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Rasul Shams*

The World Bank's Structural Adjustment Loans: a Critique

Following the introduction of its structural adjustment loans the World Bank became the object of the criticism that had until then been directed only at the IMF and its stabilisation and adjustment programmes. This article shows that structural adjustment loans do in fact take the traditional criticism into account. It then proceeds to analyse the various interests involved in order to highlight the constraints to which the Bank is subject in the formulation of its policy.

In 1980 the World Bank introduced structural adjustment loans, or SALs for short, to add to its traditional project and programme lending. SALs are conditional on the willingness of the recipient country to formulate and carry out an appropriate programme of structural adjustment. They are intended to help countries overcome serious medium-term payments deficits that would jeopardise the attainment of development objectives if adjustment did not take place. By the end of 1986 twenty countries had taken up 38 loans of this kind. A further 25 loans are due to be granted in 1987/88.

With the introduction of SALs and the IMF paying greater attention to supply side aspects, the two Bretton Woods institutions have moved closer together as regards lending criteria.¹ One result has been that the criticism of stabilisation and adjustment programmes is no longer being directed only at the IMF but at the World Bank as well.

The following article has two objectives. Firstly, it will show that SALs take most of the traditional criticism of stabilisation programmes into account, and secondly it will examine the interests involved in order to highlight the constraints to which the Bank is subject in the formulation of its policy.² Such an examination should allow a less emotionally charged assessment of the structural adjustment policy to be made and hence instigate a more factual debate with the policy's proponents.

Conceptually, SALs do largely take account of the traditional criticism of IMF policies. Stand-by agreements with the IMF are primarily intended to bring about the short-term macro-economic stabilisation of the economy in question, thereby laying the basis for future growth. SALs, on the other hand, are aimed

directly at achieving stabilisation with growth³ by means of a series of reforms designed to bring about fundamental structural improvements in the country in question, thereby encouraging growth:

- The dismantling of price controls, the liberalisation of foreign trade and the reform or privatisation of state enterprises lead to more efficient resource allocation and a better system of incentives.
- The removal of interest rate ceilings and the reform of the financial sector lead to better capital utilisation, higher private and public sector saving and hence higher investment.
- Deliberate export promotion, including exchange rate measures, makes it possible to convert domestic savings into foreign exchange.
- Additional loans are provided and the conditions for the inflow of foreign direct investment improved.
- Institutional reforms in the fields of debt management, central banking and taxation and in the financial sector raise the general standard of economic policy and widen the scope for macro-economic tuning.
- The removal of state controls eliminates or reduces rent seeking and releases additional resources for productive purposes.

¹ See in this connection Manfred Holtius: Die schriftliche Stellungnahme des HWWA-Instituts für Wirtschaftsforschung zur öffentlichen Anhörung von Sachverständigen zum Thema „Einfluß der von der Weltbank und dem Internationalen Währungsfonds geforderten Anpassungsprogramme auf die entwicklungspolitische Zusammenarbeit“, in: Deutscher Bundestag, 10. Wahlperiode, Ausschuß für Wirtschaftliche Zusammenarbeit 714-2450, p. 73.

² Since criticism is directed against both institutions, the following analysis also extends to the IMF where appropriate.

³ Since 1986 the IMF has also had similar instruments in the shape of two new facilities for structural adjustment, although they are available only to poorer member countries. The Extended Fund Facility introduced in the seventies also contains elements of structural adjustment.

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Complemented by Social Programmes

Apart from the growth effects of adjustment programmes, their distribution effects are hotly contested. The World Bank and the IMF are repeatedly accused of causing a dramatic worsening of the economic situation particularly of the poorest sections of the population by imposing conditions on their lending.⁴ It is almost impossible to assess the distribution effects of adjustment programmes accurately, however. It is not known how wealth and income distribution would have changed as a result of the acute balance-of-payments crisis that would have ensued if structural adjustment had not taken place, nor can the effects of adjustment measures be distinguished clearly from the effects of other state measures or of simultaneous changes in the world economic environment. Nevertheless, it can be assumed that adjustment will always entail costs, since in practice the intended reallocation of resources never comes about immediately, so that particular population groups may be affected especially severely by transitional unemployment, for example. Where it can be shown that particular groups will suffer hardship as a result of adjustment policy, it would therefore make sense to ease their plight by means of appropriate social programmes.

The World Bank has already recognised this problem. The first and most important example in this respect is Ghana, which decided on a programme of action to ease the social costs of adjustment in co-operation with Unicef at the end of 1987. The programme, which includes many projects to create jobs, promote communities and meet basic needs, has the support of a number of donor countries, which have promised funds totalling US\$ 85 million. After initial hesitation, the World Bank is also participating in the programme of action. Social programmes of this kind have not yet become a regular feature of structural adjustment policies, but it can be expected that in future they will increasingly be taken into consideration as a matter of course.

