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STABILISATION AND STRUCTURAL ADJUSTMENT: A REVIEW OF BASIC CONCEPTS AND METHODOLOGY

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Stabilisation and Structural Adjustment Programmes (SSAPs) designed to eliminate current account and public sector deficits have generally emphasized stabilisation in the early stages, giving fiscal restraint and currency devaluation leading roles. Liberalisation, deregulation and privatisation to be followed by the establishment of the regulatory framework and the building of required institutions were to come next.

Past experiences, however, have revealed that SSAPs have not generally succeeded in bringing lasting solutions to external and internal imbalances. Excessive reliance on reductions in government spending and imports, disregarding selectivity in expenditure cuts were some of the major shortcomings of the SSAPs. Unsustainability, arising mainly from overemphasis on liberalisation and privatisation were others. Waiting for the completion of liberalisation to initiate the structural-institutional reforms has also damaged SSAPs. Hasty external liberalisations, especially those involving the capital account, have also been detrimental to the success of stabilisation and structural adjustment.

1. INTRODUCTION

The international debt crisis and the ensuing widespread adoption by many developing countries (DCs) of the stabilisation and structural adjustment programmes, promoted by the International Monetary Fund (IMF) and the World Bank, are two major facts that have shaped the economic performance of the Third World in the 1980s and 1990s.

The debt crisis broke out in 1982 with Mexico's somewhat spectacular suspension of debt servicing to its creditors, and acquired an international character in 1985 when it became evident that there were many overindebted DCs facing similar balance of payments problems, stemming mainly from the adverse economic conditions prevailing in the world economy.

The overall adjustment programmes, which were initiated in 1980, began to be extensively implemented in the second half of the decade. Their

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importance has not diminished in the 1990s. These programmes are composed of two components, namely stabilisation and structural adjustment. The principles of the structural adjustment component, which constitutes the new part of the programmes, were put forth by the World Bank in 1979. The overall adjustment programmes are implemented under the surveillance of the Bretton Woods institutions, which also provide support to the programmes in the form of conditional loans. The commitment of funds to the DCs by the international commercial banks, regional development banks and public lenders on the one hand, and the commencement of rescheduling negotiations with the Paris Club on the other, have also become dependent on the successful implementation of those programmes. The “seal of quality” of an IMF-supported adjustment programme has also given that institution a decisive power over the economic policies of DCs.

This paper is an attempt to analyse stabilisation and adjustment programmes (SSAPs) at the conceptual and methodological level. It also aims to illuminate factors affecting the success of these programmes. Within that context, the concept of stabilisation and its basic characteristics will be discussed first. This will be followed by an analysis of the structural adjustment, covering its theoretical foundations, and a review of the basic elements of SSAPs. The third section is devoted to the analysis of factors — including the theoretical shortcomings of the programmes— affecting country performance.

2. STABILISATION AND THE EVOLUTION OF STABILISATION POLICIES

2.1. The meaning of stabilisation and the scope of stabilisation measures

Macroeconomic imbalances arising from excess demand compared to supply generally lead to current account and budget deficits. These deficits can be temporary and reversible, or permanent and irreversible. In the first case, it may be easy to finance them and some controls on trade and payments may also be imposed. In the second case, a correction is required. Such a correction involves restoring equilibrium through the implementation of stabilisation policies. “The problem that stabilisation is often intended to solve is excessive demand in relation to output, or excessive money creation in support of a budget deficit” (Streeten, 1991a:306).

It should be expressed at this point that correction or financing of deficits are not necessarily alternatives. Finance can also be used to ease correction by stretching it over a period and making it less painful. But, on the other hand, it can be used to perpetuate the status quo and avoid adjustment (Streeten, 1991a:304). In that case, it contributes to the widening of existing imbalances. Persisting imbalances stemming from excess demand give rise to balance of payments problems and inflationary pressures.

Since, in brief terms, the balance of payments deficits can be defined as the excess of imports (M) over exports (X), which is identical with the excess of investment (I) over domestic savings (S) plus the excess of government expenditures (G) over government revenues (R), equilibrium (when resources are fairly and fully employed) requires a reduction in I or consumption (so that savings rise) and/or a reduction in G and/or a rise in R (Streeten, 1991a:306). The identity described above can be written as:

$$M - X \equiv (I - S) + (G - R)$$

The left side of the identity gives the external deficit whereas the right side, composed of two distinct parts, gives the internal or domestic deficit. It should be noted that (G - R) can be defined as the budget deficit, which generally constitutes the basis of internal deficits. Macroeconomic imbalances of the same magnitude do not necessarily yield similar results. The impact of a budget deficit on the general price level, for example, depends on many economic and non-economic factors, one of them being the method employed in financing the deficit.

Stabilisation policies aiming at external and internal balances make use of expenditure-reducing and expenditure-switching measures. The expenditure-reducing measures are composed of limitations on the growth of money and credit supply, cuts in government expenditures and increases in tax revenues. The most commonly used expenditure-switching measure is the devaluation of the currency. Others include tariffs and other restrictions which can be imposed on imports and payments, though they are not recommended by international financial institutions.

Since a deficit in the current account of the balance of payments implies an excess demand for imports, expenditure reduction, by reducing total expenditures and hence curbing the demand for imports and by making more goods available for exports, contributes to the elimination of the external deficit. Raising the prices of tradables through a change in the exchange rate, however, has been extensively used as the principal tool of eliminating external deficits. It has been employed to increase the supply of tradables by shifting resources from non-tradables to tradables and reducing the domestic demand for tradables and raise it for non-tradables. Reliance only on expenditure cuts, without expenditure-switching, would result in an excess supply of non-tradables and an excess demand for tradables. The switching policy reduces both (Streeten, 1991a:306-7).

2.2. Standard stabilisation packages and the IMF

Stabilisation is a short-run policy operating largely on demand. The primary impact of stabilisation is at the level of absorption. Therefore, stabilisation policies are also called demand-management policies. They typically include monetary and fiscal measures designed to affect the aggregate level or rate of growth relative to production. “The achievement of a higher growth rate in the medium term generally requires an increase in productive investment, while stabilisation requires a reduction in the savings-investment gap” (Khan, 1986: 3-4).

Macroeconomic adjustment has often been viewed as synonymous with policies designed to restrain aggregate demand and absorption. This, to a great extent, is an outcome of the primarily demand-oriented adjustment programmes promoted and supported by the IMF, especially during its first thirty years.

