Introduction: Poverty and Adjustment in the 1980s

Lyn Squire

One of the most important debates of the 1980s has centered on the impact of structural adjustment programs on the poor. Some argue that the poor suffered severely during the 1980s and that much of their suffering can be attributed to adjustment. Others hold that declining standards of living were experienced by some, but certainly not all or even most, of the poor and that without adjustment the extent and depth of suffering would have been greater.

The debate encompasses two distinct questions: what happened to the poor during the 1980s and have adjustment policies intensified poverty? The first question is factual, and the answer lies in a careful analysis of available information. But, to answer the second question, one must be able to develop a credible outline of what would have happened without adjustment; that is, an appropriate counterfactual situation has to be developed. The articles in this issue address both questions.

I. WHAT HAPPENED TO THE POOR DURING THE 1980s?

Although analysis of how the welfare of the poor has changed in the 1980s is simpler than determining why the changes occurred, it is complicated by problems of definition, data availability, the unit of analysis, and method of measurement. These problems of measurement are addressed comprehensively in the January 1991 issue of The World Bank Economic Review.

There are four major measurement issues that must be addressed. First, while a policymaker's objective may be to ensure some minimal level of welfare for all citizens, highly contentious political and ethical issues are involved in selecting the particular aspects of well-being to be considered and their acceptable minimal level. (The wide differences in results of “apparent prosperity measures” derived from intensive field work and “current and permanent income” classifications are illustrated in Lanjouw and Stern 1991.)

Second, data problems are pervasive in analyzing living standards. Several elements of well-being are qualitative and resist measurement. Even when
clearly quantitative indicators are considered, comparable and reliable time series data are seldom available in developing, and often even in industrial, countries.

Third, the unit of analysis may be based on residence, household, shared expenditures, family, or individual, and the resulting measurement of poverty will depend on the distribution of welfare among the members of the unit and the equivalence scale used to account for differences in the number of members across units (the difficulties and differences even in studies with relatively ample data are illustrated in Atkinson 1991).

Finally, issues of aggregation and weighting will impinge on measurement within and across sectors, regions, and periods. If the utility of income declines with increases in its level and if some minimum threshold of income or consumption is needed for survival, even a similar absolute reduction in income (for instance) may hurt the very poor more than the relatively poor. But how should the changes in the income of the very poor and the less poor be weighted? (The degree of poverty is reflected in measures of the poverty gap applied by Ravallion and Huppi [1991] in their decomposition of changes in poverty in Indonesia.)

The *World Development Report 1990* (World Bank 1990) argued that well-being is a product of a range of factors, including adequate consumption of goods and services, health, status, achievement, and security. Because most of those factors can be attained in the market, available income will generally determine access to them and thus is the most commonly used measure of well-being.

The *World Development Report 1990* demonstrated that sustained increases in the incomes of the poor require broadly based economic growth. Since the distribution of income changes only slowly, most observed reductions in poverty are primarily a consequence of increases in average income. The great majority of the poor are found in South and East Asia (520 and 280 million people, respectively, in 1985), regions that sustained annual growth in per capita gross domestic product (GDP) of 2.8 and 7.0 percent, respectively, from 1980 to 1988. Sub-Saharan Africa and Latin America, with 180 and 70 million poor, respectively, experienced declines of 2.4 and 0.7 percent during the same period (World Bank 1990, table 2.1 and indicator tables 2 and 26). These data suggest that the majority of the world’s poor—those in Asia—may have benefited from broadly based economic growth during the 1980s. In Sub-Saharan Africa and Latin America, however, the 1980s can be aptly labeled “a lost decade,” and indeed much of the debate has focused on these regions. Analysis of those (few) countries with reliable data drawn from household surveys confirms this general picture.

Such data are available throughout the 1980s for Hungary, Poland, and Yugoslavia. Milanovic shows that with the distribution of income remaining more or less unchanged, poverty moved in line with average income—increasing in Poland and Yugoslavia and remaining roughly constant in Hungary. Two
developments stand out in the Polish and Yugoslavian experience. First, poverty became an increasingly urban phenomenon. And second, the increase in poverty was associated with a decline in real wages rather than an increase in unemployment.

