Structural Adjustment and the Spreading Crisis in Latin America

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INTRODUCTION

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When the bottom fell out of the Mexican peso in December 1994, there was no shortage of intense reaction. Mexico's new president, Ernesto Zedillo, blamed former president Carlos Salinas for not devaluing the peso sooner. The World Bank insisted that the Mexican government, whose economic program the Bank had praised just months earlier as a model for other countries to emulate, had failed to implement the last few crucial reforms in its free-market economic program. Later, the International Monetary Fund (IMF) insisted that the economic collapse had been triggered by the selfish actions of Mexican investors.

In other countries in the hemisphere, the Mexican crisis led foreign investors to panic. Many pulled out their capital, particularly from Argentina and Brazil, and put new investments on hold. Constrictive economic measures taken in the former in order to induce investors to return and to shore up financial institutions have led to protests in most provincial capitals. But Argentina's precarious situation and popular unrest is not unique in Latin America: this year alone, citizens have taken to the streets in opposition to adjustment measures in Costa Rica, Panama, Venezuela, Ecuador, Bolivia and other nations, most notably, of course, Mexico.

The cure prescribed for Mexico and the region's other destabilized economies by the international financial institutions (IFIs) in the aftermath of this shock has been the same medicine that they have taken for as long as a dozen years. It is a prescription that has weakened them at their core and made them dangerously vulnerable to the whims of international investors. Not only have the IFIs and the U.S. Treasury continued to demand government adherence to stabilization and structural adjustment programs, they have reacted to the current crisis by insisting on the more rapid and extensive implementation of these programs and many of their key component measures.

Stabilization and adjustment programs work in tandem. Stabilization measures are short-term actions designed to bring down inflation and help countries improve their balance-of-payments situation. They often involve deep cuts in the money supply (e.g., by restricting credit) and a large devaluation of the local currency. Stabilization is usually followed by longer-term policy changes that together constitute "structural adjustment".

Structural adjustment programs (SAPs), principally a policy tool of the World Bank, but one also utilized by the IMF, other multilateral development banks (MDBs) and bilateral aid agencies, generally entail the privatization of state-owned enterprises, the reduction of government expenditures, and the liberalization of trade regimes. They are intended to open the economy to increased foreign investment -- attracting foreign capital by deregulating markets and offering low wages and high interest rates -- and to encourage other private-sector activity, including the expanded production of goods for export.

Stabilization and adjustment programs pushed on countries badly in need of international financing have, in some cases, helped to tame inflation and effect some measure of economic growth, albeit usually uneven and unsustained. In almost all cases, however, they have depressed wages, undermined rural livelihoods, increased poverty, and further concentrated income. Nowhere have the polarization of society and the unsustainability of this economic model been so vivid as in Mexico, which became overly dependent on imports and foreign capital while sacrificing the development of its own local productive capacity.

Yet, there have been even greater economic and social disasters in Latin America, foremost in Nicaragua, which has suffered under a donor-financed adjustment program since 1990. Meanwhile, in the Andean countries, small farmers, squeezed by adjustment policies, have turned to producing coca to survive. Even historically democratic and stable Costa Rica has seen a steady deterioration of economic and social conditions during its dozen years under adjustment. Poor women, workers, small farmers and businesspeople, and many in the region's middle class, who have borne the consequences of the economic-reform programs, were warning of growing economic and social polarization in their respective countries as early as the mid-1980s.

By the '90s, investors and politicians in the region were also becoming increasingly concerned about potential crises and instability in most Latin American nations. Nonetheless, the World Bank, the IMF and Northern finance ministries have substantially succeeded in preventing an examination of the relationship between economic adjustment programs and the social and economic problems they have repeatedly left in their wake. While additional social spending has once again been proposed as a means of mitigating the effects of adjustment programs, the principal measures in the adjustment package -- trade liberalization, privatization, deregulation, credit reduction, wage suppression -- are not on the table for discussion in most official forums. Yet, to take effective action to address the growing poverty, unemployment and disintegration of societies throughout the Americas without a critical examination of the economic programs that have been in place for a decade or more and without a serious exploration of policy options is clearly impossible.

Therefore, as part of the now broad-based citizen effort in the hemisphere to highlight this ever-deepening economic and social crisis that is characterizing the last years of the 20th century, we offer the following brief case analyses of structural adjustment programs and their economic and social effects in five Latin American countries. In the cases of Mexico and El Salvador, we have incorporated the incisive grassroots analysis of close local partners, updating a jointly published, prophetic report by Equipo PUEBLO in the former and summarizing FUNDE's extensive recommendations for change in the latter. Field-based research also provided the core of the analysis in the Nicaragua, Costa Rica and Bolivia studies, and we thank our colleagues in those countries, as well, for their assistance in the preparation of this document.

We hope that, in making our own contribution, we have done justice to the dramatic and distressing story of the Latin American people struggling under structural adjustment.

Doug Hellinger
Karen Hansen-Kuhn

STRUCTURAL ADJUSTMENT IN MEXICO: The Root of the Crisis

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by Carlos Heredia and Mary Purcell
Equipo PUEBLO

The economic and social crisis gripping Mexico today began some thirteen years ago when the Mexican government, confronted with a massive foreign debt, implemented a set of structural adjustment measures promoted by the World Bank and the International Monetary Fund. Those policies, intended to control inflation and generate foreign exchange to help pay off the debt, resulted in increased unemployment, poverty and economic polarization. By steadily tearing away at Mexico's economic and social fabric -- and particularly at the well-being of its small rural and urban producers -- they set the stage for the economic collapse of December 1994.

Even then, the Clinton Administration, the IMF and the Mexican government refused to address the failure of the economic model. To the contrary, they designed a US$51 billion bailout package that, by further entrenching the very policies that caused the collapse, has plunged the country into an economic depression.

The further tightening of credit, suppression of wages, cuts in social spending, and liberalization of trade and financial markets have intensified the decline of local productive capacity, deteriorated the welfare of the vast majority of Mexicans, and increased the country's dependence on foreign capital, imports and markets. Social and political tensions, manifested most dramatically in the Chiapas crisis, threaten to tear the country apart as its economy founders.

Since the onset of the crisis in December, the Mexican stock market has fallen 35 percent and the peso has lost half its value vis-a-vis the dollar. Annual inflation will reach nearly 50 percent this year. With consumer interest rates at 80 percent, businesses and individuals are finding it impossible to pay back loans, and major banks are going under. Nearly two million workers have lost their jobs as factories and other businesses fail or severely cut back production. Sales of basic goods in supermarkets are down by 25 percent, construction has fallen by 35 percent, department store sales have dropped by 40 percent and sales of new cars are down 67 percent.

The Crippling Effects of Structural Adjustment in Mexico

From 1982 right up to the economy's collapse in late 1994, the Mexican government implemented virtually all of the adjustment policies promoted by the World Bank and the IMF: reductions in public expenditures (including social services); elimination and/or targeting of subsidies; tax reform; restriction of credit; privatization of most state enterprises; trade liberalization; devaluation; removal of barriers to foreign investment; and "competitive" wages. Privatization and deregulation contributed to a steep concentration of income and wealth, a trend that ran counter to the imperative of creating a strong domestic market as a factor in ensuring sustained economic growth. In what analysts term a "trickle up" process, there was, in Mexico, a massive transfer of resources from the salaried population to owners of capital, and from public control to a few private hands.

<u>Health and Nutrition</u>. One of the first adjustment policies implemented was a drastic cut in public spending. In general, adjustment suggests the cutting of "non-productive", or primarily social, spending so as not to affect output or revenues. Thus, during the decade of the eighties, the health budget as a percentage of overall public spending fell from 4.7 percent to 2.7 percent. The World Bank acknowledged in a 1990 staff appraisal report that the Mexican government "...may be under-spending on health care," but because of the need to control public spending the Bank argued that it was necessary to look for alternative sources of financing, "...including the possibility of privatizing health sector activities such as curative services." The poor who rely on these services are hardest hit by such cuts, since they cannot afford private alternatives. One result was that between 1980 and 1992 infant deaths due to nutritional deficiencies almost tripled to rates higher than those in the seventies. In September 1995, the Salvador Zubiran National Institute on Nutrition reported that 80 children under the age of one die each day in Mexico due to malnutrition. With 30,000 such deaths each year, Mexico is near the bottom of UNICEF's rating of countries' efforts to address malnutrition. The only countries with a greater rate of infant mortality are at war.

<u>Squeezing Small Producers</u>. Meanwhile, trade-liberalization and restrictive-credit policies were undermining many domestic small industries and agricultural producers who were unprepared for the dropping of trade barriers and unable to compete with cheap imports. Many of them went out of business or turned into retailers for U.S. manufacturers. This situation has been

exacerbated as interest rates have skyrocketed in 1995 and priority access to the limited credit that is available is given to producers with export potential. This credit structure has reinforced monopolies in the Mexican economy and is now devastating micro, small and medium-sized businesses, more than a third of which have not survived the current crisis. Sixty percent of these smaller enterprises, which historically employ 80 percent of the country's labor force, have laid off workers in 1995. Even before the peso crash and the bailout program, those who could get credit faced extremely high real interest rates, maintained in an effort to attract foreign investment and prevent capital flight.