The early stabilisation programmes, usually associated with the IMF, were based on a simple diagnosis of the balance of payments problems and inflation. “Excess government spending” leading to internal deficits was held responsible for both domestic inflationary pressures and external deficits. A complementary problem was the overvaluation of currencies, supported by quantitative import controls and designed to reduce artificially the costs of imported wage-goods and industrial inputs (UN, 1991: 6).

The IMF “stabilisation packages” have usually contained some of the following elements (Streeten, 1991a: 308):

– Credit restrictions by the monetary authorities, especially of borrowing by the government and public enterprises.

– Reduction in the budget deficit which can, in principle, be done by: (a) raising taxes, (b) raising the prices of the products and services of public enterprises that contribute to revenue, (c) cutting government expenditure on defence, (d) cutting government expenditure on public consumption, and, (e) cutting government expenditure on investment.

– Devaluation or depreciation of the currency, either in a series of small steps or in one big step.

– Liberalisation of international trade and capital movements and some domestic sectors which were previously controlled.

It can be asserted that IMF's stabilisation programmes, supported by stand-by credits (1952) and other conditional loans dependent on successful policy implementation, have been dominated by two fundamental prescriptions: "balance the budget and get the prices right". Cuts in government overspending, large devaluations and positive real interest rates would allow a suppression of the rationing mechanisms for foreign exchange and domestic credit allocation, while resolving the balance of payments and inflation difficulties (UN, 1991:6). This view seems to overlook domestic structural problems and adverse external environments.

2.3. Orthodox and heterodox approaches to stabilisation

The standard IMF stabilisation packages, also called orthodox stabilisation policies, have resulted either in failures, or have led to social upheavals and political turmoil in many DCs. The "heterodox" approach, developed as a reaction to the failure of "orthodox" anti-inflationary policies, was implemented in countries under chronic inflation. Heterodox stabilisation programmes have been adopted in economies suffering from hyperinflation, their major goal being the alleviation of hyperinflation within a very short span of time. They rely heavily on "shock" measures.

Policy instruments that are employed constitute the line of demarcation separating "orthodox" and "heterodox" policies. A heterodox approach is an orthodox one plus income policies (wage and price controls) and a looser monetary policy in the second stage of implementation.

The heterodox policies put into implementation in the 1980s took account of price rigidity and gave a distinct role to the co-ordination and control of prices and income by governments. Price controls, wage freezes or de-indexation of wages to inflation and exchange rate controls have been used to stop inflationary expectations under conditions of hyperinflation, typically during the first phase of stabilisation.

Although orthodox packages call for real-wage reductions, they recommend price liberalisation instead of price controls. Price controls have the disadvantage of being difficult to administer. They may also give rise to black-markets and in the medium and long run lead to a widening distortion in relative prices. Therefore, the heterodox approach suggests that they be abolished in the second phase of the programme.

As opposed to orthodox programmes, which use both tight monetary and tight fiscal policies, heterodox programmes make use of tighter fiscal policies but allow for somewhat loose monetary policies, especially in the second phase of stabilisation. According to the heterodox approach, if hyperinflation has been curbed during the first phase and inflationary expectation eliminated, a renewed expansion of money supply is required to prevent a recession.

Heterodox policies make use of fixed exchange rates during the first phase of stabilisation when price and wage freezes are in effect, the purpose being to break "rapid exchange-rate depreciation expectations" and brake cost inflation.

In practice, "many heterodox attempts fell into the trap of outright abandonment of fiscal adjustment. Premature reflating of the economy, inadequate changes in relative prices, disregard of economic incentives to recover investment and abuse of temporary import liberalisation (as a means to repress domestic price increase in the presence of inappropriate exchange rates) are the main elements defining the inconsistency of several failed attempts at heterodox stabilisation" (UN, 1991:8).

Implementation of heterodox expansionary stabilisation policies in some countries provided a better understanding of the limitations in the short run and the need for structural reform without resort to inflationary financing. This helped to narrow the gap between the two previously irreconcilable approaches and a blend of orthodox and heterodox components began to appear in stabilisation packages. These packages emphasised fiscal discipline and market-oriented policies as a means of achieving rapid deflation with reduced output losses (UN, 1991:9).

2.4. Evolving views on stabilisation

The vast accumulated experience with the IMF-promoted standard stabilisation programmes has given rise to many criticisms. Some of the most important criticisms are as follows (Didszun, 1988 and UN, 1991):

– The intensity of the conditional intervention of IMF is not economically justified when compared to the adjustment required and, thus, it hinders the longer-term structural development. The same results can be obtained by less restrictive economic measures. When the reduction of demand via a too tight monetary and fiscal policy, together with the reduction of real wages, goes beyond that which is necessary to free capacities for the production of exportables, "overkill" takes place. Overkill leads, via falling capacity utilisation, to a massive reduction in productive capacity and thus to losses in growth and employment. It should also be noted that such stabilisation policies lead to lower tax receipts and wider budget deficits.

– Large devaluations prove to be inflationary in a context of real wage resistance.

– Large devaluations frequently cause significant drops in industrial output as important intermediary goods suddenly become more expensive while exports respond weakly to the exchange rate change. Restrictions on demand can set exportable resources free, only in semi-industrialised economies. In others, there are no capacities for an enlarged supply of exports.

– The burden of debt service, defined in foreign currency, increases as a result of devaluation. Quantities exported must be increased in order to earn the same sum in foreign currency as originally. This implies that raw material stocks are exhausted more quickly and supplies on the domestic market from agricultural and industrial production are reduced. Domestic absorption must repeatedly be cut back.

– Government budgets also are negatively affected by devaluations in cases where tariff revenues are small compared to the public sector external debt service; budget adjustments made under the pressure of meeting 3-month targets are frequently short-lived.

– Private savings do not always respond positively to the very high real interest rates. On the contrary, financial fragility brought about by the impact of high real interest rates frequently lead to collapses in financial markets and bankruptcies.

– The standard approach to stabilisation regards slow price responses, foreign exchange shortages and reduced domestic savings as consequences of over-ambitious import substitution strategies. External difficulties are also disregarded. For instance it is argued that DCs are very small vis-à-vis the rest of the world and, therefore, face an infinitely elastic external demand for their exports.

– Structural problems, like underdeveloped human potential and insufficient institutional and physical infrastructure, make market-controlled adjustment processes difficult. Such problems can be solved only in the long run. The narrow time horizons of stabilisation programmes do not leave enough time for structural changes. The shorter the time horizon the greater the effects on employment and income.

- Budget cuts in practice often lead to the limitation of social welfare programmes. Since such programmes are indirectly productive, adverse social-economic consequences may arise. Public health and education may be seriously hampered. This in turn may also cause falls in output.