In these countries an explicit choice was made to try to distribute the social costs of adverse economic developments more evenly by allowing decreases in real wages rather than increasing unemployment. The extent of public employment made such a policy feasible. But in most countries this is not an option, and the ultimate impact on poverty, especially in urban areas, will depend on the flexibility and responsiveness of the labor market.

This point emerges clearly from Pissarides' analysis of developed countries. Despite the presence of social insurance, poverty increased during economic recession mainly because of increased unemployment in Australia and the United Kingdom and mainly because of lower wages among unskilled and low-skilled workers in the United States. Pissarides' study also shows that, unlike the other industrial countries in his sample, the impact of recession on the poor in Sweden has been much less severe, apparently reflecting the combination of limited-duration unemployment insurance and a public sector job guarantee. This, it is claimed, provides protection but minimizes adverse effects on incentives because one cannot receive unemployment benefits indefinitely. Most countries in the developing world are not able to administer or finance such systems, but the basic principle underlies public employment schemes such as the Maharashtra State Employment Guarantee Scheme in India.

The general relation between growth (or decline) and poverty notwithstanding, it is still possible for the poor to suffer a decline in well-being even when average incomes are rising. According to Ahmad and Wang this seems to have happened in China. China undertook systemic policy reform in 1979–83, especially in rural areas. Because the system of reporting changed in 1984, data for the pre- and post-1984 periods are not strictly comparable. The evidence suggests, nonetheless, that between 1978 and 1988 real average per capita net income for rural residents approximately doubled, and real average per capita expenditure for urban residents may also have almost doubled. The dramatic improvement in average personal income was reflected in a significant decline in the incidence of poverty in rural areas through 1983, but this trend was partially reversed thereafter. From 1981 to 1984 the incidence of poverty declined significantly in urban areas. Although urban poverty was also lower in 1988 than in 1985, the trend rose after 1986. Ahmad and Wang attribute these setbacks to a combination of the dismantling of some aspects of the system of social security and services, on the one hand, and stagnation in agricultural production and accelerated inflation, on the other hand. The poor were rendered more susceptible to adverse economic events.

Without household surveys the analyst is forced to rely on approximate indicators of the income of the poor. In their analysis of five Sub-Saharan African countries, for example, Sahn and Sarris look at the effect of changes in relative
prices on the incomes and expenditures of the poor, assuming that production and consumption behavior remains unchanged. This has the obvious advantage of requiring information only on changes in prices (which is relatively easy to collect) and on the initial distribution of sources of income and pattern of expenditures (a more difficult undertaking). The empirical gains, however, come at a cost; when prices increase, for example, improvements in the well-being of net producers will not account for resulting increases in production and thus will be underestimates. Similarly, losses suffered by net consumers will be overestimated because substitution into competing goods will not be reflected. Nevertheless, given that most countries lack time series data on income distribution, the Sahn-Sarris approach provides a framework for examining the direct effect of changes in key prices as well as the indirect effect of adjustment policies more broadly through changes in wage rates.

While acknowledging these qualifications, Sahn and Sarris conclude that "there is little evidence of large welfare gains or losses" for the poor arising from the changes in relative prices witnessed in the 1980s in their five countries despite the overall decline in average incomes noted above. The article focuses, however, on rural smallholders. Although most of Africa's poor are in this group, it leaves open the question of what happened to the urban poor. One inference to be drawn from this article is that much of the burden of adjustment in Africa falls on those, including the poor, in urban areas.

A key conclusion of the World Development Report 1990 is that economic growth does not translate automatically into comparable improvements in such nonincome measures of the poor's well-being as life expectancy, primary school enrollment, and so on. By the same argument it might be expected that temporary economic decline is not necessarily associated with a reversal in social progress. And yet much of the debate has focused on the issue of the poor's access to basic social services during the 1980s.