Unemployment. Mexico had been cited by the World Bank as a successful example of a country where adjustment has included a real wage reduction in order to prevent massive unemployment. However, in a 1991 study, the Labor Congress (CT) indicated that, out of an economically active population of 34 million, 15 percent were openly unemployed, and over 40 percent -- some 14 million people -- were underemployed. According to the United Nations' Economic Commission for Latin America and the Caribbean (ECLAC), Mexico is the rare case in which the economy is marked by an inverse relationship between investment and employment. While the former has increased by nine percent from 1992 to 1994, the creation of new jobs went down. Furthermore, every day since January 1995 an average of 7,933 people have lost their jobs. The government only measures urban unemployment, while the problem is thought to be greatest in rural areas. But even by government figures, unemployment has risen by 106 percent since the start of the Zedillo administration in December 1994.

Declining Wages. Mexico witnessed a steep and continual decline in real wages during the eighties alongside massive layoffs and high levels of unemployment. By mid-1994, the minimum wage in Mexico was the equivalent of US$4.42 per day. According to a study by researchers at the Faculty of Economics of the National Autonomous University of Mexico (UNAM), from the initiation of the government's Pact with business and labor in December 1987 until May 1994, the minimum wage had increased by 136 percent, while the cost of the Basket of Basic Goods had grown by 371 percent. Official government figures show the minimum wage lost 53 percent of its purchasing power between 1982 and 1988, another 28 percent from 1988 to 1994, and an additional 13 percent during only the first four months of 1995.

Growing Poverty. The World Bank estimates that the number of Mexicans living in poverty grew by an average of 660,000 during each of the past fifteen years. The United Nations Population Fund says that the number living in poverty is growing by 1.2 million annually. According to a 1992 study commissioned by the government's primary anti-poverty agency, Pronasol, about one half of all Mexicans lived in poverty in 1990 (42 million) and 18 million lived in conditions of extreme poverty. The study goes on to say that "... if the poverty figures are frightening, their consequences should be even more frightening... Malnutrition has become the normal condition of society..." A recent study by the newspaper El Financiero revealed that the intensified adjustment program of 1995 had caused the ranks of those classified as "extremely poor" to swell by 2.193 million by August of this year.

Skewed Income Distribution. Over the past decade, the already large gap between the rich and the poor in Mexico has widened. The richest 20 per cent of the population received 54.2 per cent of national income in 1992, against 48.4 per cent in 1984. The income of the poorest 20 per cent fell from five per cent in 1984 to 4.3 per cent of national income in 1992. To illustrate the extreme concentration of wealth and income, the wealthiest Mexican, Carlos Slim, the owner of Teléfonos de México, is said by Forbes magazine (18 July 1994) to be worth 6.6 billion dollars. At the other extreme, about 20 percent of the population -- 17 million people in extreme poverty -- subsist on incomes of less than $350 per person per year. In other words, the assets of the richest man in Mexico total more than the annual income of the poorest 17 million people combined. Slim is not an isolated case: during the Salinas Administration the number of billionaires in Mexico rose from two to 24.

These effects of structural adjustment have been felt in urban and rural areas throughout Mexico. The plight of peasants and food producers in Chihuahua and of women in the San Miguel Teotongo slums of Mexico City are but two of the many examples of how profoundly these economic policies have affected the lives of Mexicans at the community level.

Structural Adjustment in Rural Mexico: The Case of Chihuahua

Bordering on the United States, Chihuahua is one of Mexico's largest states, with a population estimated in 1990 to be 2,441,873. Its rain-fed agriculture is dedicated primarily to the cultivation of corn and beans, two staples of the Mexican diet. Peasants generally grow these crops for their own consumption and to supply the urban population in the city of Chihuahua.

Although adjustment has proceeded more slowly in the agricultural sector than in other areas, by 1992 the Salinas administration had utilized a variety of adjustment policies to transform the agricultural sector into a more efficient producer for the international economy. Mexico received an Agricultural Sector Loan (ME-2918) from the World Bank in 1988 that guided agricultural reforms for two-and-a-half years. The overall objectives of the program were to:

1. remove global food subsidies and target remaining food subsidies to the poor;
2. reduce government intervention in agricultural markets, in part by moving from guaranteed prices for grains (corn and beans excluded) toward market-determined pricing;
3. abolish export controls and quantitative restrictions on key products;
4. reduce the role of agricultural parastatals;
5. liberalize agricultural trade;
6. cut the subsidization of inputs;
7. increase the efficiency of public investment in agriculture in real terms; and
8. decentralize and cut staff of the agriculture ministry.

In addition, other sectoral loans making up part of the adjustment "package" directly affected Chihuahuan corn and bean producers. For example, the Bank, through a financial-sector loan, sought to reduce subsidized credit from development banks; a trade liberalization loan was linked to a reduction in tariffs on agricultural imports; and a fertilizer sector loan required the internationalization of fertilizer prices. Together, these loans have led to a comprehensive restructuring of the agricultural sector.

The loan programs have reduced credit to small grain producers, eliminated farm-input subsidies, reduced or eliminated guaranteed prices, and further liberalized trade. Their effect has been to stimulate the large-scale production of export crops and reduce support for the production of basic foods, with import-tariff reductions resulting in a surge of cheap imported basic grains with which the farmers cannot compete. While increasing the cost of farm inputs, they have at the same time decreased the price of basic grains.

Faced with such drastic cuts in credit, the peasants of Chihuahua have been forced to seek various forms of supplemental financing. This may entail the selling off of livestock, though, more commonly, family members are forced to work in the cities, in the maquila industries, for large landholders, or in the United States, creating more financial problems on the farms because of the loss of free family labor. In fact it is becoming more and more difficult to find a family that does not have at least one relative working in the United States and sending money home. The situation of Martha Hernández de González is typical:

My husband is always here during planting season, but the rest of the year he spends working in the United States. He and four children in Texas, Florida, Colorado and New Mexico take care of all the family expenses and they take turns helping with the planting. When we are short of money, my husband and my children are contracted to work in the apple orchards or to do some other work in the countryside.

The adjustment policies have thus resulted in decreased peasant production and productivity and a further concentration of land ownership. A vicious cycle of decapitalization, low productivity, decline in incomes, deterioration of living standards, and migration is repeating itself. The overall quality of life in the state has deteriorated.

It is clear to many that the government is attempting to slowly force small farmers out of corn and bean production. However, no practical alternative has been offered. Officials at the World Bank recommend that these producers move on to more productive activities or to crops "like strawberries". Aside from the fact that strawberries cannot be competitively produced on these lands, such a transition would require financing, training, and technical and marketing assistance, and very little government support is available in any of these areas. Without comprehensive programs to assist in the restructuring of economic activity, current economic policy will only lead to increased poverty and migration to the cities.

The Impact of Adjustment on the Urban Poor: The Case of San Miguel Teotongo

As opportunities have diminished in the countryside, Mexicans have increasingly moved to the cities in search of a better life. Although poverty is most severe in rural areas of Mexico (due largely to decades of an urban bias in public policy), it is broadly believed that the urban poor have been hit hardest by the adjustment process. They constitute the group that relies most heavily on wage employment, consumer subsidies and public services -- all of which have declined under adjustment.

The community of San Miguel Teotongo is located in the Iztapalapa district on the eastern outskirts of Mexico City. Iztapalapa is the largest and one of the poorest districts of the metropolitan area. San Miguel was settled in 1972 by poor families that left the center of the city because of high rents and overcrowding. Since then, San Miguel has grown rapidly to a population of close to 80,000 today.

Three sets of adjustment policies have had the greatest impact on the residents of San Miguel Teotongo: the reduction of real wages and reduced public investment; cuts in subsidies and the liberalization of prices; and cuts in public services. The effects of these policies include: a reduction in real income and purchasing power; an increase in the importance of the informal economy and family labor; an increase in the relative price of many basic goods and services; and a reduction in the quality of public services while their costs increase.

Declining real wages and job opportunities are the most serious problems faced by families in San Miguel Teotongo. A central feature of the government's stabilization and adjustment program has been the reduction of real wages, while declining investment, the growing privatization of the economy, and public-sector cutbacks (all part of adjustment) have led to fewer employment opportunities. In general, families in San Miguel are working harder and longer for less income today than 12 years ago.

Nationally, decreases in wages have occurred at all salary levels, but losses have been greatest among the lowest wage earners. Considering the 67 percent loss in purchasing power of the minimum wage between 1982 and 1991, workers should be making three times the minimum wage just to stay even. With only 5.7 percent of the workers surveyed in San Miguel in 1993 earning more than twice the minimum wage, it is clear that there has been a substantial decline in overall family and community purchasing power. According to national poverty indicators, 67.9 percent of the population of San Miguel Teotongo lives in poverty.

The decline in real wages has been accompanied by an increase in prices. Studies show that the prices of basic foods have risen even faster than those of many other consumer goods. Since food is the primary expense of poor households in San Miguel, the latter are severely affected by such price rises. Increases in food prices are the result of the reduction or removal of subsidies and the liberalization of the basic-foods market. Both of these policies were mandated under adjustment. The "canasta básica" (the basket of basic goods deemed necessary for a family of five) cost 46 percent of the minimum wage in 1983, 81 percent of the minimum wage in 1988, and 61 percent *more* than the minimum wage in 1992. Today, the same "canasta básica" costs four times the minimum wage.