- Stabilisation measures frequently give rise to destabilisation at the social and political levels, jeopardising social peace, consensus and the rule of law.

- Unfortunately, stabilisation programmes contribute to the world-wide devastation of the environment. An example relates to the consequences of raising kerosene prices. As a result of this measure, poor people started to resort to wood as a substitute, leading to the clearance of scarce forests, erosion damage and the cumulation of flood catastrophes in the Andes / Himalaya region. Furthermore, in some DCs, the necessity of debt servicing has led to the depletion of natural resources. The deforestation in countries with tropical forests gained momentum with the implementation of stabilisation programmes.

The shortcomings and inconsistencies of the stabilisation packages contributed to the evaluation of views on stabilisation. An important improvement in that direction was the revision of IMF guidelines in 1979 which extended the time-limit of stand-by arrangements —previously one year— up to three years. This made it possible to take into account the supply side of the adjustment.

One of the intentions of the new guidelines of March 2, 1979 was to allow for the harmonisation of adjustment programmes with social, political and economic priorities; but in effect this proved to be very difficult (Didszun, 1988:165).

The stagflationist external shocks of the 1970s enhanced the belief that most of the DCs were facing an increasingly adverse external environment. It became clearer than ever that a major structural adjustment effort was needed, and, in principle, it had to be different from the conventional IMF stabilisation packages.

3. STABILISATION AND STRUCTURAL ADJUSTMENT PROGRAMMES

3.1. The origins and evolution of the concept of structural adjustment

Several definitions of "adjustment" can be made. One of them is that adjustment is "to bring about a more satisfactory state". It is also defined as "an orientation to the demands of a new order", "the achievement of a truer or more effective relative position", and "the rearrangement of components after assembly to improve performance" (Thomas and Chhibber, 1989:2). For Streeten, adjustment is "adaptation to sudden or large, often unexpected changes" (Streeten, 1991b:93). All these definitions suggest that adjustment has two phases: (1) acknowledging a new reality or one that had been denied or suppressed, and (2) reshaping and redirecting policies and institutions (Thomas and Chibber, 1989:2).

The issue of "structural adjustment" came up for full discussion within the World Bank and the IMF in October 1979. The steep rises in oil prices in 1973 and 1979, the 1979 interest shock, a prolonged period of slow economic growth in the industrialised countries and the deterioration of the terms of trade in many DCs, had given rise to severe balance of payments problems. Under these circumstances, the World Bank took the initiative to provide assistance through structural adjustment lending.

In the words of the World Bank "structural adjustment lending was seen as one response in an effort to supplement, with longer-term finance, the relatively short-term finance available in order that the current account deficits of many developing countries do not become so large as to jeopardise seriously the implementation of current programmes and foreign-exchange-producing activities. But since many of the changes to which developing countries need to adjust are permanent, or are long term in character, finance to tide them over the expected deficits will, therefore, be no substitute for structural adjustments in their economies. To achieve desirable growth rates in the future, developing countries will have to use available capital more efficiently, increase domestic savings, increase domestic production of energy and economise in its use, increase domestic output of food and diversify their exports. Actions of this sort will require a pattern of investment different from that in the past. The Bank lending for structural adjustment is designed to assist in this difficult task" (World Bank, 1980:67-8).

The structural adjustment lending, distinctly different from the conventional project or sector lending of the World Bank, started in 1980. Structural adjustment loans (SALs), dependent on the implementation of structural adjustment programmes, were intended to be flexible and tailored to the needs of individual countries and it was declared that they could involve the following (World Bank, 1980:68):

– Measures to adjust production to higher energy prices;

– Emphasis on labour-intensive investments that have a long gestation period and a substantial impact on employment;

– Diversification of economies dependent on exports of a few primary commodities, especially by promoting investment in the production of non-traditional exports;

– Enhancement of export competitiveness in economies that have suffered from excessive protection of domestic industry, or redirection of investment to domestic markets in the face of changed cost structures or limited export prospects;

– Reassessment of the balance between public investment plans and expenditures for the maintenance and operation of existing public assets;

– Reappraisal of policies on price and fiscal incentives and the efficient mobilisation of domestic resources; and

– Institutional changes designed to improve the efficiency of production and marketing systems.

The basic objectives of this strategy of long term structural adjustment can be summarised as follows (Tomann, 1988:205):

– Switching from the import-substituting industrialisation strategy to export-led growth and a concomitant reform of foreign trade.

– Reform of public budgets with the prime aim of reducing deficits.

– Reform of the price structure, especially the liberalisation of agricultural prices.

– The Privatisation of state enterprises and, hence, at the same time, a slimming of the public sector.

The World Bank's structural adjustment programmes reflect the shifting of its policy emphasis away from targeted project financing, aimed at combating poverty during the Mc Namara era, towards financial assistance for the implementation of economic reforms. This change has been strongly affected by the conservative economic policies dominating the scene in industrialised countries during the 1980s (Tomann, 1988:204).

The world-wide recessions of 1980 and 1982, followed by the international debt crisis and the ensuing cessation of commercial bank lending to the DCs, gave rise to an extremely adverse environment. This had two results. The first pertains to the change of emphasis concerning DCs' debt overhang. A solution began to be sought with respect to this issue.

In September 1985, an initiative was launched by the US Secretary of State J. Baker, aiming at the revival of economic growth in fifteen heavily-indebted countries by means of a combination of economic policy reforms and the injection of fresh money. In accordance with the Plan, the World Bank, together with international development banks, was to provide 9 billion dollars to those countries. The Baker Initiative, which gave a prominent role to the Bank, failed due to lack of detailed proposals in the Plan and the unwillingness of international banks to cooperate. At the spring meeting of 1988 between the Development Committee of the IMF and the World Bank in Washington, it was declared that the international organisations should support methods of reducing outstanding debt where loan packages between commercial banks and middle-income countries were concerned. This was followed in 1989 by the declaration of a new Plan by the US Secretary of Treasury N. Brady. The Brady Plan contained new elements that aimed at supporting debtors' continuing adjustment efforts through voluntary reduction of debt in commercial banks and continuation of injection of fresh money.

The second result of the prevailing adverse external environment has been the enhancement of the liberal "market-friendly approach which culminated in the Washington Consensus". The consensus is the name given to the new World Bank/IMF adjustment recommendations.

