td>
<td></td>
<td>Encourage investment in/utilization of domestic energy sources.</td>
</tr>
<tr>
<td>Efficiency</td>
<td>Improve efficiency and resource allocation in agriculture and industry</td>
<td>Liberalise price restrictions and smooth wage changes to allow more flexible responses to changing resource availabilities</td>
<td>(Above) Review agricultural supply pricing to provide better incentives to agriculture.</td>
</tr>
<tr>
<td>Area</td>
<td>Final Objective</td>
<td>Intermediate Objective</td>
<td>Policy Instruments</td>
</tr>
<tr>
<td>--------------------</td>
<td>--------------------------------------------------------------------------------</td>
<td>----------------------------------------------</td>
<td>-----------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Central Government</td>
<td>Increase public resource mobilization and efficiency of public resource use</td>
<td>Reduce central government fiscal deficit</td>
<td>Liberalize industrial price control system to provide for more rapid responses to price change needs. Complete price liberalization for some commodities. More frequent review of directly administered prices. Raise and more frequently monitor lending rates to ration scarce credit and restrain imports.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Increase public revenues through raises in specific taxes, surcharge, and import duties. More frequent adjustment of specific taxes and departmental charges. Review measures to improve collection of fees and taxes, and to increase the buoyancy of the tax system. General curtailment of the development budget, with funding priority to projects not yet completed. Institutionalize and rationalize procedures for forward budgeting and revenue projections. Take measures to improve public enterprise performance, which in turn reduces the central government’s budgetary burden.</td>
</tr>
<tr>
<td></td>
<td>Increase effectiveness of public investment and medium term planning</td>
<td></td>
<td>Along with development budget reduction and priority to on-going projects, increase allocation of funding to agriculture and social services at the expense of transport and especially government buildings. Increase support for previously under-funded recurrent activities relative to capital spending.</td>
</tr>
</tbody>
</table>
Table 4: MALAWI: SUMMARY OF OBJECTIVES AND POLICY RECOMMENDATIONS OF TWO SALS (cont'd)

<table>
<thead>
<tr>
<th>Area</th>
<th>Final Objective</th>
<th>Intermediate Objective</th>
<th>Policy Instruments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public enterprise</td>
<td>Bolster</td>
<td></td>
<td>Strengthen medium term planning and project identification capacity. New committee to monitor major public and private investments. Increase training to upgrade personnel's economic/financial/statistical analysis.</td>
</tr>
<tr>
<td>sector</td>
<td>Strengthening</td>
<td></td>
<td>Increase public enterprise charges and promote associated decreases in their implicit subsidies.</td>
</tr>
<tr>
<td></td>
<td>deteriorating</td>
<td></td>
<td>Periodic central government review of financial accounts of the public enterprises.</td>
</tr>
<tr>
<td></td>
<td>finances of public</td>
<td></td>
<td>Implementation of ongoing studies for financial/managerial improvement of the parastatals. More timely filling of high level vacancies.</td>
</tr>
<tr>
<td></td>
<td>enterprises</td>
<td></td>
<td>Major restructuring of Press Holdings, Inc. (a quasi-public enterprise) to prevent insolvency, ensure proper management.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>High tariffs on imported oil (above).</td>
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<td></td>
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<td></td>
<td>Increase fuelwood prices to reflect production costs.</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td>Increased investment in fuelwood production and research.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Research into ethanol and other alternative energy sources - develop a coordinated energy program.</td>
</tr>
<tr>
<td>Energy</td>
<td>Reduce energy</td>
<td>Minimize effect of current disruptions.</td>
<td>Creation of secretariat to coordinate import allocations during transportation disruptions.</td>
</tr>
<tr>
<td></td>
<td>costs and</td>
<td></td>
<td>Study/explore alternative transportation routes, most probably through Tanzania.</td>
</tr>
<tr>
<td></td>
<td>encourage domestic</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>energy production</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transportation</td>
<td>Ensure transportation</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>link to coastal</td>
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</tr>
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</table>
more traditional export crops such as tobacco and groundnuts. In April 1983, new procedures for agricultural pricing strongly raised relative producer prices for tobacco, groundnuts, and a variety of other crops, suggesting a strong supply response in 1984. Moreover, the response of maize supply to increased prices was large enough to create large exportable surpluses in 1982 and 1983. Nevertheless, the 1983 current account deficit rose relative to both 1982 levels and general expectations as a result of a strong decline in export tobacco prices and large increases in transportation costs. As both these factors were largely out of the control of the authorities, it seems clear that reforms have been working in the right direction.

Prices

Rationalization of agricultural prices and dismantling price control proved to be one of the politically more sensitive areas of the Government's structural adjustment programs. After a considerable delay, the program is finally in place.

In consultation with the Bank, new procedures for determining the producer prices were adopted in 1983. Fertilizer price has been adjusted and subsidy has been removed except for smallholders using longer transportation routes. The Government has also introduced an estate sub-sector program.

In September 1983, the first measure to liberalize industrial/consumer prices was taken: the time allowed to process applications for price changes was limited to 60 days. As a result of the success of this program, the limit was scheduled for reduction to 30 days in April 1984. Most importantly, the prices of 23 commodities out
of 56 which had been officially controlled were decontrolled in December, 1983. The controlled items were further reduced to 18 in December 1984. General efficiency requires the appropriate pricing of public services as well: charges have been raised for housing rent, water, electricity, and schooling. Interest rates on time and savings deposits have also been raised.

Central Government

Efforts to reduce the government fiscal deficit have focused both on the revenues and expenditures sides. The buoyancy of tax revenues has been enhanced by new domestic sales taxes, increased excise taxes, and increased motor vehicle taxes. On the expenditure side, there has been a general freeze in salary scales since 1982, though government employment increases and normal salary increments have contributed most heavily to expenditure increases. 1983/84 represented the first full year of operations of the new expenditure control system specified in the SAL program; this was reported to be working satisfactorily. Comparing the projected 1983/84 figures with 1980/81, total government expenditures as a percentage of GDP have dropped from 34.2 percent to 25.8 percent; as indicated in the SAL objections, this cut has largely come out of the development budget rather than recurrent expenditures. Revenues as a percent of GDP fell much less over this period, so the government deficit has fallen from 10.7 percent of GDP in 1981/82 to 8.1 percent in 1982/83, and is anticipated to reach 6.6 percent in 1983/84.

Malawi's first medium-term public investment program was produced in time for preliminary preparation of the 1984/85 budget. The
core of the program is a three year projection of government revenues and expenditures.

Public Enterprise Sector

In general, the public enterprise sector is not anticipated to be an important source of savings, for it is saddled by high debt service burdens. However, closing public enterprise operating deficits frees the central government to generate its own savings. The performance of ADMARC, the agricultural marketing agency, improved in 1983 largely as a result of its export sides of maize; under the SAL II program, policies are being implemented to reduce marketing costs, improve pricing analysis, limit new investments to marketing/processing activities, and improve management quality. Increases in changes have been implemented to improve the accounts of the public housing, railroad, water, and electricity corporations. In December 1983, the agreement was finally signed to initiate the much needed restructuring of Press Holdings, Inc.
| Table 5: MALAWI: SOME ECONOMIC INDICATORS |

<table>
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<tbody>
<tr>
<td><strong>Growth Rates</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>6.6%</td>
<td>-1%</td>
<td>-3%</td>
<td>2.6%</td>
<td>4.4%</td>
</tr>
<tr>
<td>Manufacturing value added</td>
<td>6.5%</td>
<td>3.7%</td>
<td>1.8%</td>
<td>-6.1%</td>
<td>15.4%</td>
</tr>
<tr>
<td>Agricultural value added</td>
<td>4.5%</td>
<td>-5.4%</td>
<td>3.6%</td>
<td>5.9%</td>
<td>3.2%</td>
</tr>
<tr>
<td>Total fixed investment</td>
<td>-6.2%</td>
<td>-6.8%</td>
<td>-33.7%</td>
<td>-11.5%</td>
<td>7.1%</td>
</tr>
<tr>
<td>Public fixed investment</td>
<td>-12.5%</td>
<td>14.5%</td>
<td>-50.9%</td>
<td>-21.7%</td>
<td>4.7%</td>
</tr>
<tr>
<td>Private fixed investment</td>
<td>3.2%</td>
<td>-34.4%</td>
<td>-9.7%</td>
<td>13.0%</td>
<td>9.3%</td>
</tr>
<tr>
<td>Imports ($US million)</td>
<td>465.7</td>
<td>509.2</td>
<td>429.6</td>
<td>348.8</td>
<td>366.2</td>
</tr>
<tr>
<td>Exports ($US million)</td>
<td>256.7</td>
<td>327.5</td>
<td>328.7</td>
<td>279.5</td>
<td>250.3</td>
</tr>
<tr>
<td>Major Agri. Exports</td>
<td>n.a.</td>
<td>238.3</td>
<td>242.7</td>
<td>224.7</td>
<td>192.5</td>
</tr>
<tr>
<td>Current Acct. Def/GDP</td>
<td>-23.4%</td>
<td>-19.0%</td>
<td>-12.0%</td>
<td>-8.3%</td>
<td>-11.4%</td>
</tr>
<tr>
<td>Government Def/GDP</td>
<td>-9.6%</td>
<td>-11.1%</td>
<td>-10.7%</td>
<td>-8.1%</td>
<td>-6.6%</td>
</tr>
<tr>
<td>Private/Total Investment</td>
<td>43.6%</td>
<td>32.4%</td>
<td>41.9%</td>
<td>51.9%</td>
<td>52.9%</td>
</tr>
<tr>
<td>Real Exchange Rate Index</td>
<td>100.0</td>
<td>101.2</td>
<td>102.4</td>
<td>99.7</td>
<td>103.4</td>
</tr>
<tr>
<td>GDP Deflator Growth</td>
<td>3.4%</td>
<td>14.9%</td>
<td>15.4%</td>
<td>14.5%</td>
<td>9.3%</td>
</tr>
<tr>
<td>Money Supply Growth</td>
<td>0.9%</td>
<td>12.6%</td>
<td>26.0%</td>
<td>14.5%</td>
<td>8.9%</td>
</tr>
</tbody>
</table>

1/ deflated by GDP deflator
2/ of goods and non-factor service
3/ increases indicate appreciation
PHILIPPINES

An Overview

During the 1970s growth in the Philippine economy accelerated. GNP growth increased from 5 percent in the 1960s to almost 7 percent at the end of the 1970s and the ratio of fixed investment to GNP increased from 15 percent to nearly 25 percent over the same period. However, the balance of payments problems became more and more evident as the heavy reliance on foreign savings, external borrowing and imported oil grew. The government made some attempts to diversify exports which resulted in reducing the current account deficit temporarily.

