



## Lecture 7: Structural Adjustment

Williams College ECON 204:  
Global Poverty and Economic Development  
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# Mixed Evidence on the Impacts of State-Led Development

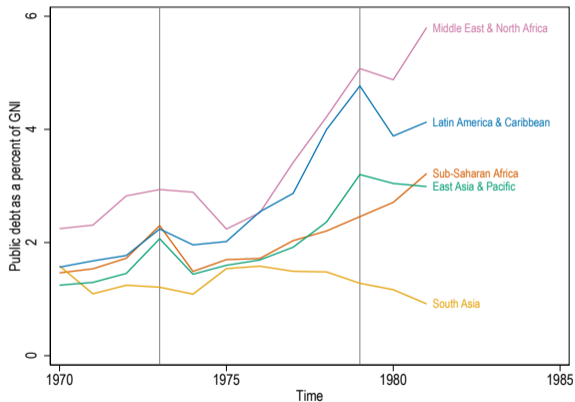
## Development successes:

- Life expectancy increased from 51 (1960) to 61 (1980) years across LMICs
- Large increases in educational attainment and literacy, particularly among girls/women
- GDP per capita grew by more than 2 percent a year in LMICs in the 1960s and 1970s

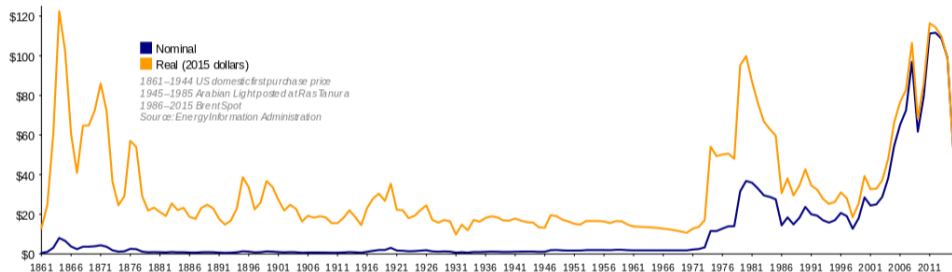
## Development failures:

- Most economies had not reached the “take-off” stage of industrialization
- Large infrastructure investments (e.g. dams in India, roads in Kenya) had limited benefits
- State-owned enterprises were obviously failing in many African countries, in particular

# Rising Debt Burdens in the 1970s

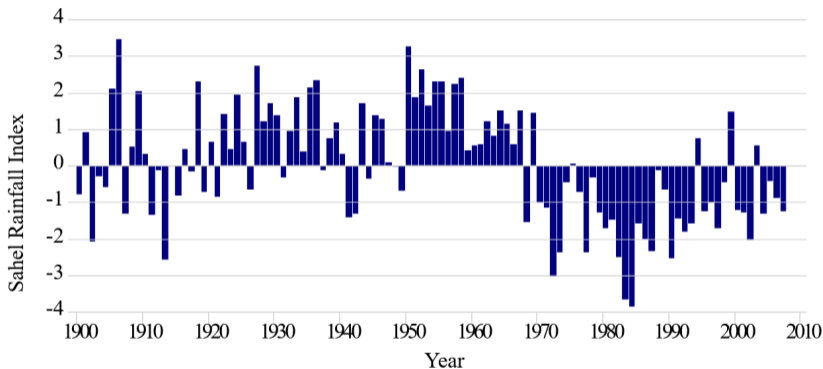


# External Shocks in the 1970s: The Oil Crisis



Source: wikimedia commons

# External Shocks in the 1970s: Drought in the Sahel



Source: public domain

# Balance-of-Payments Crises

A country's **balance-of-payments** reflects its transactions with the rest of the world

- A country receives money for exports, through aid, and from foreign investment
- Money leaves the country through imports, debt repayment, and the withdrawal of capital
- A crisis occurs when the latter (outflows) exceed the former (inflows) by too much

Rising debt burdens (and interest rates) pushed many LMICs into balance-of-payments crises

- Senegal received a **structural adjustment loan (SAL)** from the World Bank in 1980
  - ▶ IMF and World Bank SALs involved **conditionality**: loans in exchange for policy reform
- Mexico announced that it was defaulting on its sovereign debt in 1982
  - ▶ US responded by loaning Mexico 3.5 billion USD, brokering an SAL with the IMF

# Washington Consensus

1. Exchange rate liberalization, typically involving **currency devaluation**
2. Fiscal **austerity**: reducing deficits, and paying off unsustainable debt
3. Public expenditure rationalization: eliminating most subsidies (not in health/education)
4. Trade liberalization through the removal of trade barriers, tariffs, and quotas
5. Tax reform to simplify the tax code and reduce market distortions
6. Allowing the market to set interest rates
7. Allowing foreign direct investment
8. Privatization of state-owned enterprises, public sector layoffs
9. Deregulation and the elimination of unnecessary red tape
10. Protecting property rights

# Currency Devaluation

What is it?