According to the Washington Consensus approach, the deepest roots of the instability and lack of growth then prevailing in Latin America lay in the development strategy adopted during the post-war period, i.e. the import-substitution strategy of industrialisation. The same approach deemed that strategy an inward-oriented model of growth and a serious misallocation of resources, especially because of the central role played by the public sector as an "engine of growth" (Frenkel, Fanelli, Rozenwurcel, 1993:3). The five principles of the Washington Consensus consisted of: (i) budget balancing, (ii) relative price correction, (iii) trade and foreign investment liberalisation, (iv) privatisation, and, (v) domestic market deregulation (UN, 1991:7).

Trade liberalisation was to be achieved in a sequence, starting with the replacement of quotas and ending with free trade. Foreign investment was to be promoted mainly by non-discriminatory treatment of foreign investors.

"Privatisation involved the devolution to the private sector of formerly private firms that had, for one reason or another, fallen into the hands of the public sector; secondly the closure of loss-making public enterprises, with the establishment of bankruptcy proceedings to deal with such cases; and thirdly, the transfer to the private sector of large public firms that were in the past thought to be of strategic importance" (UN, 1991:7-8).

Domestic market deregulation, on the other hand, implied the elimination of all controls affecting prices and the establishment of necessary mechanisms to guarantee this.

This formal agenda of the Washington Consensus also indicated the fact that the Bretton Woods institutions started to envisage adjustment as a longer concept than previously conceived.

In 1990, the World Bank also proposed a two-part strategy, a more labour-intensive growth and better access to social services for the poor. A close study of the Bank's own first evaluation, however, revealed that the first part of the strategy had not received the attention it deserved. As for the second part, the Bank did not formulate a clearly-defined social reform policy, integrated to its economic and financial reform policies. In practice, it only emphasised education, population, health and nutrition. Therefore, the Bank has been criticised for acting as if economic growth plus education will be sufficient to make a significant dent on poverty as well as improve the social climate (Emmerij, 1995).

3.2. Methodology of stabilisation and structural adjustment programmes

3.2.1. Scope of policy reforms

As has been mentioned before, SSAPs consist of the components of stabilisation and structural adjustment. Some economists, however, group the involved policies according to their primary impacts and distinguish between four different types. They are composed of demand management policies, structural policies, exchange rate policies and external financial policies (Khan, 1986:2). Demand-management policies have impact on the level of absorption, structural policies on the current and potential output, exchange rate policies on the composition of absorption and production as between tradable and non-tradable goods, and external financing policies on the level of capital flows.

The nature of prevailing macro imbalances and distortions determine —or at least should determine— the emphasis to be given to specific policies. Thus, hyperinflations and serious foreign exchange shortages require basically different policy priorities in the adoption of policy reforms. In a small economy starved of foreign exchange, removal of exchange rate distortions may generate a more disorganised economy, if delays in supply response and lack of credibility of government policies are not taken into account when implementing cuts in government expenditures (UN, 1991:13). Thus, the first steps of policy reforms are determined by the type of dominant imbalance in the economy.

Once the first moves of policy reform are decided upon, the problem of determining the intensity of those moves arises. What should be the rate of devaluation, or how much should government expenditures be cut or taxes raised? In providing answers to such problems three facts should be taken into account: (1) Short-run advantages of big moves which should be counterbalanced by the need of maintaining policy consistency for a long time. (2) Political and economic strength of groups negatively affected by the policy moves and the possibilities open to the Government to target measures to compensate or protect those losing from the policy. (3) The fact that after a large devaluation or an overadjustment of public sector prices to obtain higher government revenues, the government has more room to use nominal anchors than would otherwise be the case (UN, 1991:13).

Policy reforms are generally related to trade policy, fiscal policy, public sector management, financial sector policy, antipoverty policy, industrial policy and agricultural policy.

With respect to trade policy, it can be said that successful export performance helps liberalisation of imports. Lowering import protection has sparked greater resistance than a reduction of the direct bias against exports (Thomas and Chibber, 1989:18). Reform of exchange rates and improvements in the incentive structure of exports are central elements of this policy.

Fiscal reform has always been a difficult task. Tax reforms implemented to increase domestic savings have not generally been successful. Fiscal deficits have been reduced, mainly by cuts in government expenditures which could not be maintained in many countries for social and economic reasons. External shocks not taken into account, they also have led to unexpected increases in interest payments due.

Public sector management involves reforming or privatising public institutions, the main aim being increasing efficiency. The need to reduce budget deficits, arising from the losses of public enterprises, has been the major reason behind public sector reforms. Elimination of those losses through price increases, by created or existing monopolies, should not, therefore, be seen as successful outcomes of public sector reforms.

Financial sectors of most DCs suffer from weak management, insufficient supervision over bank loans and incorrect lending signals during financial repression. Improving regulation and achieving restructuring through reforms in the financial sector require an appropriate macroeconomic policy framework, since this sector is very sensitive to the macroeconomic situation (Thomas and Chibber, 1989:20).

The effects of adjustment on poverty, which in certain cases has led to social disruptions, require special measures to be taken. Promotion of labour-intensive activities and public works, correcting mistargeted public expenditure on social programmes by redirecting public funding for education and health care, and targeted food aid programmes are ingredients of the antipoverty policy.

The declared aim of industrial policy reforms in the SSAPs is to make the industrial sector more competitive and achieve higher sectoral growth rates. Within this context, investment incentives are restructured, public investment redirected from the manufacturing to infrastructure and pricing policies changed. In countries where there is lack of skilled labour and industrial inputs and where the capacity to absorb new technologies is lower, policy reforms should aim at eliminating these constraints.

SSAPs' agricultural policy reforms involve price policies and investment schemes, institutional reforms and investment-expenditure policies. The lifting of price restrictions on agricultural goods can yield positive results only if farmers do not face constraints in the areas of transport, agricultural inputs, irrigation and access to credit. Institutional change is also an indispensable element of agricultural policy reforms of many SSAPs where progress has been unsatisfactory.

3.2.2. Sequencing

Since stabilisation and structural adjustment measures can, and are, generally announced in single packages, but cannot all be put into implementation at the same time, the problem of the appropriate sequencing of reforms is posed.

Primary emphasis in sequencing is on stabilisation in the early stages, with fiscal restraint and currency devaluation taking the leading role. “As the macroeconomic environment is stabilised, the emphasis is supposed to shift to structural adjustment, encompassing various microeconomic and institutional reforms to remove inefficiencies and ensure adequate growth rates. Among these, trade liberalisation, price deregulation in industry and agriculture, financial liberalisation and privatisation constitute the predominant reforms, some of which are in fact attempted very early on” (Rodrik, 1990:933).