The trends in education in San Miguel reflect what is happening nationally. Most children complete primary school, but increasing numbers of secondary-school-aged children are dropping out. One of the stated goals of SAPs regarding education is the transfer of government resources from higher education to primary education. However, between 1982 and 1990, the education budget fell from 5.5 percent of GDP to 2.5 percent. As public spending declined, the cost of books and materials increased. As a result, the cost of sending children to school is often prohibitive for poor families, and economic crises frequently force even young children to work. The impact has been felt by many in San Miguel, including Gloria Bautista:

I have six children. My two oldest dropped out of secondary school after the first year. We couldn't afford to buy the books and they got bored. Now they help with family expenses by doing odd jobs in the street... It's a problem because they aren't old enough to work legally, so they are paid almost nothing...

In 1970 the Mexican government adopted the goal of providing health care to the country's entire population by the year 2000. Adjustment, however, caused sharp reductions in overall health-care spending during the eighties. Subsequent spending increases have been significant, but they still have not compensated for the earlier cuts. In theory, all Mexicans are covered by some type of health care program. In practice, however, very poor or non-existent service, exacerbated by budget cuts in the 1980s, has meant that many poor Mexicans do not have access to adequate health care through public institutions. They either go to private physicians or they do not go at all. This is the case in San Miguel, which, like so many other communities, is lacking in health centers.

Today in San Miguel, families must work harder and longer hours to make less money and to purchase more costly goods and services. Items such as books and health care are cut out of their budgets under these circumstances. Food consumption is cut back and consumption patterns change, with a variety of nutritional foods being replaced with less expensive, and often less nutritional, foods.

Conclusion

The economic collapse of December 1994 generated headlines around the world, but the problems associated with the economic course chosen by Mexico were apparent well before then. While the World Bank and the IMF were applauding Mexico's economic performance under adjustment, one half of the population was living in poverty and their ranks were swelling daily.

The removal of government from most areas of economic planning left the future development of the country principally in the hands of the market. This change has helped generate even greater profits for a relative few, but it has not addressed structural problems blocking long-term participatory and sustainable development. The case of Mexico is a clear lesson that success in the achievement of some macroeconomic indicators of "success" does not necessarily translate into the improved social well-being of the population. The pursuit of economic efficiency and short-term profits overrode concerns about greater equity, leading to an increased economic polarization of society.

Even before the current crisis, structural adjustment in Mexico had resulted in:

1. high unemployment and underemployment;
2. a worsening of the already steep concentration of wealth and income;
3. a deteriorating physical and social infrastructure;
4. a continued disequilibrium in the trade balance and in the current account of the balance of payments;
5. a greater dependence of the economy on external financing; and

6. the absence of an authentic political consensus around the consolidation of adjustment policies.

The distribution of the costs of adjustment was very unequal. The Salinas government deliberately chose to compress salaries, with the supposed purpose of maintaining the competitiveness of Mexican exports. This policy led to the over-exploitation and a deterioration in the quality of the labor force. Furthermore, even with extremely low real wages, unemployment and underemployment remain high.

The net effect of the adjustment program on the population groups that are the focus of this study is extremely negative. Not only has adjustment not contributed to laying the groundwork for an improvement in their standard of living, but it has threatened their very livelihood. Small farmers in Chihuahua have seen the prices of their products go down while the prices of their inputs have increased substantially. The residents of San Miguel have seen prices rise much faster than wages, while social services decline in quantity and quality. Many have been cut out of subsidy programs and forced to supplement family income in any way possible.

What has been lacking throughout the adjustment process in Mexico is a social and economic policy that truly puts people first. Needed in particular is an income-generation policy that more fully incorporates the poor into the national economy. Nevertheless, both the Mexican government and the IFIs continue to support an economic program that has more to do with bailing out commercial banks and foreign investors than with addressing the people's needs.

Mexico is one of many cases worldwide where adjustment and the free market have not only failed to alleviate poverty, but have further polarized the country and led to disaster, economic and social. World Bank and IMF officials continued to say -- right up to the current crisis -- that adjustment's attack on poverty would take time, but, after more than a dozen years of adjustment in Mexico, things have never been worse than they are today, and there is no light at the end of the tunnel. There must be a point at which these institutions acknowledge that their strategy has failed and needs to be abandoned, and that a new, more democratically determined approach to the country's development has to be taken.

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STRUCTURAL ADJUSTMENT IN NICARAGUA: Tearing the Economic and Social Fabric

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by Karen Hansen-Kuhn
The Development GAP

The 1990s have been a time of transition for Nicaragua. With an end to the contra war and the U.S. economic blockade, a new government took office in 1990 with very different goals than those of the previous, Sandinista administration. While the government of President Violeta Chamorro has actively promoted programs of political reconciliation and reactivation of the war-torn economy, it has also committed itself to the promotion of free-market economic policies that have undermined the achievement of these goals. The evidence to date is that, instead of promoting reconciliation through economic development, the structural adjustment policies insisted upon by the World Bank, the International Monetary Fund and the U.S. Agency for International Development and implemented by the Chamorro government since 1990 have increased poverty and unemployment and deepened political rifts in the society.

Background

Nicaragua entered the nineties with an economy in crisis. The Sandinista government had attempted to establish a mixed economy, balancing production by the state with that of the private sector, including small producers, while placing a heavy emphasis on improving the social and economic conditions of the poor. The results of the Sandinista program were similarly mixed: there were some impressive achievements, such as improved literacy rates, but there were also significant problems, including an overemphasis on large state-run projects and a price-control program that generated tensions between urban and rural workers. By 1987, with decreases in international coffee prices and skyrocketing military costs associated with the contra war, the Sandinistas felt compelled to introduce a series of stabilization measures to reduce hyperinflation and restore macroeconomic balance.

This program, not unlike stabilization plans promoted by the IMF, involved substantial cuts in government spending on social services and on public employment and investment. Unlike standard stabilization programs, however, the Sandinista plan was implemented without funding from the international financial institutions. While it initially succeeded in lowering inflation rates, by the time of the 1990 presidential elections hyperinflation had returned and general economic prospects were bleak.

Foreign Management of the Economy

Upon assuming the presidency in April of that year, Violeta Chamorro implemented a new stabilization program that included the introduction of a new currency, further cuts in government spending and a restriction of credit. Over the next year, this program was intensified and expanded as a condition of IMF short-term financial support to the government (through a Standby Agreement), an Economic Recovery Credit (ERC) from the World Bank, and bilateral funding from the United States and other Northern governments.

With Nicaragua ineligible for new loans from the IFIs in 1990 due to debt-payment arrears, USAID became intimately involved in the design of an expanded economic adjustment program. USAID's second Stabilization and Recovery package, granted that September, committed the Nicaraguan government to begin the process of privatizing the economy and adopting other adjustment measures in advance of IFI financing, which came a year later along with an intensification of the country's stabilization program. The new structural adjustment program also included a further reduction in public-sector employment, as well as trade and financial-sector liberalization. These measures were intended to hold inflation to single-digit rates, to save foreign exchange so that the country could resume payments on its foreign debt, and to substantially reduce the role of the state in the economy by selling off state-owned enterprises and reducing government spending.

Policy-Induced Depression

The major achievement of the stabilization and adjustment programs to date has been the reduction in inflation, which fell from over 13,000 percent in 1990 to 12 percent in 1994. Other macroeconomic indicators, however, reflect the heavy cost of those policies. In effect, the inflation rate dropped because of a deep, policy-induced economic depression. GDP per capita in 1993 fell to 71 percent of the 1985-1989 average, while investment decreased to 63 percent of the average during the late 1980s. While real GDP did increase 3.2 percent in 1994, the highest rate in the last ten years, growth in GDP per capita was flat.

As part of the stabilization and adjustment program, credit to the agricultural sector was slashed by 62 percent. New bureaucratic requirements and very high interest rates have meant that small- and medium-scale farmers have been especially hard hit by these cuts, with many small farmers forced to produce subsistence crops using environmentally unsustainable "slash and burn" practices. The high interest rates have also led many large producers to shift to low-risk cattle production. Industrial production has also dwindled since the adjustment program began. High interest rates have favored speculative short-term investments, particularly in imports of luxury consumer goods, over productive investment. Average industrial production since 1990 is 14 percent less than during the 1985-1989 period, which itself was a time of economic slowdown.

The trade deficit increased from US$304 million in 1989 to US$433 million in 1994 as imports increased after trade liberalization, while production for export has grown more slowly, despite a sharp increase in coffee prices and prices on a few non-traditional exports. This burgeoning deficit, which could grow even more rapidly in the future if coffee prices fall once again, has been financed not by new investment but by extraordinary foreign aid flows totaling over US$3 billion in grants, new loans, and debt cancellations and rescheduling. These resources are now rapidly dwindling, but between 1990 and 1993 over one-third of the aid received in cash was used to pay foreign-debt service, and nearly all of the rest went to finance the trade deficit. In 1994, 73.4 percent of the foreign exchange entering the country was used to service the foreign debt. Nicaraguan economist Oscar Neira explained, "The profound defect of the adjustment program has been its favoring of disproportionate debt payments at the cost of productive use of foreign resources."

Nicaragua continues to have one of the highest per capita debt burdens in the world. In 1994 its foreign debt totaled nearly US$11 billion. Despite the clear need to redirect resources to the local economy rather than to foreign creditors, Nicaragua was granted only debt rescheduling at the March 1995 Paris Club meeting of many of the country's creditor governments, with no reduction in the stock of debt, along with lectures on the virtues of continued adherence to the structural adjustment program and the need to resolve the property-rights problems. While this rescheduling will in fact alleviate some balance-of-payments pressures, continued adherence to the adjustment program, which has produced high domestic interest rates and limited credit availability for local production, makes it unlikely that the Nicaraguan people will reap any benefits from this concession in the foreseeable future.