Means-Ends Relationship

Gearing adjustment programmes towards growth and cushioning their social effects should make them much more acceptable. Nevertheless, one must ask oneself how far the package of prospective measures can be considered an appropriate means of achieving the intended objectives. Less-than-optimum resource allocation, inefficient production structures and wastage

of resources are endemic in many developing countries because of excessive state intervention. Liberalisation and the development of market forces are therefore often the only way out of an already critical situation. To that extent, structural adjustment as demanded by the World Bank is the appropriate response to the special problems of these countries. A number of issues nevertheless remain unresolved:

□ Even the maximum period of five years is not long enough for many structural reforms to be completed. For example, the privatisation of state enterprises raises a host of legal, economic and organisational questions that can scarcely be settled adequately within five years, quite apart from any political resistance that may be encountered. There is a danger that the reforming zeal will wane abruptly after the expiry of the SALs and that many newly-introduced reforms will not be consolidated or continued.

□ The programmes comprise a multitude of measures that are not necessarily mutually consistent. For example, liberalisation of the financial markets should lead to a rise in the savings rate, but the high real interest rates that this permits dampen private investment. In the case of some measures, it cannot even be said that there is a theoretically or empirically based understanding of the causal chains involved. This applies, for example, to the positive link between real interest rates and savings behaviour as assumed in the McKinnon-Shaw hypothesis.⁵ The question of the optimum exchange rate system for the adjustment process must also be considered to be still unresolved.

□ The same applies to the intensively discussed problem of the order in which liberalisation measures should be taken (sequencing). A consensus has been reached in this regard in the light of the experience of the countries in the southern part of Latin America,⁶ but for obvious theoretical and empirical reasons its validity remains open to doubt.⁷

□ Cross-conditionality has been severely criticised, especially by the Group of 24. In view of theoretical uncertainties, it is quite possible for there to be differences of opinion between the World Bank and the IMF on the need for particular measures, the timing of

⁴ For a discussion of this issue, see G. K. Helleiner: Stabilization, Adjustment, and the Poor, in: *World Development*, Vol. 15, No. 12, 1987, pp. 1499 ff.

⁵ Cf. G. M. G. Arrieta: Interest Rates, Savings, and Growth in LDCs: An Assessment of Recent Empirical Research, in: *World Development*, Vol. 16, No. 5, 1988, pp. 589 ff.; and D. R. Khatri: Assessing the Impact of Interest Rates in Less Developed Countries, in: *ibid.*, pp. 577 ff.

⁶ According to this, the domestic markets should be liberalised first, then foreign trade flows and finally capital movements and the financial markets.

⁷ See the arguments in favour of an alternative sequence in D. Lal: The Political Economy of Economic Liberalization, in: *The World Bank Economic Review*, Vol. 1, No. 2, pp. 273 ff.

their introduction or the necessary extent of adjustment. Such differences of opinion cause difficulties if they lead to delays in granting credit and formulating programmes. It is also likely that one institution may hold back funds to be granted according to its own criteria because conditions set by the other institution cannot be considered to have been fulfilled. The increasing co-operation between the two institutions should largely eliminate problems of this kind, however.

□ The adjustment process is financed by inflows of foreign capital, coming on top of an already high level of debt. Even if export promotion measures are successful and the country's international creditworthiness improves, there is no guarantee that its debt will not increase further. The success of the adjustment policy can easily be put in jeopardy by a subsequent increase in debt service payments as a result of adjustment itself.⁸

Adjustment as a Process of Trial and Error

In view of the theoretical uncertainties, it is therefore unlikely that the measures chosen will be the most appropriate means of achieving the objectives. The differences in the circumstances and economic structure of individual countries make it even more difficult to arrive at an optimum solution. The complexity of the problem therefore means that structural adjustment must be regarded as a process of trial and error. On the part of the World Bank, this requires a great readiness to learn, flexibility in the choice and use of instruments, a continuous and detailed dialogue with economic policy-makers in the countries concerned and a less strict evaluation of success according to performance criteria.

At the same time, such a view of adjustment policy provides a further argument for parallel social

programmes, which are justified to the extent that they are also intended to ease the hardships particular groups suffer as a result of the economic policy mistakes that inevitably accompany adjustment.

Political Feasibility

Even with the optimum combination of measures, adjustment policy will fail to achieve its objectives if political opposition to its implementation cannot be overcome. The feasibility of adjustment programmes depends crucially on whether or not they are supported by politically influential groups in the countries concerned. Depending on the economic conditions at the outset and the structure of the proposed measures, an adjustment programme has widely differing effects on the interests of the various socio-economic groups in the country and therefore provokes both resistance and support. Hence the success of the adjustment programme hinges mainly on the configuration of the various groups (the most important groups, their degree of organisation, the scope for them to form alliances and to manoeuvre politically, etc.).⁹ In order to guarantee the success of adjustment policy it is therefore advisable to involve all the relevant socio-economic groups in the political dialogue.