- Allowing market forces to determine the exchange rate

Why was it necessary?

- Many LMICs maintained **over-valued exchange rates**; fixing your country's currency at an inflated value (e.g. in dollars) allows you to purchase more dollar-denominated goods
- But this also makes your country's exports more expensive, ↓ demand for your currency

Who wins and who loses when a country devalues their currency (or floats their exchange rate)?

# Fiscal Austerity

What is it?

- Government expenditures cannot exceed government revenues (by much)
  - ▶ In Sub-Saharan Africa, deficits averaged 10+ percent of GDP in the 1970s

Why was it necessary?

- Many LMICs had unsustainable levels of public debt, especially when interest rates ↑
- Countries can only borrow if someone is willing to lend to them

Who wins and who loses from fiscal austerity?

# Domestic Market-Oriented Reforms

What is it?

- Privatization of state-owned enterprises
- Deregulation, elimination of “red tape” and government subsidies (e.g. industrial policy)

Why was it necessary?

- Many state-owned enterprises were being operated at a loss, particularly in Africa
- Excessive regulations (e.g. “the license raj” in India) implicitly taxed firms, created opportunities for corruption when government officials could “sell” permits and licenses

Who wins and who loses from privatization, deregulation, and other market-oriented reforms?

# Trade Liberalization and Foreign Direct Investment

What is it?

- Removal of trade barriers (quotas and tariffs)
- Elimination of restrictions on foreign investment

Why was it necessary?

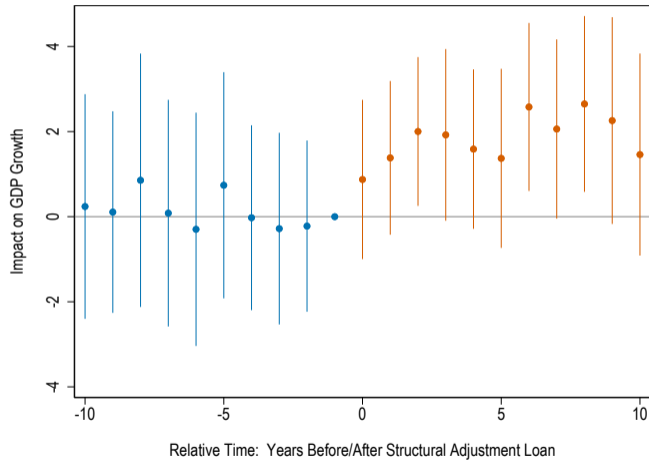
- In the post-WWII period, many LMICs increased trade barriers to protect infant industries and strategically important sectors; few countries phased trade barriers out over time
- Limiting imports  $\uparrow$  prices and  $\downarrow$  quality in the domestic market

Who wins and who loses from trade openness?

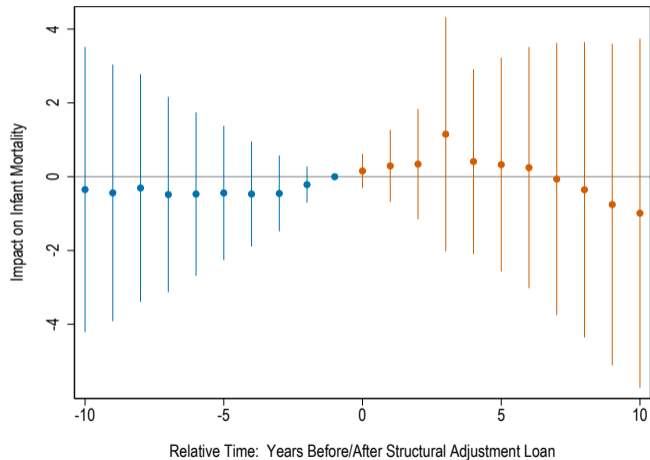
# Does the Impact of Structural Adjustment Vary by Country?

- Nigeria
- Uganda
- Ethiopia

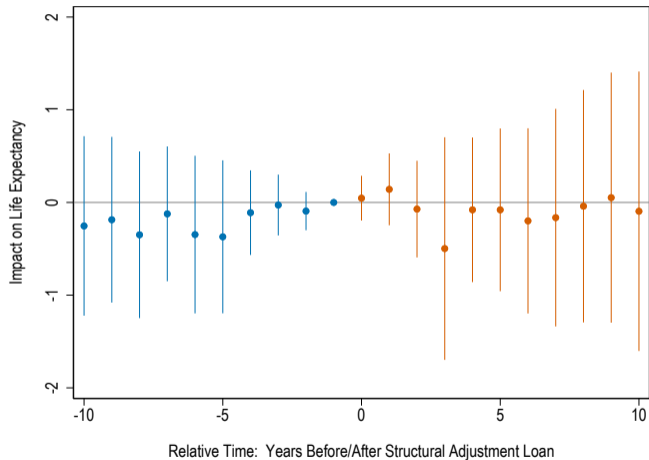
# Did Structural Adjustment Impact GDP Growth?