A Social Disaster

While Nicaragua's economic performance during the 1990s under adjustment has been dismal, the deterioration in social indicators has been more distressing. As a result of massive public-sector layoffs and economic slowdown, over two-thirds of the population is either un- or underemployed, and the problem only continues to grow. Over 285,000 public-sector workers have lost their jobs since 1990, forced to enter the private sector just as employment opportunities were at their lowest.

Women have been especially hard hit by adjustment policies. Over 70 percent of those laid off from government jobs during the first year of the program were women. According to a study by economist Nan Wiegersma, women were also hurt disproportionately by the privatization of state-owned enterprises. In addition, the poorly capitalized garment and textile industry, which alone employed nearly ten percent of Nicaraguan women working outside the home, has been replaced for the most part by maquiladora factories operating in free-trade zones. There are increasing reports of poor working conditions in the maquiladoras, as well as an age-bias in hiring decisions, with many of these new factories refusing to hire women over 35 years old. Hence, women who have lost their jobs because of privatization are often forced to turn to employment in the already overcrowded informal sector. The Nicaraguan research center, FIDEG, found that 75 percent of salaried women have experienced job losses or cuts in wages, benefits and work hours compared to 65 percent of men.

The purchasing power of wages for those people fortunate enough to find employment has also fallen. In 1993, real wages were just 59 percent of their level in 1980. In early 1991 the average wage covered 92 percent of the cost of a "basket" of food and other basic necessities; by 1993 it covered just 70 percent of those needs. According to the United Nations, 75 percent of Nicaraguans now live in poverty.

The severity of this social impact is due in good part to the tremendous contraction in production. Increasingly, workers unable to find work in either the agricultural or industrial sector are forced to turn to the swelling informal sector for employment. With wages and employment declining, many families throughout the country have simply been forced to eat less: per-capita consumption of corn was down 16 percent in 1993 from 1990, and bean consumption dropped 14 percent during the same period.

The Public Responds

Nicaraguans have not reacted passively to these changes. Since the first stabilization plan in 1990, there have been a series of public strikes and demonstrations protesting the measures. An August 1994 transportation strike protesting hikes in fuel prices, for example, effectively halted the distribution of goods within the country for eight days.

The economic recession and high unemployment rates have also contributed to increasing political polarization in Nicaragua. As the war ended, the contras were demobilized and the Sandinista army was cut from 96,000 in early 1990 to less than 17,000 by the end of 1992. The ex-combatants on both sides were promised access to land, credit and other resources so that they could reintegrate themselves into productive life. Unfortunately, due to the economic contraction and cuts in government spending under the adjustment program and to continuing conflicts over land titles, these promises have been largely unfulfilled. Many former combatants have taken up arms again to demand that the government honor its commitments. In April 1992, ex-contras and ex-Sandinista soldiers even joined together in these actions.

More often, however, the two groups have separately invaded farms, cut off transportation in and out of cities or taken prisoners to publicize their demands. For example, the Frente Norte 3-80 (FN 3-80), a group of former contras, launched a military offensive in February 1994 that resulted in more than 50 deaths. While the group has called for political changes regarding the country's military structure, most of the FN 3-80's demands have centered on the need for social and economic assistance for ex-combatants. A peace accord was reached in late February, but some of these ex-combatants, skeptical of new government promises, continue to fight for what they consider to be their rights. In a public declaration issued two months later, the rebels stated, "We are not asking for charity; we only want to be equipped to be able to work. We have a right to this... We favor a peaceful solution, but if the army wants war, they will get it."

Political instability has taken other forms in rural areas, as well. During the first half of 1994, police reported that over 400 agricultural producers in the north of the country had been victims of kidnapping by armed groups. This violence, combined with increasing crime throughout the country, has further depressed economic activity.

The Government Reacts

In response to these actions and the growing public outcry against the continuing economic crisis, the Nicaraguan government has attempted to construct a consensus around its economic program. Several rounds of negotiations have been held with ex-combatants, unions and other groups. In early 1994 several non-governmental organizations and academic groups were included in a series of consultations on the second adjustment loans from the World Bank and the IMF.

These consultations, however, have generated more cynicism and distrust than consensus. NGOs, many of whom came to the sessions with their own analyses and alternative proposals, reported that the meetings on the adjustment package were little more than briefings on the programs planned by the Bank and the Fund with scant opportunity for constructive dialogue. Whatever the government's intentions in organizing the meetings, in reality it had little latitude to change the nature of the adjustment program, given the loan conditions of the international financial institutions and its own desperate need for foreign exchange.

More of the Same

Despite the continuing failure of, and public opposition to, the country's adjustment program, the Nicaraguan government last year adopted another IMF-crafted program, financed from the latter's Enhanced Structural Adjustment Facility, that deepened its commitment to many of the policy reforms implemented to date. This action was coupled with a new ERC loan from the World Bank, which was approved in June 1994. The Bank and the Fund have closely coordinated a series of policy conditions in the two loans: the dismissal of 13,569 public employees; privatization of the remaining state-owned enterprises, including the telephone company; further reductions in government spending, including the elimination of funds earmarked for universities; increases in taxes on gasoline and other products and in fees for health and education services; financial-sector reforms, including the requirement that the government not recapitalize state banks; resolution of property-rights disputes; reduction of the discretionary powers of government ministries in the area of fiscal policy; further tariff reductions; and changes in labor policies.

THE (IN)HUMAN FACE OF SAPs

About four blocks from the main street there was a raging fire burning on one of the abandoned lots. The neighborhood was pitch black and quiet since the power had been cut again. I had seen small fires set near the road curbs to burn garbage but this was different, it was a real blaze. It looked like someone's house was burning down.

After reaching the street corner I saw a man sitting on a wooden box staring into the blaze. He didn't look worried. He was sitting very close to the blaze, the heat of the night combined with the heat of the fire didn't seem to affect him. There was something non-threatening and tranquil about him, so I approached and asked if he was ill. He looked at me with an expressionless face. He said that over the last two weeks he hadn't brought any money home to his family and that his children were going hungry.

The year before he had been working for the state-owned airline Aeronica, but when the company was privatized he lost his job. Since then he had looked for work but had found nothing. As a last resort he was selling brooms door to door. Now these were not even selling. Not knowing what to say I asked if I could buy some of his brooms. He turned away, looked into the fire again, but this time his face was different. What I had thought was tranquility was in fact hopelessness. There were no more brooms, he said. I noticed one of the broom handles sticking out of the blaze awkwardly.

-A Canadian researcher living in Managua, 1993

* * *

"At present, the major threat to the democratic system [in Nicaragua] is not political conflict, but the deterioration of living conditions and the consequent loss of faith in democracy and its institutions."

-UN Secretary General Boutros Boutros-Ghali, 1994

Many of these conditions dictate changes in Nicaraguan laws, further complicating local efforts to achieve national consensus on economic-policy issues. For example, before the ERC loan document was presented to the World Bank's Executive Directors for approval, the Bank required that the Nicaraguan government present it with a "satisfactory" letter outlining changes the government would make in labor laws and policies. Not only does this raise questions about the Bank's interference in Nicaragua's internal political affairs, but several of the legal changes outlined in the subsequent letter from the Ministry of Labor clearly violate internationally recognized labor rights. The government committed itself to abrogate the right of workers to strike in the public-service sector or in "services in the general interest," to subordinate collective agreements to individual contracts, and to provide the legal conditions for easy dismissal of unnecessary workers. It also promised to monetize benefits, converting them to cash payments, the value of which could be wiped out if inflation were to increase again. Each of these promises closely mirrors recommendations in the Bank's 1994 Country Economic Memorandum on Nicaragua.

In 1995, political tensions reached a boiling point after the Nicaraguan National Assembly passed a series of 67 constitutional amendments designed to take back power from the executive branch. In addition to changing the Constitution to shorten presidential terms and to prohibit the election of a President's relatives, the constitutional reforms reduced the executive branch's power to unilaterally set fiscal and other economic policies. President Chamorro attempted to suppress the amendments by refusing to promulgate them, and a standoff between the executive and legislative branches ensued. Under pressure to resolve the constitutional crisis before the June 1995 Consultative Group meeting of Nicaragua's donor governments, a compromise was reached that recognized the Assembly's right to approve fiscal policy measures and international agreements. If the National Assembly should reject a future structural adjustment program, the executive branch would now be required to renegotiate it with the IFIs.

The Future: An Alternative Vision

Although Nicaragua remains a country deeply divided by political and economic policy disputes, there is widespread agreement on the continuing failure of the adjustment program to deliver the economic prosperity and social stability that many had hoped would materialize after the 1990 elections. While strikes and popular mobilizations still occur, some organizations are moving from protest to proposal by beginning to develop the elements of an alternative economic program.

Some elements of a consensus around an alternative are emerging despite the inflexibility of the IFIs. Many organizations from across the political spectrum advocate increasing credit to the agricultural sector. CRIES, a Managua-based regional network of research centers, sent its proposals to a meeting of donor countries, called in Paris in June 1994, to coordinate aid programs in Nicaragua. They included: reduction and renegotiation of the foreign debt; selective tariff protection in key sectors; financial reform and channeling of domestic savings to productive sectors; a program to stimulate production, especially that of small and medium-sized producers; and the expansion of public-health and education services. These recommendations had little impact, however, on the donors' deliberations.

