Structural adjustment and poverty reduction in Africa

A lack of rapid, broad-based growth lies at the heart of Africa's economic problems. Can poverty reduction strategies help?

Kamran Kousari
Special Coordinator for Africa
United Nations Conference
on Trade and Development (UNCTAD)[1]

The failure to attain rapid and broad-based growth in Africa is at the heart of the continent's problems. Over the past two decades, growth in income in sub-Saharan Africa (SSA) has barely kept pace with population growth, and longer-term growth projections at around 3.5 per cent are half the levels required to meet international poverty alleviation targets. Slow and erratic growth in SSA has also been accompanied by regressive changes in income distribution. The decline in average per capita income for the poorest 20 per cent of the SSA population was twice that for the population as a whole between 1980 and 1995. Hollowing out of the middle class has become a prominent feature of income distribution in many developing countries.[2]

The new elements in poverty reduction programmes

Country ownership and participation. An important novelty in the post-1999 approach to poverty alleviation is the preparation of PRSPs by recipient countries as a prerequisite for reduction of their debt and for concessionary loans and grants. Broad-based participation by civil society organizations, stakeholders and the poor is also required. The new framework also defines the role and involvement of the staff of the two Bretton Woods institutions in various stages of the design and implementation of poverty reduction programmes:

- Staff are not expected to play more than a supportive role in the preparation of the papers.
- A "joint staff assessment" (JSA) by the World Bank and IMF of, first, the "Interim Poverty Reduction Strategy Papers" (I-PRSPs) and, ultimately, the final versions of the PRSPs is required before they are endorsed by the Boards of the two institutions as the basis of the relevant aid package.

"Ownership" of the PRSP process has been a contentious issue. Some of the concerns expressed in this respect have been summarized in a joint IMF/World Bank review of the PRSP experience:

> … Some NGOs contend that alignment of donor strategies to the PRSPs will always be a trivial matter because the content of the strategies will necessarily be determined largely by the agendas and preferences of the donors, especially the Bank and the Fund … Governments write into the PRSPs what they already know the donors want to hear … [and] this will be the case as long as the Bank and the Fund must endorse the strategy as a condition for concessional assistance.

As far as the participation of the poor is concerned, a comparison of the policy aspirations of the African poor with the policy recommendations in the PRSPs suggests that there are significant divergences between the two. For example, while the poor place emphasis on employment, the policy recipes call for a reduction of rigidities in labour markets; or where the poor aspire to lowering school fees at all levels and to free curative health care, the emphasis in PRSPs is on provision of primary education and preventive health, with user fees for higher levels of education and curative health care.

Conditionality and poverty reduction. An important issue in the current approach to poverty reduction is how to reconcile country ownership and participation with the conditionality attached to aid and debt reduction. The original rationale for conditionality was to protect the financial integrity of the Bretton Woods institutions (the International Monetary Fund and the World Bank) and, in particular, to preserve the revolving character of IMF resources. Over the years, however, conditionality became tighter, gradually encompassing a large number of areas, including actions related to the restructuring and privatization of public enterprises, deregulation of markets, trade regimes, pricing and marketing policy, public sector management, public safety nets, the agricultural sector, the energy sector, the financial sector and more recently issues of political and economic governance.

There is now a general recognition that conditionalities imposed by the international financial institutions go beyond their respective areas of competence. Slow progress in streamlining conditionality was one of the "strong concerns" expressed by Heavily Indebted Poor Countries (HIPC) ministers in their declaration at the 6th HIPC Ministerial Meeting, held in London on 5 March 2002.

Stabilization, adjustment and poverty

Macroeconomic and structural policies. The IMF recognizes that macroeconomic stability may require some temporary sacrifice of growth, possibly to the cost of the poor. Similarly, measures to attain stability may lead to regressive changes in income distribution in the short term, with attendant consequences for poverty. Accordingly, such transitory effects should best be dealt with through appropriate compensatory measures, rather than by giving up macroeconomic stability. In such cases, it is recommended that a poverty and social impact analysis (PSIA) be undertaken. Although, according to recent reports, the World Bank has now started undertaking a significant number of PSIAs, as yet, no significant work on poverty and social impact analysis appears to have been completed. Furthermore, there seem to be definitional problems as to what should constitute an adequate PSIA. As noted by HIPC ministers at their recent meeting, "analysis of the links between macroeconomic and structural policies and poverty reduction remains among the weakest areas of most PRSPs".

Stability and growth. The mainstream policy advice in responding to external shocks is to tighten macroeconomic policy if the shock is not just a temporary one. Bearing in mind a secular decline in the prices of commodity exports of most poor countries, tight macro policies have led to weak, erratic growth resulting in increased poverty.