# Did Structural Adjustment Impact Infant Mortality?



# Did Structural Adjustment Impact Life Expectancy?



# Partial Reform Syndrome

Structural adjustment policies were controversial, often lacked country “ownership”

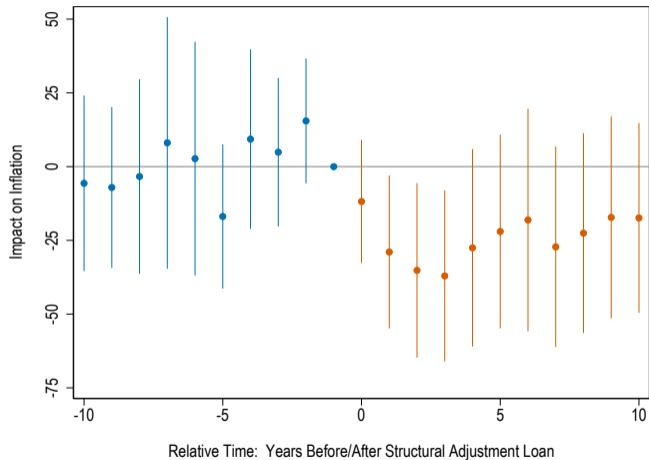
- Laying off public sector workers, cutting government budgets often sparked protests
- Washington Consensus explicitly called for the protection of spending on health, education, and social protection, but country governments often cut pro-poor policies

Many countries simply failed to adjust, and Cold War spending priorities meant loans continued

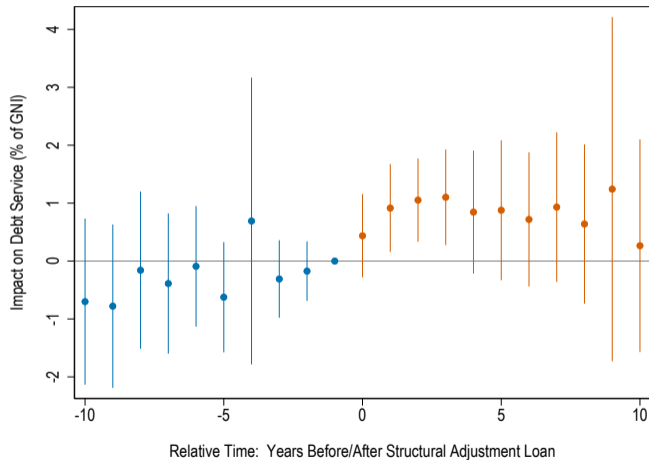
- Zambia produced four plans to lay off public sector workers between 1979 and 1993
  - ▶ Employment in the public sector increased
- Kenya wrote the same agricultural reform into five consecutive WB/IMF SALs
  - ▶ Also agreed to privatize the train service, but failed to do so

Large flows of conditional financing propped up weak governments, further ↑ debt burdens

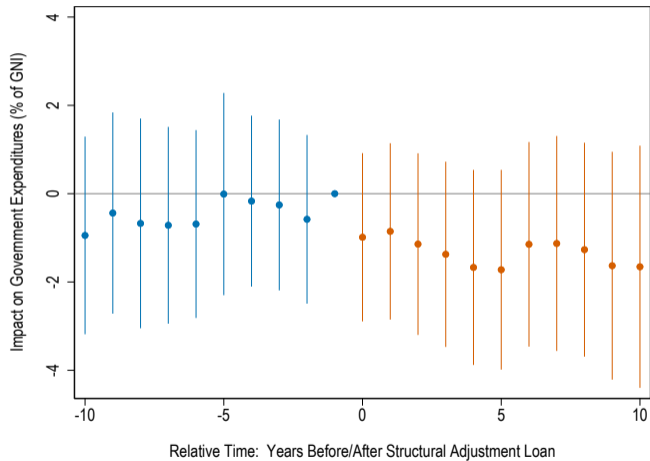
# Did Structural Adjustment Impact Inflation?



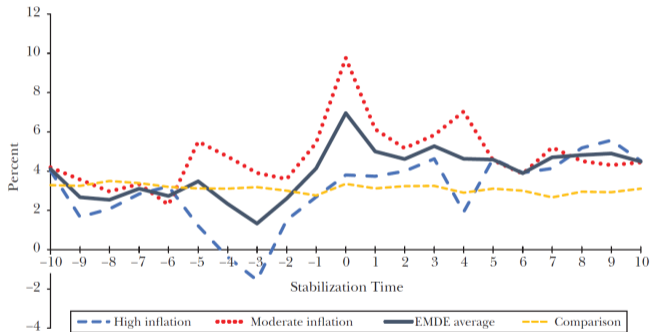
# Did Structural Adjustment Impact Debt Obligations?



# Did Structural Adjustment Impact Government Expenditure?



# The Impacts of Structural Adjustment: Inflation



Source: Chari, Henry, and Reyes (2022)

# The Impacts of Structural Adjustment: Inflation