Behrman and Deolalikar focus on this issue in their analysis of the Jamaican structural adjustment program. They ask whether selected measures of well-being deteriorated significantly during 1984 and 1985, years of intense economic adjustment. They estimate the secular trend for each variable of interest and test for a statistically significant deviation from that trend in 1984 and 1985. By focusing on departures from trend, this method avoids the undue reliance on changes in levels that has often characterized previous studies. Their general conclusion is that, when viewed as departures from trend, the changes observed in Jamaica in 1984 and 1985 are much less significant than has been suggested by other researchers, who focused on changes in level. For example, they find no evidence of significant deviations in a range of measures related to educational and health outcomes but do detect some nutritional deterioration among small children. Although there are clearly questions of the short- versus long-term sensitivity of well-being that cannot be addressed in this brief time frame, the value of their contribution lies in its emphasis on careful empirical investigation and interpretation.
The articles in this issue do not provide a definitive answer to the question of how poverty changed in the 1980s, but they do suggest that, as more careful empirical analysis becomes available, some of the more extreme views of the 1980s will have to be modified. They also point to some important insights and suggestions for future work. First and foremost, the quality and reliability of data related to poverty needs to be improved. The value of household surveys is revealed in Milanovic's study of Eastern Europe and Ahmad and Wang's analysis of China. This suggests the importance of improving the capacity of countries to undertake periodic surveys of living standards. Second, for many countries, and obviously for historical analysis, simpler approaches will be required. The articles by Sahn and Sarris and by Behrman and Deolalikar point to the variables that are most likely to be correlated with poverty and that could form the basis for analysis in data-scarce countries. Third, and consequently, empirical confirmation of the assumptions underlying these two articles would be an important contribution. In particular, can existing household surveys be used to test the Sahn-Sarris assumption that changes in producer and consumer behavior can be ignored in the short run so that the analyst can legitimately focus on changes in prices? Similarly, is the Behrman-Deolalikar reliance on such nationwide indicators as infant mortality appropriate for assessing changes in the well-being of the poor?

II. HAVE STRUCTURAL ADJUSTMENT POLICIES INTENSIFIED POVERTY?

Those who wish to tackle the second question must confront not only the absence of reliable data but also the need to specify what would have happened had the adjustment policies under consideration not been pursued. The need to compare results with an appropriate counterfactual applies to all analysis of economic policy, but it has often been forgotten in the debate on adjustment. In this respect Sahn and Sarris are careful to stress that their analysis of prices and poverty says nothing about adjustment policies precisely because they do not analyze what prices would have been without adjustment. Similarly, Behrman and Deolalikar's analysis of departures from trend says nothing about adjustment policies unless it is argued that the trend would have indeed continued had adjustment policies not been implemented, a slim possibility considering the untenable economic conditions of the period.

Among the policies commonly adopted in structural adjustment programs is devaluation of the domestic currency and reduction of disincentives to international trade. This is intended to increase foreign exchange earnings (improving the current account balance) and the perceived creditworthiness of the country (increasing capital inflows) and to induce a more efficient allocation of resources domestically to reflect the comparative advantage of the country. What is not known is whether these policies entail lower levels of welfare for the poor in the short run compared with a continuation of the existing policy regime or some other package of policies.
Reform of fiscal (and related monetary) policies raises the same issue. Clearly these programs can reduce welfare in the short run, but in most cases they were preceded by declines in terms of trade and external finance, increasing debt service costs, and unsustainable growth in external and fiscal deficits and inflation. Thus any analysis of the effects of structural adjustment on poverty must compare the outcome not with the preceding period, but with the outcomes that could be expected from alternative policies that would have been economically and politically feasible under the difficult conditions of the 1980s.

By stressing the importance of what would have happened without adjustment, the issue is correctly posed as one of choosing among alternatives. Bourguignon provides a simple framework for exploring options following a negative external shock. His analysis captures the key elements of the long-run strategy set out in the World Development Report 1990 and places them in the context of a short-run economic crisis. The report demonstrated that poverty had been reduced most successfully in countries that both pursued growth that created productive opportunities for labor (thus increasing the most important asset owned by the poor) and invested in the human capital of the poor (thus increasing their capacity to benefit from the opportunities arising from economic growth). It argued that with this two-part strategy the poor not only benefited from growth but also contributed to it.