As a result of the 1979 oil price increase and ensuing international recession, the balance of payments problems worsened, real GNP growth fell gradually from almost 7 percent in 1977-78 to an estimated 2.9 percent in 1982, and inflation accelerated.

In response to the increasing balance of payments constraints and their subsequent adverse effect on the development effort, the Government embarked on a stabilization program beginning in 1980. This was supported by (a) the Fund with two stand-by arrangements; and (b) the Bank with two SALs and a US$150 million industrial finance loan.

The overall performance of policy reforms recommended under SALs has been good. The reform of the tariff system and realignment of indirect taxes have been substantially completed; however, less progress has been made in the area of import licensing and regulation. The implementation of export industrial promotion policies, energy
diversification and conservation, and resource mobilization measures has been good.

(a) **Industrial Strategy - a Historical Perspective**

In the early 1950s the principal objective of the Philippine industrialization policy was import substitution. Consequently, by the end of the 1960s the manufacturing sector was heavily dependent on imports and high protection led to inadequate employment creation, over-concentration of capital intensive industry in the Manila area, inefficient investment, chronic external deficits, and rapidly deteriorating balance of payments. The 1970s was characterized by a more outward-looking industrial policy. Policy measures included a depreciation of the exchange rate and a reform of the tariff system. While these measures resulted in an improved manufactured export performance, manufacturing employment remained constant at 10-12 percent of total employment - the same level as in the 1950s and industry remained concentrated in Manila.

One of the major causes of the structural problems of the manufacturing sector has been the high tariffs and trade regime. Tariff rates ranged from 10-100 percent. The average level of protection was 44 percent and quite uneven giving varying incentives. Tariff protection was compounded by import licensing restrictions. Resources were directed into those industries with the highest protection — namely consumer goods for the domestic market. Inherent in the system was a bias against labor intensity and exports, further contributing to low growth in manufacturing employment. Furthermore, the financial
The system reinforced the capital-intensive bias investment incentives through below free market interest rates.

(b) System of Industrial Incentives and Promotion

The structure of investment incentives in the Philippines was such that import-substituting and capital-intensive activities were encouraged. Incentives were aimed at reducing capital costs and took the form of accelerated depreciation allowances, net operating loss carryovers, tax deductions for expansion reinvestment and tax exempt status for imported equipment. A Board of Investments was created to determine investment priorities and administer import licenses. This system failed to identify areas of the country's comparative advantage, reinforced the import-substitution bias of the protection system, reinforced the bias towards capital-intensity as opposed to high labor absorption, and its administration was complex as well as being biased towards industries in the Manila area.

(c) Energy

Prior to the 1973 oil crisis, oil imports placed only a small burden on the Philippines' balance of payments. In 1972 oil imports represented 12 percent of merchandise imports. As a result of the increase in oil prices, the share of oil imports rose to over 25 percent in 1980. The Philippine government responded effectively to the crisis during the period from 1973 to 1980 with petroleum pricing and tax policies which encouraged energy conservation, and development and conversion to alternative energy sources.

However, following the second oil price shock of 1979 the oil import bill increased from $1.0 billion to almost $2.5 billion and by
1981, oil imports share of merchandise imports was 31 percent. Furthermore, public sector financed energy development contributed to increasing budget deficits. The petroleum price increases imposed throughout the 1970s were effective in generating revenue and conserving energy; however, due to different tax rates on gasoline and diesel, inefficient substitutions began to develop.

(d) Public Sector

Historically, the role of the public sector has been very passive in Philippine economic development. In the late 1960s, government expenditure averaged 12 percent of GNP and public investment only 2 percent of GNP. During the 1970s a series of tax reforms brought about increased revenues and a rapid expansion of public expenditure. Despite the expansion, public sector resource mobilization is relatively low in the Philippines. Prior to 1981, public sector resource mobilization was nearly 16 percent of GNP. Since then, due to recessionary conditions, it has fallen to 14 percent. Tax revenues represented 11.6 percent of GNP in 1978-80 and fell to 10.3 percent in 1981 under the impact of increased exemptions for personal income tax, the tariff reform and recessionary conditions. Government corporations finance less than 10 percent of their investment programs from internal cash generation and are nearly entirely dependent on Government contributions and the budget.

(e) Resource Mobilization

Foreign savings share of GNP increased from 5.0 percent in 1979 to 5.4 percent in 1981 — quite high relative to the 3 percent share in
1979 of all middle-income oil-importing developing countries. This reflects the inability of the economy to increase domestic resource mobilization. In order to avoid any further increase in external debt, this dependence needs to be reduced and the domestic savings rate increased.

(f) **Exports**

The major share of the Philippines export earnings are derived from a few primary products—(coconuts, sugar, copper, timber)—thereby keeping the Philippines economy highly vulnerable to commodity price fluctuations. During the 1970s, the Government succeeded in its attempt to diversify exports, and non-traditional manufactured exports increased from US$50 million in 1970 to US$2.30 billion in 1981, or 40 percent of merchandise exports. However, due to their dependence on imported inputs, the net positive effect on the balance of payments was probably much lower than that.

**Response to Oil Price Increases**

The weak balance of payments in the 1970s was further aggravated by the 1973-1974 oil price increase and subsequent collapse on commodities prices. The Philippines felt the impact of these increases substantially as more than 90 percent of the economy's energy was being supplied by imported oil.

The Philippine government responded to the oil price increases by pursuing a number of adjustment measures. During the decade, exports were diversified, and non-traditional products were developed. Export growth accelerated from 5 percent in the late 1960s to 7 percent during
the 1970s. Import growth was slowed by policy measures aimed at constraining energy demand, expanding domestic energy production, expanding rice production in an effort to reduce food grain imports and restraining consumption through demand management policies. These measures were supported by the IMF with a three year financing arrangement from 1976-78 and a one-year standby in 1979. The government embarked on a large foreign borrowing program to finance the imports needed to sustain growth and investment. Gross disbursements of medium and long-term borrowing grew from $400 million per year before the energy crisis to over $2 billion per year at the end of the decade. The high level of borrowing maintained growth and investment rates and the current account deficit was reduced from 6 percent of GNP in 1975-76 to 4.5 percent of GNP in 1977-78.

Unfortunately this improvement in the balance of payments was reversed by the 1979 oil price increases which increased the import bill, widened the current account deficits, slowed real GNP growth and accelerated inflation to 19 percent by 1979. In order to maintain real incomes, the government increased minimum wages in mid-1979 only to further aggravate inflationary pressure. Despite the policy improvements in the 1970s, the 1979 oil price increase further exacerbated the long term balance of payments problems which faced the Philippines in 1980 and the underlying structural problems: (1) two thirds of foreign exchange earnings were derived from traditional commodity exports; (2) the industrial sector placed a net burden on the balance of payments; (3) more than 80 percent of energy needs were supplied by imported oil; (4) government deficits representing 6 percent
of GNP could not be sustained if the economy was to meet its stated development objectives.

**Stabilization Attempts 1980-83**

With a balance of payments deficit of $580 million in 1979 the government formulated an adjustment program supported by an IMF standby facility. The measures introduced included limits on net domestic assets of the banking system, and limits on new approvals of foreign borrowings of 1-12 years' maturity. However, due to worsening world economic conditions and rising oil prices the program turned out to be more difficult than envisioned. The need for strengthening long term policies became more apparent. A second standby facility was agreed upon for 1983 to support a short-term financial program. The aims of the program were to reduce the budget deficit from $1.2 billion in 1982 to $600 million in 1983 through tighter monetary and fiscal policies and a flexible exchange rate policy.

The need for structural change was reflected in the two 5-year development plans set out by the Philippine Government for the period 1978-1987. Critical to the success of the development effort and the structural adjustment program was an increase in the efficiency of investment, reduced dependence on imported oil and improved performance of the manufacturing sector and its export performance.

The Government's program of structural reform was initiated in 1980. The first phase of the program focused on trade, industrial and financial policies which were major factors behind the low investment efficiency. The trade and industrial policy reforms were supported under SALI. They were complemented by a financial sector reform package.
supported by a Bank industrial finance loan. The second phase of the program was supported under SALII. Trade and industrial reforms started under SALI were continued and new reforms in energy development and conservation and public resource management were initiated.

The Structural Adjustment Program -- Objectives and Policies of SALs

The economic analysis and policy recommendations of the SALs were based on the work of the Philippine division and numerous World Bank reports. These include Domestic and External Resources for Development (2674-PH), Industrial Development Strategy and Policies (2513-PH), Aspects of the Financial Sector Report (2546-PH), Selected Issues for the 1983-87 Plan Period (3861-PH), and an Energy Sector Survey (3199a-PH).