The emphasis on policy sequencing seems to have developed as a reaction to the failures experienced in the mid-1970s in the Southern Cone of Latin America, where liberalisation measures tended to precede fiscal adjustment and ended in serious balance-of-payments crises. Therefore, it is now widely accepted that fiscal adjustment should precede liberalisation and that deregulation should start in those markets which adjust more slowly, that is the labour market, followed by the goods and financial markets respectively. It is asserted that if that order of sequencing is not followed, overshooting of exchange and interest rates will be inevitable. The consequence of premature deregulation may be high volatility of interest rates induced by speculative behaviour, increased uncertainty as to the cost of loans without any favourable counterpart in financial deepening, widespread priority of “financial thinking” in private business before flexibility in the savings/investment intermediation is achieved, and finally, capital flight stemming from high uncertainty (UN, 1991:14-5).

By the beginning of the 1990s, the need to stabilise the economy first, before adopting structural adjustment measures such as liberalisation, deregulation and privatisation and then to invest and grow, began to be stressed in different circles, including the World Bank.

3.2.3. Design

Serious problems are encountered in designing SSAPs. A major problem arises from the fact that policies to solve a problem in one area may create problems in other areas. A devaluation, for example, may improve the current account of the balance of payments but, at the same time, increase the budget deficit, if the government is a net purchaser of foreign exchange. Tariff reductions may increase industrial efficiency, but may also lead to unemployment and/or revenue losses. Such adverse effects of a devaluation can be mitigated by budgetary subsidies, which in turn may give rise to a higher budget deficit. Higher budget deficits can worsen the balance of payments, speed up inflation and hurt the real and financial sectors (Thomas and Chibber, 1989:4).

The DCs have had great difficulty in stabilising their economies since the onset of the international debt crisis in 1982. There are still many countries where the stabilisation process has not been satisfactorily completed. Reduction of current account deficits has been achieved by big investment cuts, which is neither a recipe nor an indicator of stability. Therefore, in many DCs, structural adjustment has been attempted in the midst of economic and political instability (Rodrik, 1990:933). Inadequacies in the technical design of adjustment programmes which simultaneously attempt to reduce excess demand, shift resources toward the production of tradable goods and reduce inefficiencies cause serious problems (Thomas and Chibber, 1989:5).

In order to avoid such complications, SSAPs should strive for sustainability. A sustainable policy environment bars large unexpected shocks, thus continues in the foreseeable future and is perceived as stable by the private sector. Its key components are (i) stable macro policies, chiefly a small fiscal deficit and a realistic exchange rate policy, (ii) a credible and predictable set of micro incentives, widely expected to be sustained indefinitely and (iii) the absence of sharp distributional changes that would create political pressures to reverse course down the line. Therefore, SSAPs should strive for sustainability. Liberalisation policies that are not sustainable bring few benefits but have high costs. Hence, illiberal policies which do not damage macro stability should be preferred to them (Rodrik, 1990:933-5).

3.3. Conditional loan support

Stabilisation programmes have always required external financing for the elimination of economic bottlenecks, especially foreign exchange shortages which often lie at the basis of unutilised capacity and inflationary pressures. Since 1952, the IMF has been giving conditional loans to member countries who have made stand-by arrangements with the institution. The extended arrangements initiated in 1974 provide a second source of conditional loans.

In the mid 1980s, the IMF recognised that many of its low-income member countries needed highly concessional support on a longer-term basis than it was able to provide through existing financial mechanisms. For this reason, it set up the Structural Adjustment Facility (SAF) in 1986 and the Enhanced Structural Adjustment Facility in 1987. Under ESAF arrangements, the Fund extends support for 3-year structural adjustment programmes aimed at fostering sustainable growth and strengthening a country’s external position.

The World Bank, on the other hand, introduced structural adjustment loans (SALs) in addition to its traditional project and programme credits in 1980. SALs were conditional on the willingness of the recipient member country to implement a structural adjustment programme acceptable to the Bank. With the introduction of SALs and the SAF and ESAF, the two Bretton Woods institutions abandoned the traditional division of work between them and moved closer together as regards lending criteria. “One result has been that the criticism of stabilisation of adjustment programmes is no longer being directed only at the IMF but the World Bank as well” (Shams, 1988:208). Structural adjustment, however, does not mark the beginning of the Bank’s policy-influencing role. From its inception, the World Bank has played that role in various ways, including studies and economic research, technical expertise transmitted through project lending, discussions with borrowing members and a combination of policy dialogue and informal conditionality backed by the threat of restricting its credit volume (Kapur, 1997:128).

Structural adjustment differs in two respects from the past lending modalities: (1) the distinctness with which it was anchored in balance of payment of borrowers and (2) the explicitness and detail of conditionalities.

Although conditionality has always been a key element of World Bank loans, the structural adjustment lending introduced a much greater formalism and a greater commitment to enforce them (Kapur, 1997:128).

The conditionalities imposed by the World Bank increased significantly as time went by. Some SSAPs contain conditions on more than 100 separate items (Sachs, 1998:47). Unlike the World Bank, the IMF, which has been providing conditional loans since 1952, has limited its conditionality agenda with several criteria related to major macroeconomic policy issues. The striking difference of the World Bank’s conditionality policy can be explained by the fact that the Bank’s adjustment operations take place within a much larger sphere, encompassing not only economy in the narrow sense of the word, but also education, health, public administration, etc. Therefore, it can be said that the World Bank has not shown an effort to limit its conditionality agenda.

The overflow of conditionality related to the SALs has been and is being criticised. We will dwell on these criticisms in the following section. It should, however, be stated at this point that a typical World Bank SAL has a limited number of key conditions and many non-key conditions. The key conditions are often stressed by government officials and Bank staff since they are likely to influence stabilisation or adjustment over 2-3 years. The Bank has been inclined to list non-key (desirable) conditions in the description of the loan and the key conditions in the loan agreement (Thomas and Chibber, 1989:28).

4. FACTORS AFFECTING SUSTAINABLE GROWTH UNDER STABILISATION AND STRUCTURAL ADJUSTMENT PROGRAMMES

Countries which are mostly highly indebted and are engaged in the implementation of SSAPs have failed to achieve high and sustainable growth rates during the last decade. Although evidence suggests that "countries that comply with IMF/World Bank programmes seem to outperform countries that do not", it is also true that "even countries in compliance with the programmes have poor to mediocre growth performance" (Sachs, 1998:46).