Conflicts of Interest within the World Bank

It is not only the pattern of interests within recipient countries that is important for the adjustment process. Groups with differing interests are also represented within the World Bank, so that the Bank's policy must always be regarded as a reflection of a weighted equilibrium between these various interests. It is influenced not only by the bureaucracy of the Bank itself but also by the developing and industrial countries as shareholders. The interests of these various groups as regards structural adjustment are examined in further detail below.

As with any bureaucracy, it can be assumed that the bureaucracy of the World Bank has a vital interest in extending its powers. This finds expression primarily in

⁸ As the examples of Turkey and Jamaica show, this is also a serious problem for relatively successful countries.

⁹ Cf. Manfred Holthus and Rasul Shams: Anpassungspolitik und Interessengruppen in Entwicklungsländern, in: Hamburger Jahrbuch für Wirtschafts- und Gesellschaftspolitik, Vol. 32 (1987), pp. 276 ff.

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efforts to expand the organisation and take on ever more functions. The introduction of structural adjustment loans undoubtedly accords with this interest. The frequently criticised over-comprehensiveness of structural policy and the consequent overloading and lack of transparency of the package of measures stem partly from this factor.¹⁰ The problem with the bureaucracy's inclination to extend its powers is that more effective and simpler alternatives aimed at removing a few important bottlenecks and raising the developing countries' ability to solve problems may scarcely be considered. Bureaucratic top-hamper entails a high cost, and not only at the World Bank itself; it can also easily overload the recipient countries and divert their scarce administrative resources to less productive uses (such as ministering to excessively frequent visits by World Bank delegations).

As to the governments of developing countries, they have an equivocal relationship with the World Bank and the IMF. On the one hand they have an interest in obtaining more funds on more favourable terms, with longer maturities and fewer conditions, while on the other they often have an interest in diverting attention away from their own maladministration by presenting these institutions to their people as the real villains responsible for the situation in their countries. In politically difficult situations this can cause negotiations with the IMF and the World Bank to be broken off or agreed programmes to be suspended in order to ensure that the masses remain loyal to the government.

In formal terms, the developing countries have far less influence than the industrial countries within the Bretton Woods institutions, but in practice the constant pressure they have exerted has undoubtedly caused the two bodies to modify their policies in their favour. The introduction of an increasing number of development-oriented facilities within the IMF and the establishment of structural adjustment loans by the World Bank can be interpreted in this sense.

In pursuing their interests, the developing countries are supported by a committed body of international public opinion. At the same time, it can be supposed that the interests of the developing countries will match those of the World Bank bureaucracy whenever the demands of the former imply an extension of the powers of the latter.

The industrial countries also use their influence to pursue very contradictory interests. On the one hand they wish to help the Third World economies recover by promoting appropriate monetary, fiscal and development policies to be laid down by the IMF and the

World Bank in order to ensure that these countries can repay their debts and to make them attractive as locations for direct investment. At the same time, however, employment policy considerations lead them to exploit the policy of the international financial institutions as a vehicle for their own export interests without regard to the economic consequences for the developing countries and to use protectionist measures to deny these countries access to their markets. On global strategic grounds, the industrial countries may sometimes induce the international financial institutions to give certain countries preferential treatment and to discriminate against others.

All of these considerations show that there are limits to the World Bank's ability to impose a national structural adjustment policy based purely on theoretical welfare considerations. Not only are there theoretical uncertainties that cast doubts on the optimality of the means-ends relationships, but the political feasibility of structural adjustment programmes must be regarded as a serious problem on account of the particular configurations of interests in developing countries and within the World Bank.

The structural adjustment loans granted by the World Bank are a definite improvement over traditional adjustment policies oriented purely towards economic stabilisation, but since they are a compromise struck to accommodate varying interests they are unlikely to satisfy the aspirations of all those involved all the time.

It is always possible to find grounds for criticising SALs, given the theoretical uncertainties surrounding them and their compromise nature. However, it would be helpful to differentiate between the three areas mentioned above, namely the appropriateness of measures to achieve the objectives, their political feasibility in the developing countries and the limits to policy formulation within the World Bank in the light of the interests involved. Critics often confuse these three issues and play them one against the other, depending on the interests they are promoting.

Improvements in structural adjustment policy are possible on all three levels. This requires not only a readiness to modify economic policy concepts but also political reform within developing countries and within the World Bank to limit the scope for promoting sectional interests at the expense of a structural adjustment policy geared towards the welfare of all those involved.

¹⁰ The comprehensive nature of structural adjustment policy can, however, be defended as economically necessary in the interests of completely eliminating rent seeking.