The report also recognized the need for a “safety net” to protect the poor during adverse circumstances arising from, for example, a major external shock. This is the starting point for Bourguignon’s analysis. A permanent deterioration in the terms of trade that reduces income throughout the economy also raises the marginal value of income to the poor, thus increasing the social value of income transfers to them. But the marginal value of investment also increases because the structural adjustment that is now required realistically can only take place through new investment. The tradeoff between the use of limited resources for these two options is the fundamental dilemma confronting the policymaker.

Bourguignon explores this dilemma. He first asks, should resources be transferred to the poor immediately following the shock, through a system of taxes and transfers that entails both static and dynamic efficiency losses and realistically will result in some of the benefits going inadvertently to the nonpoor? And, if so, should the transfer be in the form of current income or productive assets, such as investment in human capital? Numerical optimization of Bourguignon’s model produces results that suggest that in the first few years of adjustment the net social benefits of transfers to the poor will be less than the social benefits to investment. Then, when recovery is under way, investment in education and training of the poor will provide greater social benefits than will transfers of current income to them.

These illustrative results depend critically on the assumed values of a few key variables, especially the increased productivity of capital during restructuring and the efficiency cost of taxes and transfers. Moreover the analysis, by intention, makes no allowance for the possibility that the economy is operating well
within its production frontier before the shock or for the possibility that the market signals necessary to guide investment decisions take time to be put in place. If these assumptions were dropped, the resulting optimal policy would include increased resources being made available for consumption by the poor in the short run. Finally, as Bourguignon shows, the availability of external assistance changes the preferred outcome significantly—transfers are part of the optimal strategy, even in the short run, with investment in human capital taking an increasing proportion of the transfers over time.

The level of abstraction in the Bourguignon model is both its strength and its weakness. In an effort to provide more realism, Bourguignon, de Melo, and Suwa analyze models representing a low-income African economy and a middle-income Latin American one. Their approach allows a richer representation of the underlying economic structure; relative to the Latin American model, the African one is characterized by greater wage and price flexibility, a lower stage of institutional development, and less integration with international financial markets. The authors expose the two models to the same external shock and then explore several alternative responses. These can be divided into two cases. The first is a no-adjustment case, in which the authorities rely on import rationing to support a constant real exchange rate. The second is a set of adjustment packages, including real devaluation, tax and tariff reform, and compensatory income transfers.

The value of these models lies in their ability to trace the consequences of alternative adjustment paths on income distribution. This simultaneously reveals the impact on the poor and the sources of likely political resistance to adjustment (such as those benefiting from prior policies). The analysis of options reveals two key points. First, the no-adjustment option increases poverty: during the seven-year simulation period the head count index of poverty increases from 30 to 40 percent in Africa and from 12 to 36 percent in Latin America. This result flows directly from the assumed reliance on import controls, a policy that creates rents that mainly benefit the rich. Second, initial conditions have an important effect on the outcome (including the distributional consequences) of adjustment policies. Thus the option including a real devaluation helps most of the poor (those living in rural areas) in the African case through higher export earnings but hurts those in the informal sector (see the conclusion of Sahn and Sarris). The same package, however, hurts the rural and urban poor in Latin America. Here the poor rely more on wage income, and, because market rigidities prevent the economy from responding to the new structure of incentives, employment and real wages fall.

Experience in countries as diverse as Costa Rica, Ghana, and Indonesia reinforces the conclusions drawn from these models. By far the most important point, and the main message of the Bourguignon model, is that the primary objective of adjustment should be to move the economy as quickly as possible to a growth path that allows effective implementation of the two-part strategy outlined in the *World Development Report 1990*. Three measures seem espe-
cially important: swift action to restore a sound fiscal position and to realign relative prices; some consumption-smoothing, either through a temporary cut in investment or increased capital inflows; and efforts to ensure that cuts in public expenditure are not at the expense of items, especially basic social services, that are crucial to the well-being of the poor. In some cases (such as Indonesia) this combination of measures may reduce poverty even in the transition. In other cases (such as Costa Rica) poverty will intensify in the short run. Nevertheless this package holds the best prospect for a least-cost return to a growth path consistent with sustained increases in the well-being of the poor.