The poor growth performance of DCs undertaking SSAPs is an outcome of different factors both exogenous, i.e. external to the SSAPs, and endogenous, i.e. internal to the SSAPs. One factor belonging to the first group is the world economic environment which has not been conducive to development. The other is the overhang of extreme external indebtedness which has not been resolved by the SSAPs. The inconsistencies and shortcomings of the SSAPs constitute endogenous factors which have different aspects. Some economists claim that the reason behind the poor growth performance of countries implementing SSAPs lies in the implementation that has fallen short of promise. Therefore, they assert that countries undertaking SSAPs are responsible for the failure of the programmes. This interpretation seems unconvincing. It has been extremely difficult for many DCs to implement SSAPs because those programmes either have not taken into consideration the adverse external factors and/or contain inconsistencies and shortcomings.

4.1. Exogenous factors

In this sub-section, problems emanating from the external environment and the debt overhang will be discussed first. The problem of debt overhang has its origins in the late 70s and early 80s. Therefore, it is treated within the context of exogenous factors, although its development is related to the implemented SSAPs. Problems arising from the structure of SSAPs will be analysed next. Although it is difficult to separate these two types of factors impeding success, it seems more operational to do so.

4.1.1. The world economic environment

"It is hard to envisage growth-oriented stabilisation and adjustment in developing countries without sustained growth of the world economy and favourable external conditions" (UN, 1991:5). The world economy has become highly integrated, especially during the last decade. International trade, capital flows and movements in interest and exchange rates have enhanced interdependence.

Sustainable export-led growth depends on continued expansion of trade and high rates of growth in the world economy. In a scenario of low world economic growth, it is impossible to prevent the decline in commodity prices. It seems also difficult to increase export of industrial goods in an extremely competitive market under the continuing threat of new protectionism.

The world economy, which now seems to be at the edge of a deepening recession, has grown slowly in the 1990s. "Since the beginning of the decade, world output growth has averaged about 2 per cent, compared to the roughly 3 per cent attained during the turbulent years of the 1980s" (UNCTAD, 1997:II). Although it reached 4.1 per cent in 1996 and 1997 according to the IMF figures, it seems definite that it will be well below 3 per cent in 1998.

World trade, on the other hand has displayed a better, yet unsatisfactory performance. During 1980-89, annual percentage change in world trade volume was 4.4. This figure is slightly above 6.7 for the period 1990-97. The highest growth rate was achieved in 1997 when world trade volume expanded to 9.4 per cent. Before the outbreak of the Russian Crisis, the IMF estimated that rate to fall to 6.4 and 6.1 in 1998 and 1999 respectively (IMF, 1998:173).

The expansion of world trade has gone hand in hand with the deterioration of terms of trade for the DCs. In the 1980s, the average annual percentage change in the terms of trade in the DCs was -0.9; in the 1990s it is expected to be -0.6 (IMF, 1998:173). There are several reasons for this decline. On the demand side, it can be said that "the income and price elasticities of world market demand for most commodities traditionally exported by poor DCs are not only low, but even appear to be declining further. On the supply side, the need to earn foreign exchange has intensified, not least owing to high debt servicing obligations" (Zattler, 1989:284).

In the post-Uruguay Round era, it has been feared that the prospects of trade warfare and the threat of protection would not just fade away. Industrial countries, having given up forms of protection already known, were expected to resort to the safeguard, anti-dumping and countervailing measures (Naqvi, 1994:109). It seems that there is sufficient evidence to support that fear.

4.1.2. The external debt overhang

The failure to address the continuing external debt overhang has been a major problem with SSAPs. The heavy debt burden impedes economic growth through several channels. It tends to undermine macroeconomic stability by increasing budget deficits. If debt service is covered by higher taxes instead of increased budget deficit, high taxation tends to weaken growth by introducing serious distortions in the economy, including heightened barriers to trade (via trade taxes), capital flight, tax evasion and reduced work effort (Sachs, 1998:47). If an SSAP to be set in motion is burdened from the outset by a mountain of existing debt, a development strategy based on new borrowing will be blocked, since banks will not be prepared to provide fresh money (Tomann, 1988:206). Restoring creditworthiness becomes a major task of the SSAP in such a case.

The need to reduce the debt burden of the DCs was rejected by the official community in the industrialised countries during the first half of the 1980s. The introduction of debt reduction in the Paris Club and the developments that followed were discussed earlier in this paper. The extension of bilateral debt reduction has been a positive development in this respect. Introduction of multilateral debt reduction is the next step to follow it.

It should be considered that excessive demands for debt servicing can damage creditors as well. Such demands may lead to adverse consequences for growth in the debtor countries which can reduce the present value of debt servicing in the future. External debt burden should be reduced to levels consistent with high and sustained growth in the poorest countries. In this connection, standards for judging the sustainability of the debt burden should be modified first. The standard IMF procedure makes an estimate of the "import needs" of the country and then estimates the likely exports and the anticipated inflows of foreign capital. This is insufficient because the private capital inflows to industry may be large enough to close the balance-of-payments gap, but the government may lack the revenues to service its own debt. Debt sustainability should be judged mainly according to the fiscal burden of debt servicing rather than export-related indicators. A fiscal test, accompanying a balance of payments test, based on fiscal consequences of the debt burden, should be established. Such a test should give due attention to government expenditures consistent with non-inflationary financing, taxation rates consistent with rapid growth and debt reduction necessary to achieve these goals. It is also asserted that bankruptcy law provides a useful analogy to the issues of sovereign debt reduction (Sachs, 1998:49-52).

4.2. Factors related to methodology and design

The realism of an SSAP is the major factor affecting its success. Realism involves the correct evaluation of the socio-political and economic constraints, the magnitude and distribution of the costs of adjustment, on the one hand, and the magnitude and distribution of the benefits of the adjustment, on the other. The main factors arising from the general structural characteristics of SSAPs will be discussed below.

4.2.1. Socio-political and institutional setting

The success of a realistic SSAP depends primarily on its ownership. "Even the best policy package cannot succeed in a country if the Government in charge of its implementation does not see the package as expressing its own intent" (UN, 1991:9).

Adjustment programmes subject governments to a series of pressures from different segments of society. "Those pressures usually stem from at least three sources: beneficiaries of the status quo, transient bearers of the burdens of adjustment in terms of output losses, sectoral unemployment and investment disallocations and, of course, sceptical critics whose voices gain resonance with the time elapsed before the results are recognised as beneficial" (UN, 1991:10). Therefore "the governments' commitment to reform and the support they receive from important social interest groups can be regarded as the deciding factor in the success of reform programmes" (Zattler, 1989:283).