Table 6: PHILIPPINES: STRUCTURAL ADJUSTMENT LOANS

<table>
<thead>
<tr>
<th>Loan</th>
<th>Date of Approval</th>
<th>Amount ($m.)</th>
<th>Disbursements as of 5/7/84</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAL I</td>
<td>9/16/1980</td>
<td>$200.00</td>
<td>$199.34</td>
</tr>
<tr>
<td>SAL II</td>
<td>4/26/1983</td>
<td>$302.30</td>
<td>$302.30</td>
</tr>
</tbody>
</table>

The major objectives and policy recommendations of the two SALs are summarized in Table 7. They represent policy measures chosen by the Philippine Government and supported by the Bank. The major policy changes, their implementation and results are as follows.
<table>
<thead>
<tr>
<th>Area</th>
<th>Final Objective</th>
<th>Intermediate Objective</th>
<th>Policy Instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade</td>
<td>reduce BOP deficit</td>
<td>reform tariff and import licensing regime</td>
<td>maintain a flexible exchange rate policy.</td>
</tr>
<tr>
<td></td>
<td>lower import protection</td>
<td>promote exports</td>
<td>adapt legislation to establish a system to even out spread of nominal tariff rates to between 10% and 50%</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>liberalize 70% of import licensing in stages</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>make all fiscal incentives provided under the Investment Incentives Act also available under the Export Incentives Act.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>extend tax credit/duty drawback facilities to indirect as well as direct exporters, and increase tax deductions for domestic costs and overseas trading offices.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>reduce marginal deposit requirements on imported inputs and introduce an advance tax credit within seven days after exportation of their finished product.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>liberalize bonded manufacturing warehouse arrangements so that they are available to large and small exporters.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>reduce Central Bank rediscount rate for non-traditional exports and establish Export and Foreign Loan Corporation to guarantee loans and reduce risks of export financing.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>reorganize institutions that promote trade and establish task forces on six priority export product groups</td>
</tr>
</tbody>
</table>
Table 7: PHILIPPINES: SUMMARY OF OBJECTIVES AND POLICY RECOMMENDATIONS OF THE SLS (cont’d)

<table>
<thead>
<tr>
<th>Area</th>
<th>Final Objective</th>
<th>Intermediate Objective</th>
<th>Policy Instrument</th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrial Reform</td>
<td>improve performance of industries through increased growth, reduced capital intensity, more efficient use of capital and greater regional dispersion</td>
<td>restructure industry</td>
<td>introduce higher taxes on luxury items to discourage non-essential consumption</td>
</tr>
<tr>
<td></td>
<td></td>
<td>reform industrial incentives system to increase investment efficiency</td>
<td>remove differential tax treatment of imported and domestic goods and simplify the administration of these taxes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>introduce sectoral development programs</td>
<td>reform indirect taxes in an effort to align sales and excise taxes with the new tariff and trade regime</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>adopt concept of subsectoral restructuring programs to help existing industries adjust to policy changes and develop small and medium-scale enterprises</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>create a full time team for sector studies, initiate sector programs for the textile and cement industry and implement studies in the food processing, electronics and metal working industries</td>
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<tr>
<td></td>
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<td></td>
<td>adopt a policy of rigorous economic evaluation in selecting industries eligible for incentives</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>institute a tax allowance based on value-added for new investments during the first five years of commercial production</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>reorganise Bureau of Investments, retrain staff in industrial planning, develop a Young Manager’s program, establish a management information system</td>
</tr>
<tr>
<td>Area</td>
<td>Final Objective</td>
<td>Intermediate Objective</td>
<td>Policy Instrument</td>
</tr>
<tr>
<td>---------------------------</td>
<td>---------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Investment Incentives</td>
<td>Rationalize investment incentive system</td>
<td>channel investments to industrial subsectors where the Philippines has a comparative advantage</td>
<td>and improve industrial statistics through strengthening of the National Census and Statistical Office</td>
</tr>
<tr>
<td></td>
<td></td>
<td>encourage employment generation and industry growth outside Manila</td>
<td>remove existing fiscal incentives with a capital cheapening bias like accelerated appreciation, tax allowances for reinvestments of pre-operating expenses and replace with incentives related to performance rather than investment per se</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>introduce 2 new performance oriented incentives - tax credit on net value earned and tax credit on net local content of export products</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>real economic rate of return, and indicators like domestic resource cost and the effective protection rate were introduced as investment criteria</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>encourage greater use of economic analysis in industrial project evaluation</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>streamline procedures for administering of incentives - reduce information requirements on registration forms</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>improve allocation system of incentives by establishing regional offices available to help small and regionally dispersed firms in the</td>
</tr>
<tr>
<td>Area</td>
<td>Final Objective</td>
<td>Intermediate Objective</td>
<td>Policy Instrument</td>
</tr>
<tr>
<td>----------------------------------</td>
<td>--------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
<td>-----------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Energy</strong></td>
<td>reduce the high level of oil imports through increased and diverse domestic energy production and conservation</td>
<td>adopt an investment plan in the areas of power generation, coal production, oil, gas, and geothermal exploration and development to replace petroleum</td>
<td>encourage greater conservation of energy through an adjustment of relative diesel/gasoline prices, restructuring of retail electricity rates and increased wholesale power tariffs.</td>
</tr>
<tr>
<td><strong>Energy Public Resource Management</strong></td>
<td>reduce energy sector reliance on government equity contributions</td>
<td>initiate study of the structure of wholesale and retail power tariffs and petroleum pricing</td>
<td>approve a plan to eliminate government equity contributions by 1986 and fix annual equity targets to encourage power subsector to finance investment through internal cash generation.</td>
</tr>
<tr>
<td>Technical Assistance</td>
<td></td>
<td></td>
<td>hire team of consultants to strengthen BOI's planning and analytical capabilities, prepare textile and other sector restructuring programs, on the job and overseas training for staff of the Tariff Commission, and establish an international trade center.</td>
</tr>
</tbody>
</table>
The Budget - The indirect tax system which existed in the Philippines effectively protected domestic industries with mark-up and higher nominal rates on imports providing a strong incentive for import-substitution. This system was also very effective from the point of view of revenue generation. The objective of the tax reform under the SAL was to remove the differential tax treatment of imported and domestically produced goods. At the time the SAL was proposed, the Bureau of Internal Revenues was unable to estimate the net revenue effect of the proposed tax reforms. Preliminary estimates concluded a revenue loss of P1.0 billion. Reduction of equity contributions to government corporations comprised a major portion of the effort to maintain government revenues. These measures are reflected in the energy sector reforms.

Trade Policy - Tariff Reform and Trade Liberalization - The objectives of the trade policy reforms were three-fold. First, to increase efficiency and international competitiveness of Philippine industry. Second, to reduce allocative distortions by lowering the level of protection and evening out tariff rates. Third, the government hopes to improve the export regime through export promotion measures. A variety of measures were taken to achieve these objectives. A comprehensive tariff reform was legislated complemented by a program of liberalizing import licensing. The first part of the tariff reform covered 75 percent of the items in the tariff code — realigning tariffs of 40 items in the food processing industry and 14 other industry sub-sectors over a period of five years. Peak tariffs were to be reduced from 70 percent and 100 percent to 50 percent. Minimum
nominal tariff rates were to be implemented, and the differential tax treatment of foreign and domestically produced goods phased out. Import restrictions were to be reduced in all but the national security, health and public safety sectors.

While compliance with the tariff reform program has been good, by 1983 the balance of payments situation had worsened, and the Philippines was faced with political uncertainties, and a growing debt service burden. In response, the peso was devalued substantially, government expenditures reduced, new controls were enforced on the allocation of foreign exchange and an additional import duty of 3 percent was levied in 1982 which was increased to 10 percent in May. New import restrictions had to be introduced and existing restrictions tightened. The import surcharge temporarily reversed the decline in tariff levels.

In order to avoid any adverse effects on revenue collection or the balance of payments, the SAL reform program relied on the IMF's proposed flexible exchange rate policy and measures to increase indirect taxes in case import demand and private consumption expanded significantly as a result of the trade reforms. A $1 billion tax package was incorporated into the 1981 budget. However, the government failed to make compensating adjustments in its exchange rate as is reflected in the appreciating real exchange rate index for the period 1979 to 1982 (Table 8). This policy was corrected in 1983 when the exchange rate was depreciated following IMF recommendations.

Preliminary data suggest that the program had little adverse effect on tariff revenues. The new system of foreign exchange controls
authorized the Central Bank to administer all foreign exchange through a central pool based on high priority uses. In reality, due to foreign exchange shortages, little foreign exchange has been allocated to vital domestic industries or export industries, thus making some of the reimposed import restrictions redundant.

In order to strengthen the export regime, the SAL recommended a series of measures including broadening fiscal incentives for export production, simplifying procedures, improving export financing facilities and strengthening institutions. In actual fact, most of the activities outlined in the SAL-I agreement were already accomplished by early 1980, in anticipation of the agreement, except for the policy action to introduce standard costings and allowance for the duty drawback system which was not implemented due to private sector resistance. One point of note is that the SAL doesn't include any assessment of the export categories where expansion would have the greatest potential in the world market. While this kind of formal analysis may have occurred in the design of the SAL, it is not clear from the document itself.

**Investment Incentives and Promotion Policy** - New industrial promotion policies were implemented under the SALs in an effort to improve investment efficiency, simplify the administration of incentives and strengthen the industrial institutions as a means to reduce the anti-export bias of the trade regime. Reforms in this area were aimed at increasing competitiveness and industrial efficiency through fiscal incentive measures, more rigorous analysis of eligibility for incentives, and sector programming. Five months after the new policy
became effective, 70 percent of new applications for projects were export-oriented projects. In the area of industrial restructuring, the cement and textile industries are currently under modernization. However, of the seven sectoral studies planned for 1983, only the electronics and food-processing industry studies have been completed.

**Energy Reforms** - The purpose of the energy reform program was to accelerate structural changes in the sector. The main objectives were to diversify energy sources, improve conservation and generate funds for energy investment. The measures adopted included an energy investment plan, improved resource mobilization from within the power subsector, increased wholesale power tariffs, restructuring of electricity rates, adjustment of petroleum product prices, and the initiation of a petroleum pricing and a power tariff study.