Regarding the balance between growth and price stability, prudent, non-inflationary budgetary policies and monetary restraint constitute the main macroeconomic elements of guidelines on poverty-reducing strategies. Paradoxically, SSA is a region of the developing world that has rarely experienced hyperinflation, and it is significant that the African poor do not consider inflation as a major issue affecting their welfare; their concern is contractionary macroeconomic policies.

Public spending and taxes. The role of the budget is particularly important in poverty reduction strategies supported by the Bretton Woods institutions. Thus, it is necessary to assess public spending in terms of its overall impact on growth as well as its direct impact on poverty. On the domestic side, high interest rates resulting from tight monetary policies constitute a serious impediment to poverty reduction programmes by raising interest payments on government debt at the expense of social spending, as well as by distorting income distribution. This problem may be aggravated by capital account liberalization, which often necessitates maintaining high interest rates on domestic assets in order to attract foreign financial capital or prevent capital flight.

It is essential to attain a reasonably rapid growth in public revenues in order to increase social spending and avoid further debt accumulation. In this respect, tax policies are of particular importance. In general, the recommendation in PRSPs is to lower taxes on corporate and personal incomes because of their adverse effects on investment and capital flows and lowering trade taxes. The only remaining options for increasing public revenues are introducing a broad-based consumption tax, usually in the form of VAT, and improving tax administration and broadening the tax base. But at the same time, as recently noted by the World Bank, indirect taxes tend to augment poverty because they are generally regressive.

Reforming the financial system. The shift to financing public deficits by means of government debt papers on market terms under conditions of very thin financial markets has produced very high and volatile real interest rates, leading to rapid accumulation of domestic debt. High interest rates have also contributed to the stagnation of private investment. Public investment has equally been hit by interest rate payments from the budget. The redistribution of income from the productive segments of the society in favour of the *rentier* elements has also tended to undermine the incentives to invest within the economy.[3] In short, in the light of this experience, it is difficult to share the optimism of PRSPs regarding the positive impact of financial liberalization on growth, distribution and poverty in Africa.

Capital account liberalization. Recent years have witnessed the increasing elimination of exchange controls and the opening up of the capital account in Africa. Opening of the capital account is endorsed as a pro-poor policy in the IMF's *PRSP Sourcebook.* However, efforts in the region to integrate into the global financial system and to attract private flows through a rapid liberalization of the capital account have resulted in greater volatility, with attendant consequences for exchange rate instability and misalignments.

Trade reform. Trade policy advice in poverty reduction programmes calls for maintaining liberal trade regimes, reduction of import tariffs and avoidance of non-tariff barriers. African PRSPs have generally followed this advice. Although a number of studies have concluded that trade liberalization in developing countries does not adversely affect employment, these findings have been roundly criticized on both methodological and empirical grounds.[4]

In general, evidence suggests that the effect of trade liberalization on wages, income distribution and poverty differs among countries, depending on the domestic and international conditions under which it is implemented. In SSA, liberalization has largely been the policy response to the failure to establish efficient, competitive industries in labour- and/or skill-intensive sectors. Contrary to the situation in East Asia, it has taken place before a successful export drive. Increased foreign competition brought about by rapid import liberalization has led to the wholesale closure of industries, with an even greater impact on jobs, pay and poverty because international competitiveness could not be improved despite substantial cuts in real wages in manufacturing.[5]

A significant indicator of the drift into de-industrialization in SSA is the elasticity of industrial value added with respect to GDP growth, which has declined by over 50 per cent in the past two decades. As pointed out by the United Nations High-level Panel on Financing for Development, past mistakes in trade and industrial policies cannot justify going to the other extreme and denying limited, time-bound protection for certain industries so as to provide an opportunity for actively nurturing the development of an industrial sector.

Clearly, the long-term solution lies in improving the productive capacity of the region and resolving the deep-seated imbalances and distortions in the international trading system in areas of export interest to African countries. Furthermore, adequate attention has not always been paid to forces of protectionism in industrial countries in designing trade policies in structural adjustment programmes.

Agricultural policies. The recommended policies for the agricultural sector include exchange rate corrections, withdrawal of governments from agricultural markets, the dismantling of marketing boards and deregulation of markets for agricultural inputs and outputs.