Although it is important to keep this central point in mind, many countries, and rightly so, have experimented with compensatory programs designed to act as a safety net during the transition. In designing such schemes, attention must be paid to their success in reaching the intended beneficiaries, their fiscal cost, and their impact on incentives. Public employment schemes are often proposed as cost-effective ways to transfer resources to the poor, provided the offered wage is sufficient to meet basic needs but not high enough to attract the relatively rich. Newman, Jorgensen, and Pradhan explore these issues in the case of Bolivia's Emergency Social Fund (ESF).

The ESF was established as a temporary program during Bolivia's economic crisis to finance requests from local authorities for small, labor-intensive projects. Unlike most such schemes, projects were executed and the workers hired by private subcontractors. The program has been very successful in attracting and disbursing substantial external funds. However, Newman, Jorgensen, and Pradhan consider how the program has affected the earnings of the workers hired. Of particular interest is their attempt to define what the participants would have earned without the ESF. This effort to establish a counterfactual leads to important insights.

At first glance it appears that the ESF has not been particularly successful in reaching the poor because most of the participants fall in the middle rather than the lowest deciles of the earnings distribution. But the definition of earnings in this calculation includes the earnings from the program. Estimates of the earnings of these workers without the ESF indicate, however, that about 30 percent of the participants would have fallen in the two lowest deciles of the earnings distribution and more than 70 percent in the bottom four deciles. This conceptually more accurate assessment of the fund's success in reaching the poor emerges through specification of a counterfactual.

The key element that determines the distributional effect of the program is the wage. Because private subcontractors are used, who pay market rates, the wage fails to act as a screening device. Thus, although the average participant in the program earns 51 percent more, about two-thirds of the transfer is required to replace forgone income, and not all of the net transfer accrues to the lower income groups. Thus the scheme, although reaching many relatively poor people, is not an especially cost-effective way to transfer income to the poor. Other programs, such as the Employment Guarantee Scheme in Maharashtra State in
India, set wages low enough so that only the poorest choose to participate. In principle this increases the share of the transfer reaching the poor and reduces the fiscal cost of any given transfer to the intended beneficiaries.

The articles in this issue cannot conclusively answer how adjustment policies have affected the poor. But they do emphasize the correct way to approach the problem—through a careful comparison of the results of alternative policies. The articles by Bourguignon and by Bourguignon, de Melo, and Suwa demonstrate the required approach, but the lack of country-specific application may weaken their salience for the policymaker. Country-specific analysis, however, is limited by the number of countries with reliable household-level data for the 1980s. This suggests that for future work it may be necessary to increase the size of the sample by using an approach such as that of Sahn and Sarris. But to address the question of the effect of adjustment, their approach would need to be combined with an assessment of the impact of alternative adjustment policies on key relative prices. At the very least this approach would make best use of the available data while still emphasizing the importance of comparing alternatives.

But not all effects of adjustment work through prices. At least two other areas warrant additional work. First is the need to assess the distributional consequences of public expenditures, especially those on basic health and education. Although an analysis by income class may only rarely be feasible, examining the distribution of expenditures by region (most of the poor reside in rural areas) and by service (preventive versus curative care, for example) may be possible and can provide the basis for a more equitable (and efficient) allocation of spending within the constraint imposed by macroeconomic conditions. The second is the importance of examining the effectiveness of programs designed to compensate those most vulnerable to the adverse effects of adjustment. Many countries are now pursuing schemes similar to the ESF to cushion the impact of adjustment on the poor. The fundamental issue in assessing these schemes is their cost-effectiveness in achieving their objective relative to other options. Subjecting them to the kind of analysis undertaken by Newman, Jorgensen, and Pradhan could increase their effectiveness in transferring income to the poor.

References