Measures to eliminate economic imbalances must tend to be directed against the beneficiaries of the status quo. Thus, it is asserted that the economic crisis inevitably has political implications and its solution requires the formation of political alliances (Zattler, 1989:283). Although it is not easy to make generalisations, demand-depressing measures like cutbacks in government expenditures, drastic switch from food production for domestic consumption to export crops, the impact of relative price change ensuing currency depreciation and the reduction of employment at the stabilisation stage mostly affect the poorest segments of the society, often leading to social upheavals and the abandonment of the SSAPs pursued. It is quite clear that, even if the related government succeeded to continue implementing the SSAP, it would most likely fail due to the deterioration of the country's human capital. "Therefore measures to prevent negative effects of the programme for lower income groups should be reckoned among the programme costs in order to stop such effects from developing into a strong political coalition against the programme" (UN, 1991:11). The World Bank's formulation of a social policy that is integrated to its financial and economic reform policies, with a clear definition of the social sector and specified priorities and encompassing agriculture and rural development, can facilitate the implementation of the stated measures.

There should be coherence in SSAPs between short to medium-term stabilisation objectives and the long-term development objective which entails building required institutions and enhancement of abilities to learn, adopt new technologies and manage complex organisations. The efficiency of public administration should be raised and bureaucracies restructured (Lipumba, 1995:35). "Smaller state, bigger private sector" overlooks the fact that the "enlarged state sector" may perform important functions in some societies (Zattler, 1989:283). Therefore, the analytical division into state and private sector is not very helpful.

4.2.2. The conflict between stabilisation policies and growth

The first step on the road to macroeconomic stability is usually fiscal adjustment. Since countries embarking on adjustment usually suffer from external (balance of payments) and internal (budget) deficits, and because fiscal policy plays a key role in the elimination of those deficits, reduction of the budget deficit constitutes the core of stabilisation programmes. However, the quality of fiscal adjustment, which defines the way of reducing the budget deficit, may adversely affect long-term growth. In fact, all demand-reducing policies —including restrictive credit policy— put into implementation to curb inflation and restore confidence in the domestic money, may result in declines in income and production and may dampen entrepreneurial expectations and response to adjustment policies.

The more the reduction in budget deficits is achieved by cutting spending on non-traded goods, the more the fall in the level of output will be. This outcome also means that it will not be possible to achieve the balance of payments target. "This may especially be true for cuts in government expenditures, as these outlays are usually more directed towards domestic supply. The supply reduction can ask for further demand reductions and there is the risk of a vicious circle of decline in production and cuts in demand. In this way, the economy could get stuck in a low investment equilibrium, because of insufficient investment as a result of self-fulfilling pessimism" (Zattler, 1993:296).

The decline in public investment, arising from the programme conditionality which sets limits on overall budget deficits, has led to adverse consequences, jeopardising long-term growth. First of all, cuts in public investment may exert a formidable impact on private investment, as has been witnessed in sub-Saharan Africa during the '80s. Large cuts in investment infrastructure typically have such an effect. Secondly, persisting high debt service puts a constraint on resources available for investment and discourages private investors. Consequently, the overall credibility regarding the unsustainability of the reforms may be damaged. As a result, the business sector often starts to use resources mainly for non-productive quick-turnover activities (Zattler, 1993:296).

These shortcomings can be overcome by the adoption of growth-friendly policies (adjustment measures) aiming at stimulating supply response and expenditure switching. However, it is not easy to achieve that, since it takes a shorter time and a smaller effort to reduce absorption than to increase output and because closing of the external deficits is usually regarded as mandatory. Therefore, supply-side measures are put into effect at a time when demand-management policies have already negatively affected profit expectations, investment and production (Zattler, 1993:296).

Experiences have revealed that countries implementing SSAPs reduced their primary fiscal deficits (their overall deficits excluding interest payments) mostly during the initial stage of adjustment. This reflected the urgency of restoring macro stability and was achieved mainly by a reduction of current and capital expenditures. In the second stage, there was a more balanced mix of expenditure reductions and revenue increases. Non-interest expenditures bore the burden of early adjustment because there was only limited scope for raising revenue.

Sharp cuts in capital spending, together with under-spending on operation and maintenance, lead to a reduction in the productivity of public capital stock, while cuts in some other goods and services contribute to a growing imbalance between labour, materials and supplies. Rising costs in the public enterprises may follow and the result may be the self-defeat of overall adjustment.

In order to prevent a failure and/or reduce social costs of adjustment a growth-enhancing fiscal adjustment should take into account the following:

– A core programme of the most important productive activities should be kept out of the austerity measures.

– Expenditures on education and public health increase the quality of human capital which is essential to development. They also reinforce the social safety net; hence, precedence should be given to primary education and basic health care within the context of social public expenditures.

– Reform in the areas of civil service and public enterprises should not wait for the second stage of SSAPs. The fact that these reforms do not make a significant contribution to budgetary savings in the short run is not important.

– An efficient public expenditure management system enables a government to set priorities and then enforce changes in the expenditure composition consistent with these priorities. Therefore, deficiencies in those systems should be eliminated as soon as possible.

– Tax design should take into account the limitations of tax administration. A tax reform, such as the introduction of a value added tax (VAT), requires a well functioning tax administration. Reform of tax administration is, therefore, crucial.

– Broadening the effective base of the tax system, which gives the introduction of VAT a major role, is more operational, effective and just than raising tax rates in most cases. This should be taken into account in the design of a tax reform. The income tax structure should be simple and operational.

4.3. Problems related to sequencing and external liberalisation

In order to attain macroeconomic stability and to make an economy market-oriented and responsive to relative price changes, the sequencing of policy reforms to be implemented was mentioned in the preceding section. It will be useful to summarise them in the sequencing order again as follows (Lipumba, 1995:57).

- Exchange rate adjustment and the liberalisation of domestic product and factor markets.

- Liberalisation of foreign trade by means of removing restrictions on imports of intermediate and capital goods and promotion of exports before the dismantling of quantitative restrictions on imports of domestically-produced consumer goods.

- Liberalisation of domestic financial markets following fiscal adjustment.

- Capital account liberalisation or opening up of capital account transactions for purposes other than promoting foreign direct investment —at a pace depending upon the success of the other policies in promoting growth and exports.

The appropriate exchange rate, suggested by the SSAPs, is a market-determined exchange rate. However, for a country receiving large inflows of short-term foreign capital and/or balance-of-payments assistance, the market-determined exchange rate may still be overvalued and this may prevent the achievement of middle-term external equilibrium. On the other hand, without domestic financial stability, a market-determined exchange rate system may be unsustainable. Large fiscal deficits may cause huge depreciation of the exchange rate which may be considered unacceptable by governments.