The program has made significant progress in its attempt to develop domestic energy resources. During 1982 power generation from geothermal stream increased by approximately 18 percent and coal consumption almost doubled. According to recent estimates dependence on imported oil dropped from 73 percent in 1981 to 65 percent in 1983. An important element of the energy reform program was to improve resource mobilization from within the power subsector. Equity contributions to finance its investment program amounted to one-fifth of the government's budgetary deficits in the past. Reforms proposed under the SAL included increasing internal cash generation through power tariff increases to finance investment. This was successfully achieved.

**Financial Sector Policies** - Reforms were introduced by the Government in 1981 to complement trade and industrial policy changes set
forth in the SAL. The objective of these reforms was to promote savings and increase the availability of long term finance. Banking legislation was changed, and interest rates were deregulated, resulting in positive real interest rates for the first time in three years. The government provided fiscal incentives for term lending and equity investment and a lender-of-last resort facility was established by the Central Bank. These reforms were hampered by a crisis of confidence in non-bank financial intermediaries in the beginning of 1981. Many companies became insolvent and couldn't repay their loans.

Although it is difficult to measure the impact of the adjustment program in the Philippines because of the influence of the world recession, this discussion may add further insight into the issues addressed in this paper.
### Table 8: PHILIPPINES SOME ECONOMIC INDICATORS

<table>
<thead>
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</thead>
<tbody>
<tr>
<td><strong>Growth Rates (%)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GDP</td>
<td>6.3</td>
<td>5.3</td>
<td>3.9</td>
<td>2.9</td>
<td>1.1</td>
</tr>
<tr>
<td>Industrial Value Added</td>
<td>8.0</td>
<td>4.7</td>
<td>4.5</td>
<td>2.1</td>
<td>0.7</td>
</tr>
<tr>
<td>Agricultural Value Added</td>
<td>4.5</td>
<td>5.0</td>
<td>3.7</td>
<td>3.1</td>
<td>-2.1</td>
</tr>
<tr>
<td>Total fixed investment</td>
<td>12.1</td>
<td>6.6</td>
<td>3.5</td>
<td>0.9</td>
<td>-3.0</td>
</tr>
<tr>
<td><strong>Total imports (million US$)</strong></td>
<td>8,108</td>
<td>10,348</td>
<td>11,151</td>
<td>11,690</td>
<td>11,354</td>
</tr>
<tr>
<td><strong>Total exports (million US$)</strong></td>
<td>6,256</td>
<td>8,010</td>
<td>8,618</td>
<td>8,004</td>
<td>8,138</td>
</tr>
<tr>
<td>Agricultural exports (million US$)</td>
<td>2,094</td>
<td>2,268</td>
<td>1,952</td>
<td>1,670</td>
<td>1,612</td>
</tr>
<tr>
<td>Non-traditional manufacturing exports (million US$)</td>
<td>1,474</td>
<td>2,005</td>
<td>2,374</td>
<td>2,376</td>
<td>2,387</td>
</tr>
<tr>
<td>Mining exports (million US$)</td>
<td>820</td>
<td>1,174</td>
<td>976</td>
<td>687</td>
<td>607</td>
</tr>
<tr>
<td>Other exports (million US$)</td>
<td>213</td>
<td>241</td>
<td>420</td>
<td>288</td>
<td>399</td>
</tr>
<tr>
<td>Total merchandise exports (million US$)</td>
<td>4,601</td>
<td>5,788</td>
<td>5,722</td>
<td>5,021</td>
<td>5,005</td>
</tr>
<tr>
<td><strong>Current account deficit/GDP (%)</strong></td>
<td>5.0</td>
<td>5.4</td>
<td>5.4</td>
<td>7.9</td>
<td>8.1</td>
</tr>
<tr>
<td><strong>Central government deficit/GDP (%)</strong></td>
<td>0.1</td>
<td>1.3</td>
<td>4.0</td>
<td>4.3</td>
<td>2.0</td>
</tr>
<tr>
<td><strong>Private investment/total fixed investment (%)</strong></td>
<td>73.0</td>
<td>67.1</td>
<td>61.9</td>
<td>62.8</td>
<td>65.8</td>
</tr>
<tr>
<td><strong>Inflation (%)</strong></td>
<td>15.2</td>
<td>15.5</td>
<td>11.1</td>
<td>8.4</td>
<td>11.7</td>
</tr>
<tr>
<td><strong>Unemployment (%)</strong></td>
<td>4.2</td>
<td>4.8</td>
<td>5.4</td>
<td>5.8</td>
<td>4.9</td>
</tr>
<tr>
<td><strong>Growth of Money Supply</strong></td>
<td>10.8</td>
<td>18.1</td>
<td>21.1</td>
<td>16.1</td>
<td>18.6</td>
</tr>
<tr>
<td><strong>Real Exchange Rate</strong></td>
<td>100.0</td>
<td>95.0</td>
<td>92.0</td>
<td>89.0</td>
<td>106.0</td>
</tr>
</tbody>
</table>

1/ Merchandise trade
2/ 1978 GDP deflator
3/ An increase in the index corresponds to a depreciation
B. SURVEY OF ADJUSTMENT ISSUES

1.1 Introduction

The Bank's Structural Adjustment Loan program may be seen as a response to two related recent trends. There was first the development of persistent and unviable balance of payments deficits by many developing countries in the 1970s and early 1980s. The oil crisis, world recession, and related events ensured that these deficits would not be merely temporary and amenable to external financing or monetary demand curtailment, but would require more fundamental adjustment of the debtor economies. Secondly, this historical shift was mirrored by an evolution of views about stabilization policy which became increasingly skeptical that relatively narrow demand-based approaches to stabilization were by themselves sufficient. Analysts became more concerned with distortions, bottlenecks, and structural rigidities in developing economies which could constrain the balance of payments adjustment process; their interest shifted from short-term stabilization to more gradual structural adjustment. Many policy makers came to accept the view that the elimination of external payments disequilibrium must proceed gradually and on many fronts to avoid costly side-effects of short-term stabilization.

Little academic research has been focused upon the proper design of structural adjustment programs per se. However, the growing literature on international disequilibrium and economic stabilization touches upon a wide variety of issues important to medium term structural adjustment as well as to short run stabilization policies.
While this literature by no means provides comprehensive and sufficient guidelines for SAL design, it certainly makes important contributions toward this end. The following pages are intended to highlight those issues currently being discussed which are especially pertinent to the construction of structural adjustment programs. Section 1.2 discusses the relevance of a preliminary issue: the sources of macroeconomic and external payments imbalance. This is followed in Section 1.3 by a summary of different broad adjustment modes identified in the literature. Section 1.4 focuses upon the impact of the different specific adjustment and stabilization policies themselves, while section 1.5 discusses the overall design of consistent, effective structural adjustment programs. The final two sections examine the income distribution effects of structural adjustment programs and their consistency with global economic trends.

1.2 Sources of External and Internal Imbalance

A prominent source of controversy in the literature has been the source of the marked payments disequilibrium experienced by many countries in recent years: these are often divided into external shocks and inappropriate domestic policies. External shocks are generally defined (Mitra 1983) to include adverse terms of trade changes and autonomous (from the exporter's standpoint) declines in export volume; to this list may be added rises in the interest rate on external borrowing, which made a major impact on debt service burdens in recent years. Another factor which may become increasingly important in the 1980s would be fluctuating capital flows, though Stanley Black (1983) argues they were probably less important in earlier decades.
A wide variety of policies are considered to have been domestic contributors to external payments imbalances. They include policies promoting excess demand, fiscal deficits to finance high cost, low productivity investment programs, associated expansive monetary policy, and policies promoting high wage growth. Policies reducing overall efficiency and especially export supply are also noted: overvalued exchange rates, high cost protection policies and misdirected price controls in product and factor markets.

The debate as to the relative weight of these factors occurs at both the country-specific and the aggregate level. As an example of the latter, Black used discriminant analysis of cross-country data for the 1970s to show that while external factors were important, the domestic policies of these countries were shown to be better correlated with their degree of external disequilibrium. On the other hand, Sidney Dell (1983) focused upon the 1978-81 period and argued that the oil shock and the rise in interest rates were the crucial determinants of payments imbalance. He notes that the combined current account deficit of the net oil-importing developing countries rose from $30 billion in 1978 to $80 billion in 1981, while increased oil and interest rate costs alone rose $70 billion. Hence, he contends that these countries used domestic policy to adjust substantially, but were overwhelmed by external shocks.

There appears to be some consensus that the weight of external shocks has been more important in payments imbalances, though internal factors have been especially important in the adjustment response to external shocks. However, as structural adjustment programs tend to be designed on a country-specific basis, it is not clear how useful an aggregate characterization will be to SAL design. Moreover, it is not
clear how meaningful the internal/external distinction itself actually is. As already mentioned, a country pursuing poor domestic strategy may not actually cause a payments imbalance, but may be unable to adjust satisfactorily to a mild external shock. Taken from a different perspective, the expansionary fiscal policies pursued by many developing countries in the 1970s were supported by the readily available commercial credit deriving from OPEC's surpluses. In the absence of the availability of that credit (clearly an external factor), many counterproductive domestic fiscal policies might not have been undertaken.

The importance of the distinction between the external and internal sources of imbalance must be understood in context. Sidney Dell's argument is that if the origin of imbalance extends beyond the control of the developing countries, it is (1) inequitable to force them to bear the entire adjustment burden; and (2) inefficient as well, for international cooperation and financing would serve to reduce overall adjustment costs. While this issue is important in its own right, it is less relevant to the design of SAL programs. First, country-specific SAL's must take the international environment as a given, and at the moment there exist no international cooperation program of the sort Dell proposes. And in any event, SAL designers must always take care to identify the specific causes of imbalance – it is merely that the internal/external distinction per se is less crucial.

1.3 Modes of Adjustment to External Disequilibria

Three different broad modes of adjustment to external payments imbalances have been identified in the literature. These include the
reduction of excess demand (expenditure-reduction), the promotion of exports and import-substitutes (expenditure-switching), and the external financing of a country's payments obligations.

