Chapter 4

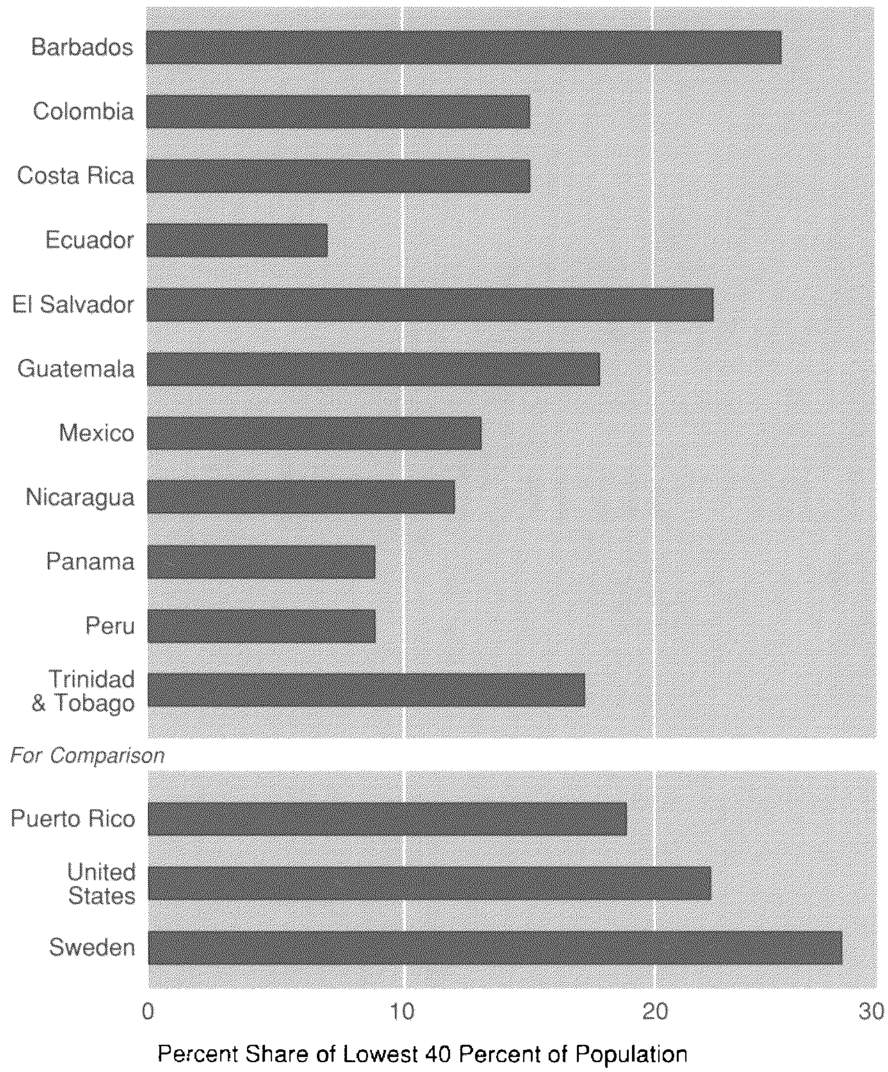
The Structural Adjustment Process

Migrant-sending nations, almost without exception, are exporting resources to meet substantial debt-service burdens.

The guiding development strategy in Latin America and the Caribbean in the decades following World War II was to create domestic industries whose output could substitute for imports. Because many domestic markets were too small to support an efficient industrial base, especially in the Caribbean and Central America, regional integration schemes developed to widen the scope for import substitution. They included the Central American Common Market, the Latin American Free Trade Association (since transformed into the Latin American Integration Association), the Andean Group and the Caribbean Community and Common Market. These organizations stressed protected regional markets

The programs had mixed results. Imports did not generally decline; instead, they shifted from final consumer products to intermediate goods. For example, instead of importing a refrigerator, parts to assemble it were imported, or thousands of parts for automobiles were brought into Mexico rather than the automobiles themselves. Because the programs were financed at the expense of agriculture—e g , keeping farmer's prices low—its output usually suffered. In most areas, the concentration on overall economic growth translated into increasingly unequal income distribution. While Mexico, some Central American countries, the Dominican Republic and Trinidad and Tobago achieved high rates of economic growth, they were not

FIGURE 4.1
Income Distribution in Mexico and Other Migrant-Sending Countries, Most Recent Estimate



Source: World Bank.

prepared for the transition from producing simple consumer goods to more complex products requiring higher levels of technology. (See Figure 4.1, p. 44.)

Development strategies have now shifted to de-emphasize protectionism and stress competition. Most migrant-sending countries in the Western Hemisphere, with Mexico in the forefront, are restructuring their economies. Private initiative is increasing. Private foreign direct investment, which had been only tolerated in much of the region, is now avidly sought. Export promotion is taking its place alongside the production of goods for the domestic market. While dormant regional economic integration schemes have yet to be revitalized, there is a growing recognition that to do so, local industries must be able to compete in the global market. (See Box 4.1, p. 45.)

Box 4.1 - Import Substitution and Export Promotion

Latecomers to the development process often seek to establish domestic industries behind protective walls. This strategy has a long history Even economists who favor free trade often concede that infant industry protection has a role This form of industrialization, often referred to as "import substituting industrialization" (ISI), was particularly prevalent in Latin America and the Caribbean during the 1950s through the 1970s.