Under the current structural adjustment program, the government's own ability to respond to its constituents' demands is extremely limited. If the country is to emerge from this period of conflict and polarization to achieve lasting peace and equitable economic growth, these constraints must be lifted and a genuine dialogue among the various sectors of society encouraged. Only then will the specter of renewed civil strife end and a new period of equitable, democratic and sustainable development begin.

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STRUCTURAL ADJUSTMENT IN COSTA RICA
Eroding an Egalitarian Tradition

[Return to TOC]

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by Karen Hansen-Kuhn
The Development GAP

In 1985, Costa Rica became the first country in Central America to implement a series of structural adjustment programs imposed as a condition of lending by the International Monetary Fund, the World Bank and the U.S. Agency for International Development. The SAP measures followed on the heels of an IMF-designed stabilization program that the government had begun implementing in 1980.

The Bank and Fund have hailed the country as an adjustment success, citing improvements in some economic indicators and the expansion of new agricultural exports. In addition, Costa Rica continues to boast the highest literacy rate (93 percent), lowest infant-mortality rate (16 per 1000), and longest life expectancy (76 years for men; 78 for women) in Latin America, though these were achieved well before the adjustment program began. This year, USAID declared "mission accomplished" and announced it was shutting down its operations in Costa Rica.

Other measures of the country's well-being, however, including a number of macroeconomic indicators traditionally used by the Bank and the IMF, reveal a troubling picture. Costa Rica's trade deficit, for instance, has increased enormously despite aggressive export-promotion efforts. The fiscal deficit and inflation, two principal targets of SAPs, also continue at high levels. Income distribution has worsened significantly, particularly in the rural areas, where many small and medium-scale farmers have faced cuts in loans and subsidies for food production and lack necessary capital and technical and marketing skills to make the transition to the "non-traditional" export crops promoted by the government and USAID.

Social indicators, such as the incidence of infectious diseases, also demonstrate a disturbing trend away from the relatively high standard of living for which Costa Rica has been well-known. This decrease in the quality of life, together with new proposals to deepen the adjustment measures, have led to growing social unrest. In July 1995, discontent boiled over into a massive public demonstration in which over 100,000 Costa Ricans from a variety of sectors marched through the streets of the capital, San Jose, demanding an end to the continued implementation of adjustment programs in their country.

A decade after starting down the adjustment road, and a full 15 years after the IMF appeared on the scene, Costa Rican policymakers still have been unable to begin delivering benefits to the majority population. Indeed, they have once again been forced into difficult negotiations with the Bank and the Fund over economic policy and their country's future.

Background

Costa Rica has long been viewed as an oasis of tranquility in impoverished, war-torn Central America: a century-old, stable, constitutional democracy which, following a brief civil war in 1948, abolished its army and nationalized the banks. Over the next 30 years, the Costa Rican government, unhindered by military coups, civil unrest or guerrilla warfare, invested resources in its poorer regions and in energy, transport and communications infrastructure. The government built an extensive and largely well-run social welfare system that included public utilities, free health care and education, low-cost housing, and insurance, pension and savings programs. It also established credit and technical assistance programs for farmers and guaranteed, subsidized prices to encourage production of food crops. These programs provided a strong social safety net for the country's poor and spurred growth of a large middle class of professionals, entrepreneurs and civil servants.

Costa Rica's post-World War II economic model was built around food self-sufficiency, a few agricultural exports (coffee, bananas, beef and sugar), trade with other Central American countries, highly protected import-substitution industries, and heavy state investment in manufacturing and agroindustries. Between 1949 and 1979, the country had one of the top economic growth rates in Latin America, with its Gross Domestic Product (GDP) climbing an average of nine percent a year. Throughout this period the U.S. government and international lending institutions viewed Costa Rica as a stable but economically and strategically unimportant backwater. It received little USAID or World Bank/IMF funding.

The situation changed in the late 1970s when Costa Rica suddenly plunged into economic crisis, the leftist Sandinistas toppled the U.S.-backed Somoza dictatorship in neighboring Nicaragua, and the Reagan administration took office in Washington. The economic down-spiral -- the worst in the country's history -- was triggered by a steep rise in prices of gasoline and other petroleum products and a rapid fall in world coffee prices. As terms of trade shifted, Costa Rica was forced to borrow heavily from foreign banks and lending institutions. The situation was particularly acute because half the country's debt was in high-interest, short-term loans from commercial banks.

Between 1977 and 1981, Costa Rica's debt service quadrupled, totalling 60 percent of export earnings. By 1980, the nation's debt reached US$3 billion, one of the highest per capita (US$2,021) in the world, and inflation skyrocketed to 100 percent. President Rodrigo Carazo suspended debt payments to nearly all of the country's foreign creditors, predominantly commercial banks.

Faced with impending financial defaults by two Latin American giants -- Mexico and Brazil -- the commercial banks and the IMF were reluctant to negotiate new loans or repayment terms with Costa Rica, a relatively small debtor country. Instead, the Reagan Administration stepped forward with a bailout scheme, motivated not so much by Costa Rica's internal crisis as by Washington's strategic need to buy its cooperation in the covert war against Nicaragua, coupled with the Administration's crusade to push "supply side" economics beyond U.S. borders.

The Introduction of Economic Stabilization and Structural Adjustment

After President Luis Alberto Monge took office in May 1982, the Reagan Administration quickly struck a deal with his government. By 1983, USAID assistance had soared to $212 million, a 27-fold increase over 1978. Between 1982 and 1989, Costa Rica received over $1.2 billion in economic, military and food aid, six times more USAID support than in the previous three decades combined. During the 1980s, Costa Rica became the second-largest per capita recipient of U.S. economic aid, surpassed only by Israel.

In return for these dollars, Washington demanded political and economic quid pro quos. The Monge government quietly, often reluctantly -- and in violation of the country's neutrality and anti-militarism policies -- allowed its northern zone to be used by anti-Sandinista rebels, known as the contras. It also agreed to a wide array of economic adjustments, including partial privatization of the banks, the sale of state-owned industries, a new agricultural strategy that called for the production of luxury export crops for the U.S. market at the expense of food production for the domestic market, and the creation of a dozen or so USAID-funded private institutions that duplicated the functions of state entities. These institutions, which became known collectively as USAID's Parallel State, included a private agricultural college, an investment company, an export-promotion institute and a finance company, all of which drained resources and authority from government institutions. At the same time, USAID gave little assistance to Costa Rica's social-service programs.

Throughout the decade, Costa Rica's relationship with the IMF and World Bank was not a particularly smooth one. The first two Fund agreements, in 1980 and 1981, were canceled due to President Carazo's refusal to comply with the austerity measures dictated by the IMF, which included a devaluation of the local currency and drastic cuts in government spending. President Carazo subsequently expelled the IMF from the country after negotiations with the Fund broke down. The country's economic situation continued to deteriorate throughout 1982, with inflation rising to 109 percent and real GDP falling by seven percent. President Monge signed a new loan agreement with the IMF in December of that year.

In 1985, besides signing another Stand-by Arrangement with the Fund, the government received its first Structural Adjustment Loan (SAL I) from the World Bank to support longer-term changes in the economy. It received a second adjustment loan (SAL II) of US$100 million in November 1989, along with a matching loan from the government of Japan. The conditions attached to these loans mirrored those in the USAID-mandated program: cuts in government spending; the privatization of state-owned enterprises; and a reorientation of production away from satisfying domestic needs and toward non-traditional agricultural and manufactured exports.

In March 1995, negotiations with the Bank over a third SAL broke down, with the Bank accusing President Jose Maria Figueres' government of not complying with conditions attached to the US$350 million package it had negotiated with the previous President, Rafael Calderón. The Costa Rican government did manage to negotiate a provisional US$80 million Stand-by Arrangement with the IMF, tied to the government taking immediate concrete steps to reduce the fiscal deficit through massive cuts in public-sector employment and increases in taxes. These actions were not enough, however, to persuade the Bank to resume funding.

Economic Indicators of Failure

After more than a decade of stabilization and structural adjustment, massive amounts of U.S. economic assistance, and significant sacrifices by the population, Costa Rica's economy appears to be in the process of further decline. Even in the narrow macroeconomic terms by which the Bank and Fund want SAPs to be judged, the economic program has failed. While GDP growth has resumed after a sharp fall during the economic crisis of 1981-82, GDP per capita, a key indicator of living standards, had only barely recovered to pre-crisis levels in 1993.

Despite claims that SAPs help countries ease their external debt, Costa Rica's burden actually increased under its adjustment program, from US$2.7 billion in 1980 to US$3.9 billion in 1993. This rise occurred despite the country's participation in the U.S. "Brady Plan" debt-relief scheme under which Costa Rica was able to "buy back" much of its outstanding commercial debt at a discount. Furthermore, debt reduction has been conditioned on continued implementation of adjustment measures and adherence to an economic model that increases the country's dependence on foreign markets, imports and loans.