Expenditure-reduction concentrates on reducing domestic absorption (GDP - exports + imports) in relation to aggregate supply (GDP) to reduce the current account deficit and inflation. In principle, this can either be achieved through a decline in domestic final demand which reduce imports or an increase in output which replaces imports or increases exports. In practice, increases in output are considered to increase imports (for reasons to be discussed below), and the focus of adjustment is upon decreasing absorption. Expenditure-reduction is therefore most appropriate when excess demand underlies the payments imbalance, as opposed to, say, a misallocation of resources between the traded and non-traded goods sectors.

Within the category of absorption reduction, the choice still remains between decreasing investment, on the one hand, and raising savings on the other. Accordingly, Mitra (1983) defines two adjustment modes: "investment slowdown" and "domestic resource mobilization". In fact, domestic resource mobilization is considered overly time-consuming and difficult for short-run stabilization programs - it requires either raising taxes to increase government savings or promoting changes in financial sector to change private savings/consumption decisions. Expenditure reduction is therefore generally associated with fairly costly reductions in investment, output and economic activity.

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1/ Keller (1980) accordingly argues that increases in working capital financing which promote production are suitable to stabilization programs.
Expenditure-switching policies attempt to shift output from the home goods to the traded sector by promoting exports and import-substitutes production. This approach is considered to entail less costs than the expenditure-reduction strategy, but is less fast acting on the trade deficit, and hence may require external financing for the transitional period. Expenditure-switching is most likely to be appropriate in response to some external shock which creates a need for greater exports and reduced imports, even though a state of excess demand does not necessarily prevail. The linking of adjustment mode with source of imbalance should not be taken too far, however. As Mitra points out, an increase in oil prices not only requires a trade adjustment, but because it lowers the economy's real income, requires an adjustment of final demand as well.

The final adjustment mode, external financing, is considered appropriate for transitory payments imbalances, but not for persistent, fundamental disequilibria. The events of the last few years indicate how dangerous the accumulation of external debt can be in a turbulent international environment with fluctuating interest rates. Nevertheless, external financing can play an important role in conjunction with other adjustment modes during the transitional period preceding full payments adjustment.

Considerable research has been undertaken at the Bank and the OECD to determine the incidence of adjustment modes across different countries (Balassa 1983, Mitra 1983). These studies draw distinctions between (among other things) "outward-looking" and "inward-looking" countries. Outward-looking countries provide similar incentives for the
production of both domestic and export goods, primary commodities and manufactures. They include among their ranks Korea, Singapore, Taiwan, Chile, Uruguay, Kenya, Mauritius, Thailand and Tunisia. Inward-looking countries, by contrast, bias incentive structures against the production of exportables and primary commodities. Examples include Brazil, Portugal, Turkey, Yugoslavia, Argentina, Israel, Mexico, Jamaica, Peru and Tanzania.

Balassa argues that while the outward-looking countries suffered greater external shocks, relative to their GDP levels, than the inward-looking nations, they were able to more successfully implement expenditure-switching policies with less reliance on external financing or economic contraction. The major reason for this was the outward-looking country's less active government discrimination against particular sectors. Not only was greater overall micro-efficiency thus promoted, but the relative absence of distortions and structural rigidities meant that different sectors were able to demonstrate the greater flexibility needed to respond to the relative price changes and other shocks provided by the international economy.

This distinction was crucial, for it will be argued in the next section that a key feature of a structural adjustment program, as opposed to a short-term stabilization program, is to heighten the responsiveness of the economy to policies or changes in the economic environment; this is to be accomplished through elimination of those factors inhibiting flexible response to shocks. Outward-looking economies which entered the turbulent international environment of the 1970s with flexible, responsive economies were more easily able to eschew costly adjustment modes in favor of easier transitions.
1.4 Impact of Stabilization and Structural Adjustment Policies

In the preceding pages, the terms stabilization and structural adjustment have been used recurrently, but no clear distinction has been drawn between them. A reading of the literature suggests a variety of possible dividing lines:

1. Stabilization is a short run (one to three year) set of policies, while structural adjustment is a medium term (three to five years or more), gradualist policy.

2. Stabilization uses demand management to cause contractions and diminish imports, where structural adjustment acts on the supply side to expand production of exports.

3. Stabilization is what the Fund promotes with its Standby Arrangements; structural adjustment is pursued through the Bank SALs and, to some degree, the Fund's EFFs.

While all those deliniations make important points, none of them fully capture the distinction between stabilization and structural adjustment. This distinction certainly encompasses more than the administrative division of labor noted in #3. Most IMF programs, and particularly the EFFs, contain measures which would be thought of falling in the structural adjustment category. Moreover, while stabilization and structural adjustment are highly dissimilar in some respects, they complement each other in the design of complete policy packages, and this complementarity has resulted in effective Bank/Fund collaboration in designing SAL and standby programs. The distinction goes beyond the temporal dimension suggested in #1. Structural adjustment policies are not merely stabilization policies implemented more slowly; they are a wider set of policies which, by striving to achieve more ambitious objectives, require more time to put in place and achieve results. Finally, the supply side/demand side distinction
cannot be pushed too far either. The exchange rate devaluation so often recommended in the stabilization programs acts to encourage the supply of exports and import-substitutes by increasing their relative prices and enhancing their profitability; conversely, SALs routinely include measures to increase savings rates and decrease investments in order to reduce absorption relative to output.

The crucial features of a stabilization package per se are first, it attempts to correct the balance of payments deficit exclusively, and second, it takes the parameters determining an economy's response to policy instruments as given, and attempts to manipulate these policy instruments exclusively to achieve its stabilization objectives within relatively short time horizons. Hence, a typical stabilization program may focus upon a contraction of monetary growth (and of demand) and on an exchange rate devaluation. In the short term, and in the absence of additional policy actions, the expenditure-switching effects of the devaluation may be quite limited; achievement of BOP equilibrium thus relies upon severe contraction of economic activity, exploiting the strong parameter linking imports and output.

The purpose of a structural adjustment program, on the other hand, is to simultaneously achieve payments deficit reduction, the resumption of output growth, and the achievement of structural changes needed to prevent future payments and stabilization problems. And in contrast to stabilization, the approach of structural adjustment is not only to manipulate the primary policy instruments, but to undertake other actions to increase the responsiveness of the stabilization
objectives to those instruments. Referring to the simple example above, structural adjustment policies would include sectoral/micro reforms to increase the responsiveness of exports and imports to devaluation, and budgetary/financial/sectoral reforms to decrease the responsiveness of current account deficits to the growth of output. Thus, while short term stabilization takes the parameters of an economy's response to stimuli as fixed, structural adjustment exploits a longer time frame to be able to transform the parameters of response themselves.

The following summary of issues associated with specific adjustment policies is organized along the lines of this conceptual framework. For each of the two major adjustment modes, expenditure-reduction and expenditure-switching, the major "stabilization" policies are described and discussed. This is followed in each case by a survey of the "structural adjustment" policies associated with the broader adjustment mode and which condition the response of the economy to the major stabilization policies.

1.4.1 Expenditure Reduction Policy

Within the broad expenditure - or absorption-reduction adjustment mode, the most frequently recommended stabilization policy tends to be a decrease in domestic credit creations in order to reduce the current account deficit and also contain inflation. This credit contraction represents the mainstay of the "monetary programming" approach dating from the 1950s; its rationale was well described in Polak's "Monetary Analysis of Income Formation and Payments Problems", (1957). This monetarist approach is based upon the belief that excesses
in the demand or supply of monetary balances are adjusted through inflows or outflows in international reserves. A country's money supply is a function of its money multiplier and its base, which in turn is comprised of international reserves and central bank loans to the government and the private sector. For a short time frame in which nominal income may be considered fixed, declines in domestic credit creation are thought to lead to excess demands for money which can only be satisfied through international reserve inflows, i.e., a current account surplus; in the longer run, reduced money growth is believed to restrain inflation as well.

This monetarist rationale for the effects of domestic credit creation is entirely compatible with a more Keynesian or absorption-oriented explanation. This approach holds that a decline in domestic credit creation leads to falls in aggregate demand which lower the gap between absorption and aggregate supply and in this way reduce the deficit between imports and exports. This standard absorption approach, on the other hand, is contested by those of a more structuralist inclination. They contend that current account deficits do not arise merely from a spillover of absorption over supply and into imports, but from a mismatch of the structures of demand and supply such that the excess demands for some products, especially important intermediate goods, co-exist with excess supplies of others. Trade deficits are therefore linked not with the excess of absorption over aggregate supply, but with actual levels of output. Domestic credit contraction
acts to reduce the trade deficit not by reducing absorption per se so much as by reducing output and activity levels. 1/

While there is general consensus upon the ultimate ability of contractionary monetary/fiscal policy to reduce the trade deficit, people with different views about how these processes work have different evaluations of the marginal effectiveness of credit restraint. Those stressing the pure absorption approach will tend to see these policies as being more effective and having fewer costs in activity than those of a more structuralist inclination. The implication of Keller's (1980) absorption-based analysis is that reductions of credit for fixed investment and consumption, combined with steady or increased financing of working capital requirements, would increase output, the savings rate, and net exports as well. Dell (1983) points out that the presumption of easy, flexible expenditure-switching must underlie exclusively demand-based approaches to stabilization. Those stressing the inflexibility of derived demands for imports, as well as the short-run inability to muster domestic substitutes, would expect an improved current account deficit only after considerably greater monetary restraint and real contraction. A growing belief that structural obstacles to expenditure-switching exist and play important roles has found adherents in the Fund as well as in other institutions (Crockett 1981).

1/ See Schydowsky's comments on Cline's analysis of the Peruvian situation in Cline and Weintraub (1981). He contends that because Peru's problem in the mid-to-late 1970s was misallocated rather then insufficient supply capacity, the country's strenuous demand reduction policies were inappropriate.
Aside from these more fundamental limits to the effectiveness of credit restraint in achieving external balance, the literature has pointed to some technical implementation problems as well. Some of these problems relate to determining the targets. Dell notes that it is not clear what the most appropriate aggregate the target is: central bank domestic credit, M1, or some broader liquidity measure. The broader liquidity measures may be more important, but are less easily controlled. Moreover, even with the liquidity measure determined, its link with absorption will be dependent upon largely unknown parameters of the money demand function. Finally, the discussion above highlights the difficulty of determining the appropriate final demand level itself (Crockett 1981).