The result has been that farmers have suffered not only from declining output prices but also from rising input prices for food crops and the elimination of fertilizer subsidies (World Bank, *Can Africa Claim the 21st Century?*, 2000, pp. 184–189). Such observations have led the World Bank to conclude that "market-friendly reforms have also sometimes hurt the rural poor ... Agricultural market liberalization without the institutional framework … could have serious consequences for poor people".[6] However, the final verdict is still that, on balance, "market-oriented reforms ... reduced anti-agriculture bias and generally increased agricultural growth"[7] and despite the problems confronted, in Africa "reforms need to be further consolidated" by encouraging private firms to enter output and input markets and by strengthening property rights (World Bank, *Global Economic Perspectives and Developing Countries*, 2000, pp. 184 and 196-197).[8]

African farmers need much greater investment in the sector, and the emphasis put on higher public expenditure on rural infrastructure in recent PRSPs and official development assistance packages is to be welcomed. But official policies need to go further and seek to create the conditions needed for higher levels of investment and input use by farmers themselves. The provision of a stable market environment, predictable output prices and input supplies at affordable costs, the easing of financial constraints on small-scale farming and significant improvements in the physical and technical environment are the necessary components of such a reorientation, and all of them call for active engagement of the public sector.

Growth: Removing the external constraints

The analysis in the previous sections suggests that the new focus on poverty, rather than revising and improving the structural adjustment programmes, merely adds new elements to them.

The emphasis on ownership and participation in poverty reduction programmes appears to grant considerable autonomy to countries in the design of safety nets and targeted anti-poverty spending programmes. However, the freedom of action of recipient governments in determining the nature and content of macroeconomic stabilization and structural adjustment programmes, or more generally of their development strategies, continues to be severely constrained by conditionalities attached to multilateral lending and debt relief.

A major concern is that while the current approach rightly emphasizes the central role of rapid and sustained growth in poverty alleviation, it does not call into question the very stabilization policies and structural reforms that have barely succeeded in bringing about growth and reducing poverty in Africa over the past two decades. It therefore stands to reason that the new emphasis on poverty alleviation should be founded on a careful and frank independent assessment of the effects of those policies and reforms on economic growth and income distribution.

Another concern relates to the direct impact of stabilization and adjustment on poverty. Although the new approach recognizes that these policies may have unfavourable consequences for the poor, very little attention has so far been given to social impact analysis, although such analysis is necessary to determine the kind of measures needed subsequently.

A third source of concern is the approach adopted in anti-poverty policies in two key areas, namely, education and health. As in structural reforms, here too there is a tendency to adhere, to the maximum extent possible, to market principles in the provision of education and health care, relying on across-the-board user fees except for primary education and basic health services. That the rich may benefit more than the poor from such services does not provide a rationale for introducing across-the-board user fees but calls for more ingenious schemes that differentiate between the poor and the rich in their access to these services.

Even if considerable improvements can be made in policies and governance in the recipient countries, the success of the new approach depends crucially on removing the balance of payments and resource constraints on capital accumulation and growth in poor countries. Increased aid, debt relief and greater market access all have their part to play in this respect. Thus, to increase the probability of success of the strategy to reduce poverty in Africa and other poor regions, as reaffirmed in the Millennium Summit, calls for a reconsideration of the respective responsibilities of national authorities and the international community in providing the conditions needed. In the last resort, greater domestic policy effort, even of the right kind, and good governance cannot make up for inadequate external financing and the adverse effects of protectionism in industrial countries.

Notes

[1] This article is based on an UNCTAD study entitled *From Adjustment to Poverty Reduction: What is New?* The study is part of UNCTAD's annual publications on Economic Development in Africa (UNCTAD/GDS/AFRICA/2, August 2002). However, some of the views expressed in the present article are the author's and do not necessarily reflect those of the UNCTAD secretariat.

[2] See UNCTAD *Trade and Development Report, 1997,* Part Two, Ch. III-IV.

[3] For an earlier analysis of African experience on financial liberalization, see UNCTAD *Trade and Development Report, 1998,* Part Two, Ch. V, sect. B.1(a).

[4] The most prominent of these studies is Papageorgiou et al. 1990. *Liberalizing Foreign Trade in Developing Countries: Lessons of Experience,* 1. Washington, DC, World Bank. See also Matusz and Tarr. 1999. *Adjusting to Trade Policy Reform*.World Bank Discussion Paper 2124. For critical reviews, see Greenaway, D. 1993. "Liberalizing foreign trade through rose tinted glasses". *Economic Journal,* No. 103, and Buffie, E. 2001. *Trade Policy in Developing Countries,* Cambridge University Press.

[5] See UNCTAD. 2001. *Economic Development in Africa: Performance, Prospects and Policy Issues,* Table 10 and related text.

[6] World Bank. *World Development Report 2000/2001,* pp. 68-69. On the impact of these reforms on poverty in the United Republic of Tanzania, see Social Watch. 2002. *The Social Impact of Globalization in the World,* p. 162.

[7] World Bank. *World Development Report 2000/2001,* p. 67.

[8] World Bank. 2000. *Global Economic Perspectives and Developing Countries,* pp. 184 and 196-197.