The implementation of the model over the past decade has also benefitted narrow commercial interests at the expense of the general population. Under the adjustment program, import duties have been reduced and tax concessions and other subsidies granted to tourism, agriculture and manufacturing for export. Not only have these measures drained resources from the government in the form of much-needed revenue, but they have also helped to rapidly increase imports. As a result, inflation and the trade and fiscal deficits have grown to unacceptable levels. Inflation has continued to fluctuate greatly in the 1990s, running at 17 percent in 1992, six percent in 1993, and 20 percent in 1994. Costa Rica's trade deficit increased nearly 400 percent in the decade since the adjustment program began, from US$134.9 million in 1984 to US$651 million in 1994. By 1994, the fiscal deficit had risen to 8.1 percent of GDP. Instead of admitting the failure of the program, however, the Bank and the Fund are now demanding an intensification of the adjustment measures implemented to date.

"Agriculture of Change"

The adjustment programs promoted by USAID, the World Bank and the IMF since the mid-1980s centered around the expansion of new, "non-traditional" export-crop production for markets outside Central America. Under SAL II, the government introduced a new agricultural policy, the "Agriculture of Change", designed to promote the production of a bevy of luxury crops -- asparagus, strawberries, macadamia nuts, melons and miniature vegetables -- for export, primarily to the United States during the winter months. The same list of products was promoted throughout Latin America and the Caribbean by USAID and the IFIs with no regard to local climatic and soil conditions or the possibility of overproduction. As a 1986 U.S. General

Accounting Office (GAO) report warned, "The countries export similar products, which could lead to increased competition and thus potentially reduced prices and foreign exchange earnings." By the end of the decade, Costa Rica's cardamom, cashews and macadamia farmers were all finding the export market glutted and prices falling.

The government provided a range of incentives for these new crops that included the removal of export taxes, the dropping of import duties on farm inputs, exemption from income taxes on production for export, preferential interest rates, and special access to foreign exchange. Many of these incentives were available to export companies, which were expected to pass them on to producers.

Forcing Small Producers off the Land

Small farmers were often reluctant, however, to give up the security of growing food crops, such as rice, beans and corn, that they could use to feed their families in hard times. Many of the new crops required substantial investment in irrigation systems, hybrid seeds, fertilizers, pesticides and sophisticated marketing systems that were beyond the financial reach of small producers. Traditionally, Costa Rica's national banks had been the main source of credit to farmers, but between 1983 and 1987 credit for the agricultural sector plummeted from 80 percent to 20 percent of total annual credit extended by the banking system. At the same time, Costa Rica was forced by the World Bank, the IMF and USAID to cut funding for the National Production Council (CNP), which, in fixing the buying and selling prices of basic grains, was the most important institution guaranteeing the country's food self-sufficiency.

The upshot of these and other adjustment measures was that many small and medium-scale farmers were forced either to work for large producers or to sell their land and migrate to the cities. A 1988 World Bank study acknowledged that "smallholders unable to move into new activities might have to sell their land and become landless workers." This was indeed the reality: in 1984 Costa Rica had 70,000 basic grain farmers; just four years later only 27,000 remained.

Not surprisingly, foreign investors and some local elites dominate both the production and export of non-traditional crops. Forty percent of macadamia production, 52 percent of cut-flower production, and 46 percent of pineapple cultivation is controlled by foreigners. Earnings from non-traditional agricultural exports increased from US$51 million in 1985 to US$153 million in 1990, but during these years growth in these exports slowed from an initial rate of 15-30 percent annually to just three percent in 1990.

For Costa Rica's small-scale producers, the "Agriculture of Change" has been a disaster. According to farmers' organizations, the emphasis on export production has led to a deepening dependence on imported food -- including, in the 1980s, U.S. food aid -- that competes with local production. Corn and beans imported under USAID's P.L.480 food-assistance program undercut national production, and wheat imports, though not in competition with local crops, altered consumer tastes. As a result of World Bank/IMF/USAID adjustment measures and the PL-480 program, Costa Rica has gone from near self-sufficiency in food production in the early 1980s to importing over one-half of all cereals consumed, while both its foreign debt and its fiscal and current-account deficits have grown.

The Environmental Cost

Production of the new export crops in Costa Rica typically involves massive use of agrochemicals because many of the non-traditional crops are not native to the country and are highly susceptible to pests and diseases. CECADE, a rural education organization, studied melon producers using such agrochemicals as Tamaron, Paraquat and Lannate (Metomil) and found that more than 70 percent of them reported witnessing domestic or wild animals die after spraying, and 58 percent knew of water supplies poisoned by the agrochemicals. Three-quarters of the farmers reported having health problems that they attributed to the insecticides and fungicides.

In addition to the development of non-traditional exports, the push to earn foreign exchange has also led to expanded production of such traditional exports as coffee, bananas and lumber. This has threatened Costa Rica's forests and its internationally acclaimed national parks and forest reserves. Illegal logging has been reported on indigenous people's reservations and in areas bordering national parks. Today, Costa Rica has one of the world's highest rates of deforestation. According to a recent survey by the World Bank, all unprotected forests in Costa Rica are rapidly disappearing, a process accelerated by the rapid expansion of banana production beginning in the late 1980s. Rural workers driven off their land by the new agricultural policies have invaded parks, cut down trees, and squatted on under-utilized land outside the parks. In addition, Costa Rica is plagued by extensive soil erosion and sewage and chemical run-offs into rivers, and indiscriminate dumping of industrial waste.

"Industrial Reconversion"

Unemployment rates in Costa Rica have remained relatively low, but the quality of jobs created could lead the country into a very different kind of development than in the past. According to Mario Lungo of Centro Superior Universitaria Centro Americana (CSUCA), "the 1980s generated a high proportion of jobs of inferior quality, of great instability and low income, which could explain the fact that employment levels have risen again [to their 1980 levels] while incomes fell and poverty increased."

The expansion of non-traditional industrial exports has been a principal feature of Costa Rica's adjustment program. The country's "industrial reconversion" program began as part of the government's 1986-1990 National Development Plan, which was deepened with World Bank support in the 1989 SAL II agreement. Similar in intent to the "Agriculture of Change", the industrial-reconversion policy has pushed exports through the promotion of both maquiladoras (export-assembly plants) and free-trade zones (FTZs). Incentives for the maquiladoras and the companies in the FTZs, which must export over one half their production, include: exemption from taxes on profits and income, as well as from import and export taxes; preferential interest rates; the right to transfer capital; and priority in construction of necessary infrastructure. By 1993, the country had eight FTZs with 134 companies, mainly textile, electronics and agro-industrial firms.

Labor rights in the FTZs and maquila industries have been undermined by the establishment of "solidarista" associations, funded by monthly contributions from member workers and employers. The associations usually have savings-and-loan plans and sell consumer goods, in addition to offering health services and access to housing, recreation, investment, small-enterprise-creation and pension programs. Based on the belief that workers, management and owners have a common interest, they deny workers' right to strike. While these associations are not legally permitted to represent workers in collective bargaining, the International Labour Organization (ILO) found that companies had used direct settlements with such groups of workers to undermine unions and collective bargaining agreements. Without independent unions to help balance employees' interests with those of plant owners, it seems highly unlikely that significantly improved labor standards and wages will be seen in the maquiladoras or FTZs.

Economic Polarization and Instability

Costa Rica's adjustment program has led to increasing economic polarization, which many observers are concerned is beginning to seriously undermine the country's relatively egalitarian economic structure and democratic tradition. The gap between the rich and poor has widened significantly: in 1970, Costa Rica's richest 10 percent earned 16 times more than the poorest 10 percent of its population; in 1990, the ration was 31 to one.

Poverty rates have fluctuated over the past decade. The percentage of households living in poverty increased from 18.5 percent in 1987 to 23.8 percent in 1992. In the next two years, however, it decreased sharply to just 15.8 in 1994. According to Costa Rican Congressman Ottón Solís, head of the Congress' Economic Development Commission, there were two factors responsible for the improvement: an increase in foreign investment that led to job creation, particularly in the maquiladora sector; and politically inspired increases in the minimum wage and public spending in the year prior to presidential elections.

In the past year, however, this small bubble of prosperity has burst. The Mexican peso crisis unleashed a series of crises termed the "tequila effect" throughout the region as investors pulled money out of countries, such as Costa Rica, considered to have overvalued exchange rates. Under pressure to reduce the soaring fiscal deficit, the government slashed social spending and has implemented a 50-percent increase in the sales tax. After a healthy increase in the early 1990s, real wages contracted 9.5 percent between June 1994 and May 1995. Private-sector wages were adjusted in August, but they still failed to make up for the loss in purchasing power resulting from the high inflation rate. While figures on poverty rates for 1995 will not be available until later in the year, it seems likely that they will once again increase to crisis levels.

Besides these indications of a decrease in material standards of living, there are also signs of deterioration in the general quality of life. The incidence of infectious diseases, for example, increased dramatically during the 1980s. The number of recorded cases of malaria jumped from 110 in 1982 to 1,142 in 1990 and then to 4,646 in the first nine months of 1992. Referring to the public-health system's inability to deal with these problems, José Sanchez of the Ministry of Health comments, "Those are the great achievements of SAL I and II. Thanks a lot."

In addition, as the poor become more desperate, crime of all types is increasing. Tourists are favorite targets, and guidebooks warn visitors to be extremely cautious. Corruption is also increasing. Some books warn tourists to be wary of shakedowns by police.