Once targets are set, hitting them is likely to be difficult as well. Since many developing countries have poorly developed capital markets, credit policy will often be implemented through the government fiscal deficit. This is much more difficult than, say, open market operations to manipulate in the short run, and as Sharpley (1984) points out, is less appropriate to countercyclical policy than long term adjustment. Sharpley also notes the existence of large, informal or "curb" markets for funds in developing countries whose indirect links with formal capital markets make monetary control even harder. Finally, Dell points out that even developed countries have trouble hitting their monetary targets; developing countries should find it even more difficult. Accordingly, Killick, et. al. stress the replacement of quantitative targets with more flexible review indicators in their recommendation for policy reform (Killick, Bird, Sharpley and Sutton 1984).
The considerations listed above point toward factors reducing the effectiveness or ease of implementation of monetary/fiscal contraction as a stabilization tool. Another strand of criticism in the literature focuses upon potential negative side-effects of these policies, their effectiveness aside. One such side-effect is the possible inflationary potential of contractionary monetary policy. Taylor (1981) argues that monetary contractions which force up the interest rate increase the cost of working capital, which in turn directly raises production costs and hence prices while reducing the output of affected firms. Most developing countries, however, tend to combine low administered interest rates with credit rationing, so that monetary contraction is associated with declines in rationed credit rather than increases in the interest rate. On the other hand, formal rationed credit markets often co-exist with informal credit markets offering capital at much higher, competitively determined rates. Bruno (1979) shows that declines in formal credit allocations will push many firms to the high priced curb markets for working capital financing, raising costs and prices. In his comments on Taylor (1981), however, Kemal Dervis points out that these inflationary effects will usually be short lived. In general, the empirical evidence does not support an actual negative correlation between the money supply and inflation (Cline 1983). 1/ Nevertheless, these considerations suggest that monetary contractions will effect costs and prices in certain industries, particularly those with limited access to formal credit

1/ For a notable exception, see van Wijnbergen (1982).
outlets; this could in turn have important consequences for sectoral source allocation.

Perhaps a more problematic aspect of conventional absorption reduction measures is their focus on investment reductions, since this limits future output growth and perhaps more importantly, hinders attempts to shift relative sectoral capacities toward tradeable goods. As pointed out above, it is often easier, in the short run, to reduce investment than increase government tax revenues or change private consumption/savings decisions. In their recommendations, Killick et. al., point out that policies to protect investment and raise savings instead are crucial. Policies which depress investment and future output capacity guarantee persistent internal and external disequilibrium.

To conclude the discussion of contractionary stabilization policy one can point to a variety of structural rigidities in the developing economy which force attempts to reduce the output-absorption gap to rely exclusively upon costly output and investment reduction:

1. Sectoral rigidities which prevent smooth production shifts from non-traded to traded goods, as well as other bottlenecks inhibiting output expansion.

2. Ineffective taxation systems which burden short-run attempts to raise government revenue, as well as inefficient money-losing public sector activities.

3. Underdeveloped capital markets and financial regulations which limit private savings mobilization.

It is obvious that in the absence of these rigidities, the same current account balance improvement achievable by strong contractionary policy could be had through a combination of increased tax revenues, increased private savings mobilization, expenditure-switching to the
tradeable goods sector, and more moderate monetary restraint. A structural adjustment program's intent is to reduce these rigidities and hence enlarge the parameters of the economy's response to policy action.

Structural adjustment policies relating to #1, expenditure-switching, will be mainly discussed in 1.4.2. However, it should be remembered that the elimination of supply bottlenecks is important not only to expenditure-switching, but also to reducing the output-absorption gap. Hence, appropriate public investment and selective credit policies can maximize the return to available investment resources and moderate the output and growth costs of expenditure-reduction policies. Policies associated with #2, which figure prominently in many SALs, are of a rather technical nature and have not received much attention in the literature. Some issues concerning #3, private savings mobilization, have arisen.

A widely recommended strategy for private savings mobilization has been liberalization of the financial sector. Work by McKinnon (1973) and Shaw (1973) argued that the financial sector plays an important role in economic development by both mobilizing private savings and efficiently allocating them to the most productive investments. 1/ In many developing countries, however, deposit and lending rates are regulated and kept at below equilibrium levels; high inflation rates often yield negative real lending and deposit rates. The effects of this (Sharpley 1984) are thought to include lower savings

1/ For a survey, see Fry (1982).
rates, 1/ credit rationing, the failure of rates to discriminate between good and bad investment projects, a related bias toward highly capital-intensive investments, and the development of informal curb markets for credit. All of these tend to restrict the benefits of financial intermediation. It is felt that the elimination of many restrictive financial regulations would not only reverse these impacts, but also reduce intermediation costs in the banking sector by introducing increased competition.

In general, there is considerable consensus that financial liberalization is important and necessary. A number of potential problems with an overly rapid implementation of the program have been noted however. First, Foxley (1981) has pointed out how large rises in the lending rate may raise working capital costs and hence prices for the affected sectors. This effect would be accentuated if combined with standard monetary contractions, so that many firms would react not only by raising prices, but by reducing inventories and output. Whether or not increases in deposit rates increase private savings rates, it is also likely that they would divert savings from informal to more formal credit markets. In the long run, this should lead to more efficient savings allocations, but in the short term this could lead to disruptions of the flow of working capital to sectors traditionally dependent upon the curb markets for financing. Thus, abrupt financial liberalization, especially combined with credit contractions, may have

1/ For a critical analysis of the interest elasticity of savings in developing countries, see Giovannini (1983).
transitory output reducing effects; it is important to ensure that these
do not concentrate in the export or import-substituting sectors during
the adjustment period.

1.4.2 Expenditure Switching to Exports and Import Substitutes

The most prominent stabilization tool for expenditure switching
has been the devaluation of the exchange rate. This action is intended
to raise the domestic currency price of tradeables vis-a-vis home goods
and hence shift production toward the former (and to a lesser degree,
demand towards the latter). Most analyses assume the devaluing country
to be a price taker in world markets, so changes in exports and imports
result solely from domestic agent decisions. Unlike absorption-
reduction policies, devaluation is considered expansionary, since it
increases production and curtails demand leakages through imports. An
important technical issue in implementing the devaluation is the type of
deviation approach chosen: a "maxi-devaluation", a series of "mini's"
(sliding peg) or both. At the time of program implementation, the
country's exchange rate may be considerably overvalued, so a large step-
devaluation would be in order. Following this, a series of mini-
devaluations may be called for to protect the new real exchange rate
from appreciation through domestic inflation (Krueger 1981).

There are a variety of factors which are considered to
condition the effectiveness of exchange rate devaluations in reducing
external payments imbalances. One of the most controversial is the
effect of the devaluation of raising prices and hence undermining the
real effects of the nominal devaluation. There is no consensus as yet
on how much devaluations contribute to inflation, but it clearly depends upon the share of tradeables in the country's GDP, the degree of substitutability between tradeables and non-tradeables, and the degree to which workers and firms can pass cost increases on to consumers in the economy. Bird (1984) notes the possibility that the improved trade balance caused by the devaluation could induce reserve inflows which would expand the money supply and thereby raise prices; this effect, however, could be sterilized through corresponding credit contraction by the monetary authorities. It is clear, therefore, that the real devaluation may not be as pronounced as the nominal devaluation, but is very unlikely to be completely eroded by the resulting price increase either. And as already suggested, the full real devaluation can be protected by adoption of a "crawling peg" which depreciates the exchange rate at the rate of price increase.

A key determinant of the effectiveness of the devaluation will be the supply response of exporters. While evidence appears to point to fairly high responses, this will vary from country to country, depending upon the capacity utilization of the export sector and/or the gestation periods associated with investments in more capacity or in expanded crops. Hence, non-traditional manufactured exports from middle-income developing countries will show quick response, while primary exports from less developed economies may be expected to demonstrate very low short-run elasticities.

The responsiveness of import demand and import-substituting supply to devaluation is not expected to be as important to trade deficit reduction as the export side. First of all, many countries have
a great variety of import quantity restrictions; the effect of a currency devaluation is to lower the profits of import licencees more than to raise the price of imports to consumers (Krueger 1981). Secondly, many developing countries have, through many decades of tariff protection, already suppressed the importation of most consumer goods and other inessentials. The only imports remaining are essential intermediate goods and capital goods characterized by fairly inelastic derived demands; moreover, these are the types of goods developing countries would have difficulty producing themselves in the short-run.

Finally, the setting of the proper exchange rate itself emerges as a serious implementation problem. Many analysts agree that devaluation targets are often set on the basis of overly crude purchasing power parity considerations, and feel the need for a more sophisticated approach. An example of this may be Nashashibi's (1980) work on Sudan; he calculates the DRCs for Sudan's key export industries, suggesting the exchange rate be chosen where maximal output response can be expected for the least devaluation.

While the considerations listed above will tend to condition a devaluation's effectiveness in any particular country, there is, as already noted, general agreement on at least the medium term efficacy of the tool in spurring net exports. The thrust of more recent criticism of the policy tends to focus on possible stagflationary side-effects in the short-run. The inflationary potential of a devaluation has already been discussed. A variety of hypotheses suggest a contractionary potential as well. A monetarist approach (Dornbusch 1973) focuses upon the devaluation caused price increases' effect on real balances; with
increased prices, the value of the real money supply drops, as well as real credit; exerting a contractionary effect. This will act to reinforce the contractionary impact coming from restraint of domestic credit creation. Krugman and Taylor (1978) note that if devaluation takes place when the trade balance is initially in deficit, and imports are inelastically demanded, the effect of rising tradeables prices will be an aggregate real income loss as the expenditures diverted to imports will more than offset the increased profits enjoyed by exporters. This, too, will be contractionary as income is leaked through imports. Finally, Taylor (1981) examines the effects of increases in the price level caused by devaluation which exceed the growth of nominal wages. He suggests that a shift of real income from high consuming workers to lower consuming capitalists will tend to reduce final demand through a savings leakage and thereby cause a contraction. According to Bird (1984), this process was evident in Argentina in 1979.