The polar opposite strategy is to base industrialization on export promotion. This approach dominated the industrial development programs in Asian countries.

This brief description overstates for the sake of contrast. All countries practice import substitution to some extent in that they find it expedient to protect certain industries until they are well established. Similarly, all countries must export, if for no other reason than to earn foreign exchange needed to buy foreign goods. The analytical issue is really the bias that exists, whether it is protective against foreign import competition or promotional in favor of exports All countries also have the dual interest of developing their internal market for national production, but also to develop foreign markets. The bias in Latin America until the 1980s was in favor of ISI.

The result, for the most part, was that Latin American countries were not strong competitors in manufactured goods outside their own countries Asian countries, first Japan, then the so-called "Asian tigers" (Hong Kong, Singapore, South Korea and Taiwan), and now other Asian countries (Thailand and Malaysia, for example) were protective but their bias was in favor of exports. As is evident, they have became formidable international competitors.

The current policy trend in the Western Hemisphere favors export promotion. Following its economic crisis of 1982, Mexico drastically shifted policy from a bias in favor of ISI to export promotion. Import protection was drastically lowered so as not to encumber export industries with high costs. Other Latin American countries similarly are shifting to an export promotion bias This has introduced increased competition in the United States and other world markets. By the same token, however, it has opened these markets to competition from U.S and other exports Not all observers agree that the current outward-looking trends are optimal, yet the evidence is strong that overall growth rates are higher in countries with an export rather than an inward bias in their industrialization strategy.

The process of structural adjustment involves the transition of an economy from a state-dominated model to one in which the market plays the major role, where prices rather than administrative decisions determine the allocation of most resources, and where regulation is designed primarily to foster rather than stifle competition. Undertaking the steps needed to decrease price distortions and allocate resources to the most efficient areas of a country's economy is always a painful process. The transition usually leads to temporary economic decline. The adjustment entails such actions as devaluing the currency, eliminating subsidies and increasing interest rates, the ramifications of which are higher prices at home and a disturbance of the status quo

Structural adjustment involves "getting prices right" Imports usually become more expensive. The cost of money increases, which affects those borrowing from established financial institutions When the government finds it is no longer able to subsidize basic foodstuffs (such as tortillas in Mexico), the disadvantaged segments of the population suffer the most. When gasoline prices are raised, all who ride motor vehicles, but mostly the poor who use public transportation, are adversely affected, unless some mechanism is established to help them. In general, the poor are most affected because they lack the resources to cope with the changes. Yet, if the adjustment process is not undertaken, the entire economy is penalized.

The United States should do what it can to ease the suffering caused by structural adjustment in migrant-sending countries. While most of the necessary resources will come from the countries themselves, additional funds should be made available through such sources as development assistance, debt restructuring and encouragement of foreign credit and direct investment.

Funds required to refurbish Mexico's badly neglected infrastructure following its prolonged period of economic stagnation need not come from the U.S. taxpayer. These resources may be made available from foreign investment or loans from multilateral development banks. On the other hand, concessional foreign aid is essential to Central America, where conflict and turmoil have consumed domestic resources. Foreign loans and investment are also required in the Caribbean, which is suffering from drastic declines in the prices of many of its main commodity exports.

Migrant-sending nations, almost without exception, are exporting resources to meet substantial debt-service burdens. U.S. policy can help alleviate this problem, by restructuring credits of official agencies in exchange for economic policy adjustments by the debtor countries and by encouraging commercial lenders to do the same.

The Commission recommends that.

(1) The provision of bilateral aid should be conditioned on the recipient country taking the necessary steps toward structural adjustment What these steps are, and the speed of their adoption, will vary by country and are best worked out through bilateral discussion.

(2) Similarly, U.S. support for non-project lending by the multilateral development banks (the World Bank and the Inter-American Development Bank) should be based on a satisfactory adjustment program. Migration considerations should be taken into account and efforts should be made to ease transitional costs in human suffering.

(3) Finally, U.S. policies should complement and not frustrate adjustment mechanisms in migrant-sending countries. In practical terms, this means, for example, that a move toward export promotion should not be negated by U.S. import barriers.

Privatization of Government-Owned Enterprises

Privatization of government-run industrial or commercial enterprises is a logical corollary of structural adjustment because it gives greater play to market forces than to government control. In addition, overburdened governments are finding it useful to sell enterprises that have little relevance to the management of the public sector. This is particularly true when government-run enterprises, the so-called parastatals, are inefficiently managed and constitute a drain on government resources.

Many of these enterprises were established or taken over under a philosophy of state control over the economic means of production. In other cases, governments took control of failing enterprises to avoid unemployment. Often, state-run enterprises served purely political purposes. Banks in Mexico, for example, were nationalized in late 1982 to bolster the government, although the stated rationale was to close off avenues of capital flight.

Privatization has progressed substantially in Mexico Most other migrant-sending countries of the region have taken comparable steps. Some enterprises are especially sensitive, however, because of their role in the development of national identity. Petróleos Mexicanos (PEMEX), Mexico's national oil company, is in this category, because of the circumstances leading to Mexico's nationalization of properties owned by foreign oil companies in 1938.

Although privatization can be encouraged by the United States and international financial institutions, its extent and speed is a decision each country must make for itself. There is no need for the United States to attempt to interfere in the decision to privatize any individual entity, or to involve itself with the pace of the process. In fact, such action would almost certainly be counterproductive.