Public Opposition Mounts

In 1993, President Rafael Angel Calderón trumpeted the "stability" of Costa Rica's "transformed" economy and boasted that "the World Bank, the Inter-American Development Bank and the International Monetary Fund...describe us as a human and economic miracle." A year after Calderón's glowing prognosis, Figueres won the 1994 presidential election declaring that "we've had enough of the neo-liberal policies that have impoverished Costa Rica." He won on the promise not to implement SAL III, by far the largest and most ambitious adjustment program to date.

Several months after taking office, however, Figueres, under pressure from the international financial institutions, reluctantly broke his campaign promise and agreed to implement the new adjustment program. Even after a breakdown of negotiations with the World Bank, the IMF continues to pressure the Figueres Administration to deepen the program, insisting on the implementation of such measures as the dismissal of 8,000 public employees and increases in sales and fuel taxes.

These proposals have been extremely controversial. After months of paralysis in the National Assembly, Costa Rica's two main political parties reached an agreement to implement these measures, along with a reduction in benefits to teachers and the privatization of the national banking system. The Costa Rican teachers' union reacted with a national strike that gradually drew in other sectors sympathetic to their cause. In July 1995, public outcry over the pact and the perception that Figueres had broken his campaign promises boiled over into the biggest public demonstration in recent history. Over 100,000 public-sector workers took to the streets demanding a change in the economic policies that have hurt them, as well as small businesses and farmers.

A coalition of women's groups also raised their voices in support of the striking teachers, stating that women have been the primary targets of the government's "labor mobility" program and have suffered from increasingly unfair salary structures and legal reforms. They, together with the public-sector unions, have insisted that the government begin a national dialogue with all affected sectors to determine a more equitable economic policy. In August, after months of insisting that the adjustment measures were not subject to change, the government agreed to enter into negotiations with the teachers' union once they return to work.

Conclusion

While Costa Rica's political stability, extraordinary levels of foreign aid and relatively high standard of living should have made the country a "best-case scenario" for the application of adjustment policies, SAPs have not led Costa Rica out of economic crisis and toward stable, equitable development. Rather, the social and economic decline in Costa Rica over the past decade and a half is jeopardizing the country's democratic tradition, a concern consistently expressed by people from all segments of the population. If Costa Rica is to escape this fate, its government must be given latitude by the IFIs to respond to the call of its citizenry for a new set of economic policies.

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STRUCTURAL ADJUSTMENT IN BOLIVIA: Inducing Illegal Drug Production

[Return to TOC]

by Tony Avirgan, Laura Parsons and Ross Hammond
The Development GAP

In 1985, Bolivia's economy was in a shambles, with the world's highest rate of inflation resulting in a nearly valueless currency. Businesses were closing and the ranks of the unemployed were swelling. President Paz Estenssoro declared, "Bolivia is dying."

The government turned to Harvard professor Jeffrey Sachs, who consulted with the World Bank and the International Monetary Fund and drew up a structural adjustment program for Bolivia designed to restructure the economy. The plan, imposed by Presidential Decree 21060 in August 1985 and officially called the New Economic Policy (NEP):

1. removed restrictions on imports and exports;
2. established a single, flexible exchange rate;

3. froze public-sector wages for four months (later reduced to three);
4. removed fixed prices for most goods and services;
5. gave state companies one month to present programs for 'rationalizing' (i.e., sacking) staff; and
6. introduced 'free contracting' at all firms, allowing management to hire and fire at will.

Subsequent decrees were designed to jump-start the economy by stimulating exports and encouraging foreign and local investment. Sachs, who went on to apply the same model in Poland and other Eastern European economies, admits that the "Bolivian miracle" -- so termed because of the way runaway inflation was controlled -- has some severe limitations. "I always told the Bolivians, from the very beginning, that what you have here is a miserable, poor economy with hyperinflation; if you are brave, if you are gutsy, if you do everything right, you will end up with a miserable, poor economy with stable prices."

The Result

That is exactly what happened, except today the "real' economy of Bolivia is significantly poorer and more miserable than it was a decade ago. The shock therapy, that by decree abolished jobs, price controls and workers' benefits, set in motion an end to hyperinflation and began a recession. It brought inflation down from more than 8,000 percent a year in 1985 to nine percent in 1994. Exports, primarily of natural gas and zinc, increased slightly and tax reform increased government revenues.

The slowed-down economy, however, stifled economic development. The per capita gross domestic product (GDP) in 1994 was US$643, just eleven dollars more than it had been a decade earlier. And imports far outstripped export earnings, soaring from US$623 million to US$1,115 billion during the ten-year period. The country's foreign debt rose steadily from US$3.3 billion in 1985 to US$4.2 billion in 1994.

A look beyond the macroeconomic figures at the "real" economy gives an even clearer indication of why the people of Bolivia have suffered under the externally imposed economic policies of adjustment. Import liberalization measures opened the door to competition from cheap, imported manufactured goods and has led to the bankruptcy of more than 120 Bolivian factories since 1985. In addition, many state-owned mines and factories have been closed and their employees laid off, contributing to high levels of unemployment and a rapid growth in informal-sector activities.

With greater competition for a dwindling number of jobs, wages have declined, driving even full-time workers into poverty. In the industrial sector, average real wages fell 22 percent between 1988 and 1991, while the percentage of temporary workers in the workforce increased from nine to 24 percent. And, as wages fell, job insecurity grew, and social services were reduced, most Bolivians sunk deeper into poverty and their society became increasingly polarized.

Meanwhile, economic stabilization has failed to attract investment, and the privatization of state enterprises has gone slowly due to a shortage of potential buyers. The country remains highly dependent on foreign aid and officially unacknowledged inflows of cocaine dollars.

Increasing Rural Poverty

Bolivia's adjustment program has been especially devastating for small peasant farmers. It has resulted in the bulk of rural credit and investment going to agribusiness operations and other medium- and large-scale farmers producing for export. Most peasant farmers in the country lack the necessary capital to engage in the production of export crops and have difficulty securing credit.

The one bank that traditionally gave loans to small farmers, the Banco Agrícola Boliviano, has been closed. Under the New Economic Policy, interest rates have averaged over 20 percent per annum, so even those small farmers deemed creditworthy find borrowing money prohibitively expensive. Bolivian peasants today receive only four percent of the country's available credit, despite the fact that they produce 70 percent of the country's agricultural output.

The lowering of import barriers has exacerbated the situation by generating a flood of cheap agricultural imports that compete against locally grown foods. Foreign-grown wheat has been able to enter local markets more easily, for example, due to the NEP's creation of a single flat tariff rate on imported goods, which is among the lowest in Latin America. Adding to Bolivia's agricultural crisis has been the U.S. "Food for Peace" program, which has provided subsidized food from the United States that also undercuts local producers.

At the same time, fuel subsidies were cut, leading to significant increases in the cost of the transport of agricultural products. Between 1987 and 1989, the cost of fuel rose 33 percent, which resulted in a parallel increase in the price of Bolivian-grown food crops. Other subsidies, as well as price controls, have also been eliminated under the NEP.

As a result of all these negative pressures on small farmers, rural poverty has increased. A study by the International Fund for Agricultural Development revealed that 97 percent of the rural population lives below the poverty line -- the highest level of rural poverty in the world.

The fall in food production and rise in rural poverty over the course of the implementation of Bolivia's structural adjustment program, has been matched, not coincidentally, by a dramatic rise in coca production.

Adjusting Farmers Toward Coca

The Andean region of Latin America is the source of most of the world's cocaine. Yet, in spite of the billions of dollars that have been spent on eradication and interdiction efforts, as well as on so-called "alternative development" programs, the war on drugs has failed to stem the flow of narcotics from this region.

In fact, drug production in the Andean region has been growing steadily over the last decade, an increase largely attributable to a declining economic situation exacerbated by structural adjustment policies required of governments by the World Bank and the IMF in return for badly needed capital. These policies have led to a rapid increase in the ranks of the poor, driving many into drug production as the only means of survival.

The situation in Bolivia, the world's second largest producer of coca, best exemplifies the clear connection between the economic programs pushed by the Bretton Woods institutions and the growth of illicit drug production.

As rural poverty has increased in Bolivia, so too has the amount of coca produced. Coca leaf has been grown and used for medicinal and nutritional purposes in the Andean region for more than 5,000 years. In recent years, however, much coca has been grown for processing into cocaine in neighboring countries.

During the first three years of the NEP, coca production in Bolivia expanded at an annual rate of 13 percent, faster than that of any other commercial crop in the country. As one farmer exclaimed, "Coca is the only alternative for me. I cannot get bananas to the market, even if I could get a better price for them. How else can I feed my family?" In fact, the prices farmers get for legal export crops are simply not competitive with those of coca: one acre of coffee brings in US$114, while coca generates US$329 an acre. Ironically, coca is the one export crop that does not require large amounts of capital.

Adjustment-induced changes in non-agricultural sectors have also exacerbated the coca problem. Many urban workers and their families who have lost jobs have migrated to coca-growing areas in search of employment. If they should be lucky enough to find work, the wages are quite lucrative: while the average annual income in Bolivia is US$150, coca crushers can earn at least 12 times that amount.

By 1990, annual coca exports from Bolivia had reached an estimated US$700 million, nearly as much as all other exports combined. According to the U.S. Embassy in La Paz, some 40,000 families are now engaged in coca farming. The U.S. Drug Enforcement Agency estimates that they produced some 80,300 metric tons of coca leaf in 1992. After its processing into crack or powder in third countries, this cocaine had an estimated street value of US$22.9 billion, over three times Bolivia's GDP for that year.