In interpreting these theories of stagflationary devaluation, it should be understood, first, that they all reply upon an inflationary effect which may or may not be very strong, depending upon the country involved. Secondly, they are theories of short-run effect and should be viewed more as factors which could cause overkill by domestic credit contraction than as important independent forces in themselves.

The extent to which the contractionary effect of a devaluation offsets its expansionary impetus reflects sectoral rigidities inhibiting full supply and demand response to the exchange rate change. Two parameters in particular determine this response, the elasticity of export supply with respect to tradeable goods price changes, and the
elasticity of import demand with respect to them. The following pages will review a variety of structural adjustment policies intended to enlarge these elasticities as well as to more directly shift resources into the tradeable goods sector.

The most important element in structural adjustment programs in support of expenditure-switching is considered to be trade liberalization. Many developing countries have histories of high tariff and non-tariff protective barriers; the effect of these has often been to raise costs, lower productivity, produce incentive biases against exports, and introduce a variety of other distortions. The elimination of quantitative import restrictions and the lowering and rationalization of tariff barriers has been a goal of most SALs and many IMF programs as well. The program is considered to have a variety of important impacts (Krueger 1981). First, it lessens the incentive bias toward import-competing industries and against exports. Secondly, it reduces export costs and acts to increase export supply by decreasing import costs, both directly through lowered tariffs and indirectly by promoting the greater general efficiency of the industrial sector. Thirdly, the rationalization of tariffs tends to reduce the bias against labor utilization implicit in the lower tariffs traditionally applied to capital good imports. Hence, trade liberalization is intended to be a central tool in achieving greater micro efficiency and aggregate output in the medium-run.

Nevertheless, like many stabilization policies thus far considered, Krueger notes that a decrease in protection may cause transitory losses of activity if newly profitable industries need time
to expand output while others lose their viability. This will depend upon the degree to which tariffs and other barriers are lowered, the initial height of the protective barriers, and the degree of uncertainty about the permanence of the policy shift. Moreover, if no strong export response was forthcoming, increases in imports could offset the intended trade balance benefits of an associated exchange rate devaluation. Finally, it is important to realize that one of the objects of trade liberalization is the unification of tariff rates; this may involve actually raising rates on imported capital and intermediate goods, with according adverse affects on the cost structures of some industries.

Closely associated with trade liberalization is a second major structural adjustment tool, price control liberalization. Many developing countries have developed widespread systems of wage and price control. These have had the general effect of promoting distortions and inefficiency in resource use, reinforcing the impact of trade barriers in raising production costs. They have also often discriminated against agricultural output and exportables, further promoting net exports problems. Hence, price liberalization is seen as a way to remove distortions, increase efficiency and eliminate sectoral discrimination in supply/demand incentives. Associated with price liberalization is the raising of public sector prices and changes to cover costs and reduce the fiscal deficit.

As with almost all the measures considered in this paper, price liberalization may have short-run destabilizing consequences. Foxley (1981) notes that after prices have been frozen for a long period, agents are not sure how to set them again. Prices may overshoot their
equilibrium level and if wages do not follow, declines in the real wage may cause decreases in demand and in output. If many oligopolistic elements are present, as is often the case, it may take a long time for prices to adjust downward to clear the goods and labor market. While it is not clear that this scenario will ever occur in full detail, it serves to point out some potential short-run effects of price liberalization and suggests some gradualism in releasing controls may be in order.

Both trade and price control liberalization reflect the current interest in moving toward more market-oriented economies. It is believed that by removing economic activity from the clumsy and inefficient administration of government and returning it to the control of the market place, the elimination of distortions and rigidities will be more readily achieved. Nevertheless, designers of structural adjustment programs might want to consider more interventionist tools, especially as second-best solutions when other distortions cannot readily be reduced. Among these may be the use of export subsidies and/or multiple exchange rates. Bird (1974) points out that these may be useful to take advantage of different response elasticities across sectors. For example, it may be considered desirable to devalue the exchange rate in exports earnings more than that on import payments, if import demand is considered highly inelastic and would promote contractionary expenditure leakages. Alternatively, a combination of a smaller devaluation plus an export subsidy would accomplish the same objective.
While export subsidies and multiple exchange rates apparently lack the destabilizing potential of policies returning activity to control of the marketplace, they are subject to many of the traditional criticisms of government regulation. They may entail fairly high administration costs, especially subsidies, and will be more or less helpful depending upon the quality of the bureaucracies administering them. Moreover, while these tools should be seen as temporary stop-gap measures until adjustments in other areas are completed, subsidies in particular will tend to develop vested constituencies which will oppose their removal. Finally, while direct subsidies on value-added exported would be the most effective means of promoting exports, this would violate GATT rulings and invite hostile reciprocation. The popular alternative, credit subsidies to exporters, tends to bias investment toward relatively capital-intensive techniques.

Another interventionist structural adjustment program to support expenditure-switching would be specific targeting of investment to the export and import-substitution sectors. This policy, to a large degree, implicitly underlies much of the public investment planning in Bank SALS. It derives its rationale, first, from the fact that many of the structural rigidities preventing easy expenditure-switching are caused by inadequate infrastructure, so that public investment must be focused on these areas. Secondly, the poorly developed quality of developing country capital markets suggests that, even if the appropriate sectors are made more profitable, intervention may be needed to guide investment financing to them. Hence, in addition to specific targeting of public investment funds, it may be desirable to give
credit and investment subsidies to exporting and import-substituting sectors as well.

In his article on credit and adjustment, Keller (1980) argues that in the absence of distortions, credit should flow toward the most productive sectors, tradeable or home goods. This is because, first, increases in output vis-a-vis absorption will always help net exports, and secondly, because increases in home goods production would reduce their price, increasing the demand for home goods and decreasing that for substitutable tradeables. His argument, however, is in general premised upon the absence of distortions. It is precisely these distortions which prevent easy expenditure-switching, reduce the importance of absorption per se and justify the use of second-best, interventionist policies.

1.5 The Design of Consistent Structural Adjustment Programs

While it is apparent that there is much in the literature on the design and impact of specific stabilization and structural adjustment policies, comparatively little has been written on the design of comprehensive programs which integrate specific policies in a consistent manner. This section explores some of the issues in this area, concentrating on the following in particular: the objectives of a structural adjustment program, its time frame and associated degree of external financing, and the design of consistent sets of policies.

1.5.1 Objectives of Adjustment

In general, it is possible to identify two broad alternative objectives to adjustment policies. The first of these is to correct the
balance of payments deficit of a country exclusively. The second is to achieve external payments reduction with economic growth (or minimized output losses), reduced inflation, and improved microeconomic performance. The main thrust of criticism of the stabilization policies historically pursued by the Fund is that they have concentrated exclusively on the former objective with little regard for the latter (Killick, Bird, Sharpley and Sutton 1984). In response, it has been argued that in the medium-term, there is no contradiction between short-term external payments reduction and economic growth (Finch 1983, Nowzad 1984). On the one hand, relatively easy expenditure-switching and the crucial need to constrain excess demand imply a short-term contraction will lead readily to an early recovery. On the other, delays in external payments improvement are felt to only make matters more difficult later on, so that BOP corrections are prerequisites to future growth.

It should be noted that even a BOP correction objective admits of a number of possible aggregates to be targeted. There appears to be general agreement that the current account deficit alone is too narrow a target if net capital inflows are sustainable, or at least not maturing within any reasonable time horizon. An alternative possibility might then be the basic balance (Killick et. al). However, Crockett points out that while the short-term debt being accumulated by many developing nations is considered accommodating and non-sustainable, this maturity structure shift may actually reflect the way OPEC has chosen to recycle its structural surpluses.

Referring to the second, broader category of objectives, a number of attempts to define these goals more specifically have been
made, and they are all fairly compatible with each other. The Bank defines one of the main intents of its structural adjustment loans as

"support a program of specific policy changes and institutional reforms designed to achieve a more efficient use of resources and thereby contribute to a more sustainable balance of payments in the medium and long-term and to the maintenance of growth in the face of severe constraints, and to lay the basis for regaining future growth momentum."

Killick, Bird, Sharpley and Sutton (1984) define a very similar "real economy" approach to adjustment whose intent is to "create a viable BOP in a manner which also promotes or at least minimizes conflicts with, that group of government objectives called "economic development" (p. 272). As with the Bank SALs, increasing the efficiency of resources allocation is considered a key intermediate goal, while improvement of the current account deficit and minimizing the growth costs of this are crucial final objectives.

These objectives, while perhaps appropriate, may not be specific enough to guide the design of structural adjustment programs. Williamson (1983) provides the following from broad targets, which though not wholly explicit in themelves, suggest where further work might be focused to refine the objectives:

1. micro efficiency to ensure the economy is on the frontier of its macro tradeoffs;
2. reduction of high inflation and prevention of its acceleration;
3. seek to avoid departure from internal balance, which is deferred as the optimal point on the country's inflation/unemployment tradeoff;
4. achievement on average in the medium term, but not continuously in the short-run, of external balance; this latter is defined as the current account balance which is optimal, given domestic savings, output, and foreign savings opportunities.
1.5.2 External Financing and the Time Frame of Adjustment

The literature on stabilization often considers as independent issues the appropriate level of external financing of the adjustment and the adjustment's time frame. In fact, these issues are very much related, for longer adjustment periods will entail longer periods of current account deficit and require higher levels of external financing than shorter term programs. An appropriate structural adjustment program design would analyse the costs and benefits of both external financing and time horizon independently, and then weigh the two issues jointly to determine the optimal combination of program length and financing level.