The abolition of price controls, which constitutes an important element of the liberalisation of product markets, aims mainly at increasing the competitiveness of export crops. Price controls, implemented by official monopolies in some DCs, have gone beyond those needed for capturing economies of scale in agricultural marketing or for stabilising prices. Therefore, their abolition should be envisaged as part of an outward-oriented strategy trying to increase the responsiveness of certain sectors to opportunities provided by the external sector (Lipumba, 1995:57).

There is a consensus on the fact that liberalisation of foreign trade should follow real exchange rate depreciation and domestic market liberalisation. Liberalisation without real depreciation increases imports that out-compete domestic production and lead to rapid exhaustion of foreign exchange reserves. Trade liberalisation must be implemented in a manner appropriate for the situation of each country. Across-the-board liberalisation of consumer imports can lead to unnecessary de-industrialisation in countries that have a significant industrial base. Dismantling of quantitative restrictions on consumer goods that can be produced domestically should be carried out only after the balance-of-payments position of the involved country has improved (Lipumba, 1995:58). Since it takes longer for exports to respond to domestic liberalisation, and since the deterioration of terms of trade may nullify the gains to be obtained by the rise in export revenues, diversification of export goods and enhancement of competitiveness in export sectors should be viewed as essential elements of a policy promoting exports.

The existence of an institutional framework capable of mobilising savings and channelling them into investment opportunities is more important than the liberalisation of the "repressed" domestic financial markets (Lipumba, 1995:58). The liberalisation of the capital account, on the other hand, poses serious problems, as Latin American and some East Asian experiences demonstrated. If "net capital inflow, succeeding the liberalisation of the capital accounts, falls at some point below the financial requirements of current accounts, reserves will start to decline. The reduction in reserves, through its direct effects on money and credit, and by pushing up the domestic rate of interest, either automatically or as a policy reaction intended to attract foreign capital, will induce recession and might ultimately lead to a run, thereby forcing a devaluation" (Frenkel, 1995:2). The generally speculative and disruptive character of short-term international capital flows, helps transform small economic disturbances into economic crises. These facts should seriously be taken into account in the sequencing of policy reforms in SSAPs.

4.4. Overflow of conditionality and shortness of time horizon

The World Bank's conditionality agenda regarding adjustment programmes has expanded significantly since the end of the 1980s. This expansion has been induced by three factors, namely: (i) increasing influence of non-governmental groups both in debtor and creditor countries, but especially in the latter, resulting in governance conditionality; (ii) criticisms of the World Bank's record on poverty and environment which led the Bank to institute projects with social-safety-net features and then to ratchet up its lending for social sector with the result that the share of social sectors in the total commitments of the Bank, which was 15 per cent in the 1980s, rose to 26 per cent in the first half of the 1990s (Kapur, 1997:130); (iii) the integration of environmental concerns into World Bank operations as a result of critiques quickly expanding from narrow ecological concerns about "human rights" of forcibly relocated people and the modalities employed by the Bank and its borrowers in designing and implementing projects, leading to questioning the development priorities of the Bank and its followers (Kapur, 1997:130-1).

Conditions related to governance have been instituted in the areas of public sector management, accountability, legal frameworks, information and transparency issues. Conditionality with respect to public expenditures has led to reviews of current and capital expenditures and to lending conditions at the level and distribution of social expenditures. Although "there are sound reasons underlying the new agenda, implementation will prove problematic, given that these issues are relatively subjective, discriminatory and politically charged" (Kapur, 1997:127). The overflow of conditionality is also likely to discourage potential borrowers.

Cross-conditionality has been criticised by the Group of 24. The concept refers to the differing opinions between the Bretton Woods Institutions on the need for certain measures and of the timing of their introduction in the adjustment process. Differences of opinion may lead to delays in the design of programmes and the provision of credits by the IMF and the World Bank.

The time horizon of SSAPs has been criticised for being too short to allow the completion of many structural reforms. "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” (Shams, 1988:209).

5. CONCLUSION

Sustainable external and fiscal positions are the most important prerequisites for lasting macroeconomic stability and growth. Most of the SSAPs put into effect during the debt crisis have not succeeded in bringing a durable solution to both external and fiscal imbalances. Generally, stability lasted for short periods because the stabilisation and structural adjustment efforts relied extensively on reductions in government spending and imports, rather than increasing tax revenues and exports. In some DCs, the situation changed drastically in the early 1990s with the massive inflow of short-term capital, allowing both external and internal (fiscal) constraints to be overcome. This development, however, also led to a build-up of large current account imbalances, loss of competitiveness and increasing fragility.

Past experiences have taught us that effective, credible, consistent and lasting policy reforms facilitate the implementation of growth-oriented stabilisation. Therefore, neither curbing inflation through reduction of aggregate demand nor achieving liberalisation and deregulation in conformity with prescribed models necessarily leads to the elimination of macro imbalances and to sustained growth. In fact, those measures most often result in dampened investment, insufficient growth rates and increasing social inequality. In order to avoid such adverse consequences, the sequencing of stabilisation and liberalisation should be adapted to the specific characteristics of the countries concerned.

The initiation of structural reforms should not wait for the reduction of macroeconomic imbalances. Structural policies which rank only third in sequencing—following stabilisation and liberalisation—should be put into implementation simultaneously with stabilisation measures. The establishment of the regulatory framework and the building of required institutions require a long time, thus, work on them should start without delay.

Demand reduction should be achieved by selective expenditure cuts. Socially necessary expenditures and expenditures that enhance productivity increases should —as far as possible— be excluded from those cuts. It has been asserted that broad-based liberalising shocks and convincing cuts in government spending seem to be the only hope for success in stabilisation. But there is enough evidence indicating that slow results and deteriorating credibility of 'big bangs' lead to quick abandoning of policy packages and reformulation of newer ones, leading to little improvement in long-term economic conditions. Therefore, the decision to resort to policy shocks should be taken with extreme caution. Lastly, the formulation and design of liberalisation policies should take due account of the prevailing socio-economic realities. Introduction of internal liberalisation should precede external liberalisation. External liberalisation, starting with the liberalisation of foreign trade, should be implemented step by step and import restrictions should be dismantled only after the balance of payments of a country has improved. The timing of capital account liberalisation should depend upon the success achieved in exports and growth and even then, restrictions on short-term capital flows should be maintained.

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