There appears to be substantial controversy regarding the relative appropriateness of "shock treatments" and gradualist approaches to adjustment. In fact, the opposite sides of the debate do not so much fundamentally disagree with each other as weight different factors differently; in actuality, there appears to be a trade-off between the economic benefits of gradualism and the political benefits of shock treatment. Analysts of a structuralist orientation such as Killick argue that gradualism is to be preferred, first because it allows fairly rigid structural parameters time to adjust and secondly, it avoids the welfare losses of harsh, rapid dislocation. An interesting simulation study by Khan and Knight (1981) shows that attempts to achieve BOP objectives in a one year time frame require much more extreme contractionary restraint and produce more marked fluctuations in prices, output, and unemployment than would a similar five year program. Conversely, Krueger (1981) and others recommend a non-gradualist
approach because of the opportunity a gradualist approach offers for the build-up of political resistance to the program; this would particularly be the case in the event of inevitable downturns or other problems in the transitionary period. A once-and-for-all implementation of policies seriously reduces the risk of political failure. Moreover, Nowzad (1984) points out that a series of shorter term programs may provide greater flexibility over time than a single longer term program. In general, it is clear that both sides of the debate have merit, and the appropriate trade-off must be determined on a country-by-country basis. In countries with strong political commitment to adjustment policies, gradualism will be most appropriate.

In terms of the optimal degree of external financing, there is a general agreement in the literature that financing is not the appropriate adjustment mode for persistent deficits, but does have a role to play in easing the transition process. While some analysts argue that international capital flows for adjustment should be increased through international cooperation to allow longer adjustment periods [Killick (1984), Dell (1983)], the SAL designer must take the international credit environment as given. Relatively little in the literature focuses specifically upon optimal financing levels for stabilization programs: work by Selowsky and Martin (1981) is a conspicuous exception. However, recent theoretical work on the determination of solvency and liquidity constraints for developing economies may provide rough guidelines in this area [Sachs (1983) and Simenson (1984)].
1.5.3 **The Design of Mutually Consistent Adjustment Policies**

As Section 1.4 showed, the stabilization literature abounds with analyses of the impacts of particular stabilization and structural adjustment policies. Very little research, however, has been devoted to analyzing how a wide set of policies will interact with each other, both over time and in the long run. Hence, few guidelines exist to help design an adjustment program *per se* i.e., a set of consistent, mutually reinforcing policies. The major example of an attempt to construct such a general framework has been the "real economy" approach proposed by Killick, Bird, Sharpley and Sutton. As they point out in their article, this approach is very similar in spirit to Bank SALs: the application of a multiplicity of different policy tools to remove distortions, enhance efficiency, promote resource mobilization, and correct payments imbalance. As with most SAL-related documents, however, they do not propose a formal framework which might be used to evaluate adjustment programs and construct sets of optimal consistent policies.

Such an ideal framework would incorporate the elasticities of response of policy objectives to policy actions, and would also account for interaction effects between policies as well. For example, the literature warns that both devaluation and monetary restraint are likely to be contractionary, but how contractionary? What will be the effect of simultaneous application of both policies? If answers to these questions cannot be determined, it will necessarily lessen the faith one would have in the final program. Answers to these questions depend first, upon knowledge of the economy's response elasticities, and secondly, upon a formal framework which integrates these elasticities in
a consistent, simultaneous manner. Furthermore, this framework must recognize the distinction between impact and long run elasticities, so that lags in the adjustment process are properly considered. As Cline (1983) points out, the time path of optimal adjustment is a high priority for future research. Otherwise, a dynamically consistent set of policies will be hard to devise. Knight and Khan's effort at modelling dynamic adjustment paths has already been noted, and their work is a step in the right direction. Their approach, however, is highly aggregate and incorporates very few policy instruments. A more comprehensive framework for adjustment program design may be that described by Lal (1984). Ideally, the time path of the economy's response to a multiplicity of different policy actions, especially at the sectoral level, would be determined.

An implementation-oriented issue in the design of structural adjustment policies is the actual number of policy actions to be undertaken. There is a fairly broad consensus across analysts that the entire range of policy actions should be pursued - this is recommended by writers as diverse as Killick and Finch. The reasons for this are straightforward: the fewer the policies recommended, the farther each individual policy must be pushed to achieve the same broad objectives. This in turn leads to other undesirable distortions and imbalances. Moreover, the elimination of widespread distortions at the micro level may simply not be achievable through manipulation of a few broad policy tools. Nevertheless, too large an adjustment program "wish list" places burdens on the government's administrative capacity as well as the ability of the Fund or the Bank to monitor the program or even negotiate
its acceptance in the first place. Hence, a trade-off exists of a type similar to that between gradualism and once-and-for-all time frames, and its optimal point will vary from country to country.

1.6 Income Distribution Effects of Adjustment Policies

The role of distributional considerations in the design of development policies has rarely been entirely clear, and this ambiguity is true of adjustment policies as well. Some analysts (Finch) contend that the income distribution is a domestic, political consideration which should not be interfered with by external, international agencies. On the other hand, there is growing belief that distributional aspects may affect economic performance, and they will certainly play a role in the domestic political support of adjustment programs. While it is unclear how much weight one might want to place upon distributional considerations in a policy objective function, it would certainly seem reasonable to attempt to avoid extreme movements toward inequality.

There is currently no consensus on the net impact of stabilization programs upon income distributions in developing countries. This partly reflects our ignorance of the topic, and partly the fact that diverse programs combined with very different economies will produce very different income distribution effects. There is, however, general agreement that far-reaching adjustment programs may have some substantial impact. The following is a short summary of some of the potential impacts of adjustment policies noted in the literature.

Considering jointly the many possible contractionary effects of adjustment policy, it is unclear how the functional income distribution
will respond. As Ahluwalia and Lysy (1981) point out in their analysis, the answer will depend partly on the elasticity of substitution of capital and labor, low elasticities will increase labor's share as output decreases. On the other hand, the key inequality in developing countries may not be between labor and capital so much as between different categories of workers and capitalists. One may expect that decreases in demand which push workers out of the formal sector and into unemployment or under-employment in the informal sector would be likely to increase inequality and poverty. (Technically, the size distribution could improve, by a variety of measures, while the number of people under a given absolute poverty line rose. In these cases, some poverty criterion might be more appropriate than a distribution measure.)

It is important to note that different demand restraint measures will cut differently across economic classes. Foxley (1981) points out that fiscal restraint involving the reduction of labor-intensive public work programs will hurt poor laborers the most. On the other hand, Omatunde and Salop (1980) note that credit restraint programs tend to discriminate against small, informal sector firms, the rural sector, and other firms with long term credit needs or limited credit access.

Analysts studying the effects of a devaluation generally focus upon its inflationary potential. Taylor's models assume that increases in prices combine with a fixed nominal wage to drive the real wage downward. As already noted, however, the effect on the size distribution of this functional inequality rise are unclear; if, as Omatunde and Salop point out, the lowered real wage increases employment, positive benefits to welfare and income equality may
result. Moreover, they show that while successful devaluation may require a real wage decrease in the export sector (in terms of tradeable goods' prices), nominal wages could still rise relative to the prices of non-tradeables. Depending upon intersectoral labor mobility and labor/capital substitution elasticities, nominal wages could rise in the non-tradeables sector as well. A more long-term issue concerns the relative labor-intensiveness of the tradeables and non-tradeables sectors; the more labor-intensive the export sector, the more marked the beneficial real wage and employment effects will be from an effective devaluation.

The effects of domestic resource mobilization upon income inequality tend to depend upon the specific policies taken. According to Omatunde and Salop, increased taxation is likely to fall heaviest upon importers, exporters, and public/formal sector workers. Conversely, many analysts note that widely recommended actions to cut consumption subsidies and raise government charges (Finch) are likely to fall most heavily upon the poor; Gwin (1983) points this out as an important issue in the case of India's attempts to design an adjustment program. Attempt to mobilize private savings through raising the interest rate will also have ambiguous effects. Foxley argues that increases in the interest rate discriminate against small firms, cause bankruptcies (especially in conjunction with credit restraint) and encourage the concentration of assets. On the other hand, increases in the lending rate should reduce incentive bias against labor utilization and hence encourage increases in employment over the long run.

This reduction of the bias toward capital-intensive investment may be a key long term output of price, wage and tariff liberalization
policies as well. As already pointed out, one of the goals of tariff reduction and rationalization programs will be to equalize tariff rates on capital goods vis-à-vis other imports and this should work to increase the relative price of capital goods. The reform of industrial wage and price administration can be tailored to work in the same direction. However, as Foxley points out, the short-run impact of these liberalization policies might be heightened disequilibrium, increased prices relative to wages, and possible decreases in output.

1.7 Global Consistency of Adjustment Policies

A final issue connected with the design of structural adjustment policies concerns the global consistency of adjustment programs. Ensuring global consistency must take place on two levels. First, encouragement of particular export industries in a country must be associated with sufficient world demand for their output. Traditional analyses often regard individual countries as price takers in world markets, (see Ahluwalia and Lysey for a notable exception) but some countries will inevitably have substantial market shares in some commodities. Factors such as world recession and increasing protectionism could seriously limit a country’s ability to expand its market share. Structural adjustment program design should include an assessment of those export categories where expansion has greatest potential. Secondly, the export policies of structural adjustment programs across different countries should be mutually consistent. Were every SAL, for example, to recommend the production and export of rubber thongs, the world thong market would quickly be saturated. Alternatively, widespread reductions in absorption across different
countries could seriously restrict the export potential of those economies exporting to other developing countries. Efforts should therefore be made to coordinate the export (and import) sides of structural adjustment plans with each other. The global modelling conducted in the Bank, and projections associated with the WDR, may provide an appropriate context for this approach. There is as yet little literature on these issues, but as increasing numbers of countries undertake adjustment programs of one sort or another, it should attract research interest.
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