"Alternative Development"

Over the last four years alone, the United States has spent US$2 billion in the Andean countries in an attempt to halt illicit drug production. Much of this money has been spent in support of adjustment programs that provide incentives to farmers to grow non-traditional export crops, such as pepper and macadamia nuts. The U.S. Agency for International Development promised big profits on the new crops, but, when the harvests came in, markets were scarce. USAID unilaterally applied the same list of approved export crops in its programs across the Americas, resulting in oversupply and lower prices for producers.

In Bolivia, over 2,000 producers have gone to court to insist that the debts they accumulated as part of this project be forgiven. As Bolivian peasant leader Valentín Gutiérrez observed, "The phrase `alternative development' has come to have a very negative meaning in Bolivia. Instead of providing us the tools or appropriate technical assistance to improve the production of traditional crops, USAID insisted that we produce new export crops."

Examples of a true alternative approach already exist. For instance, the Bolivian farmers' organization, El Ceibo, has increased peasant control over the processing and distribution of local agricultural output, bringing farmers a greater share of the profits. In 1990, El Ceibo earned US$600,000 from cocoa beans, powder and butter for its cooperative members. The organization provides marketing, training, agricultural extension and transport while exporting through alternative trading organizations in the United States and other Northern countries.

It is only by increasing opportunities for peasant farmers and others living precariously in the Bolivian economy and by supporting them with an appropriate set of economic policies that the coca problem will begin to be resolved in any significant way. "We have presented our own alternative development projects to AID, but without success to date," explains Guitierrez. "We propose that the projects begin from the needs and capabilities of the peasants themselves, and that, together with them, AID design policies to improve production and marketing of traditional crops, products that can be sold in domestic markets, as well as processing citrus and other crops."

Popular Reaction

The public's patience with the economic-reform program is wearing thin. In 1994, the Bolivian Parliament passed a major privatization bill, as well as a bill approving a World Bank-funded plan to reform the educational system. As the government began to implement these reforms, discontent among the populace grew. By April 1995, teachers opposed to the anti-union clauses in the education-reform bill were on strike throughout the country. Telephone workers opposing privatization of the phone company soon joined them.

The government tried unsuccessfully to quell the strikes with police violence. Each evening, the streets of La Paz were filled with police, clad in riot gear, chasing bands of striking workers. The smell of tear gas filled the air.

Instead of suppressing the strike, the government's hardline stance caused it to spread. Soon, all the national unions joined together in a general strike. Small farmers opposed to the government's compliance with U.S. demands to eradicate coca fields, joined the protests.

President Gonzalo Sanchez de Losado, who ten years earlier implemented the first structural adjustment measures as Minister of Planning and Coordination, declared a State of Emergency and had union leaders detained and sent into internal exile in remote villages in the Amazon region. They were eventually released, but the government has held firm on implementing the economic reforms despite protests from workers and lack of evidence of benefit to the general population.

Conclusion

Bolivia is firmly locked into structural adjustment despite the fact that the past decade has demonstrated that the New Economic Program has increased poverty and social unrest. The economic reforms have made it nearly impossible for Bolivia's small farmers to engage in food production for the local market, and falling wages and employment have reduced demand for food crops in any event. Farmers often have no alternative but to turn to the production of coca.

International pressure coupled with the risk of eradication makes coca a risky, sometimes dangerous crop to grow. Farmers are therefore open to new options, but their true concerns and perspectives must be taken into consideration. And their message is clear: there can be no significant change in their situation until the structural adjustment policies that limit their options and deepen their poverty are themselves eradicated.

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STRUCTURAL ADJUSTMENT IN EL SALVADOR: An Alternative Emerges

[Return to TOC]

by Roberto Rubio, Fundación Nacional para el Desarrollo and Karen Hansen-Kuhn, The Development GAP

In the wake of the economic crisis in Mexico, citizens' groups throughout the Americas intensified their demands that the structural adjustment programs imposed by the World Bank, the International Monetary Fund and other international financial institutions be re-examined and that alternative programs designed to promote equitable and sustainable development be seriously considered. This debate is particularly advanced in El Salvador, a country emerging from years of civil war to confront a harsh new world order. El Salvador has experienced massive foreign capital inflows in recent years that have helped to increase the country's economic growth rate. These inflows have been primarily in the form of remittances from Salvadorans working overseas and exceptional levels of foreign aid, sources that could prove to be as ephemeral as foreign investment in the Mexican stock market.

For this reason, the National Development Foundation (FUNDE), a Salvadoran research institute with ties to popular organizations, has initiated a process to define an alternative development program for the country. In November 1994, FUNDE published an initial draft entitled, "A New National Economic Agenda for El Salvador." In that document, FUNDE critiques the current neoliberal model and recommends a series of measures designed to promote democratic, equitable and environmentally sustainable development.

Background: Growth or Development?

Former President Alfredo Cristiani began implementing economic stabilization and structural adjustment policies shortly after taking office in mid-1989, eliminating price controls, increasing water, electricity and transportation fees, and restructuring the tax system. These measures were deepened in 1991 through the implementation of a Stand-by Arrangement with the IMF, a Structural Adjustment Loan (SAL) from the World Bank and an Investment Sector Loan from the Inter-American Development Bank.

In its August 1993 report to its Executive Directors recommending approval of a second SAL, the World Bank listed the major achievements of the first round of adjustment in El Salvador: unification of exchange rates; unification and reduction of tariff rates; simplification of the tax system and implementation of a value-added tax; privatization of several state-owned banks; implementation of agricultural-sector reforms; and introduction of a Social Investment Fund to "cushion the potentially negative impact of adjustment on the poor." The rate of inflation was reduced from an average of 23.3 percent during the 1985-1989 period to 11.2 percent in 1992, accompanied by an average annual increase of 3.8 percent in the GDP between 1990 and 1992, compared to 1.6 percent for 1989-1990.

FUNDE points out that these improvements in macroeconomic indicators, while impressive, are symptoms of a pattern of accumulation that is both artificial and fragile. They are based on what could prove to be fleeting external resources and conditions rather than on the development and integration of the country's national productive structure, its export capacity, or the quality of its products. One indication of this vulnerability is the doubling of the country's trade deficit, which rose from US$524 million in 1989 to US$1.125 billion in 1994 as imports soared while exports increased only moderately. This deficit was financed mostly by extraordinary levels of remittances from Salvadoran workers living overseas, particularly in the United States, as well as public and private foreign assistance. In 1994, officially registered remittances amounted to over US$1 billion, while official aid grants totaled US$284 million. Combined, these inflows easily surpass the country's US$817 million in export earnings that year.

One of the most notable aspects of this fragile pattern of growth in recent years has been the privileged expansion of the export and financial-services sectors at the expense of production in tradable goods, particularly agricultural production. In El Salvador, this growth has been based much more on consumption than on production, on demand fueled by resource flows from abroad rather than on domestic supply, and on speculative rather than productive activities.

This economic growth has also been exclusive in nature, enriching a narrow segment of the population. While persons connected to the export or financial sectors have benefitted from the recent growth, the majority population -- landless peasants, small-scale farmers, industrial and service-sector workers, public employees and small-scale businesspeople -- have been left out. Income distribution has worsened dramatically: the richest 20 percent of the population increased its share of income from 43 percent in 1989 to 54.2 percent just two years later, while the poorest 20 percent's share of income dropped from 5.6 to 3.4 percent. Given that the vast disparities in wealth and income were principal causes of the country's civil war, this pattern of growth does not bode well for the future.

Women have suffered the worst consequences from this pattern of growth. It is no accident, for example, that the great majority of the unstable jobs in the maquiladoras are held by women, as they are forced into the labor market without the training and support mechanisms they require and suffer for lack of alternative opportunities. Likewise, the devastating effects of the neoliberal program on the environment is felt especially hard by women, who are usually more involved than are men in the dynamics of the ecosystems in which they live. The reduction in water supplies caused by increases in agricultural production and deforestation, for example, affects most those rural women or women from poor urban zones who must haul water every day.

Many economists insist that growth and development go hand in hand, often using the two terms nearly interchangeably. FUNDE maintains that what El Salvador has experienced under the adjustment program is actually growth without development. This model, according to FUNDE, "has favored consumption over investment, speculation over productive investment, the production of services over goods, demand over supply, [and] imports over exports," rather than developing the country's productive capacity.

FUNDE explains that the economic program promoted by the IFIs has addressed secondary problems and symptoms rather than the underlying causes of the country's underdevelopment. Reducing the relatively high inflation rate and the government budget deficit have been two of the main objectives of the adjustment program. While these problems may reflect weakness in the economy, they are not, in and of themselves, necessarily the key development problems. Lowering the inflation rate should not be the target of economic policy at the expense of rising unemployment. The truly critical economic issues confronting the country -- problems such as the chronically high un- and underemployment levels and the waste of scarce productive resources -- have not been, and most likely will not be, resolved by a narrow focus on improvements in a restricted set of macroeconomic indicators.

Unfortunately, rather than addressing problems related to the country's productive capacity and other social and economic structures, the Salvadoran government continues to implement the economic strategy pushed by the IFIs throughout the continent. The World Bank's second SAL, which was approved on 23 August 1993, obligated the government to: "modernize" the public sector through decentralization, privatization and deregulation; improve the management of public-sector revenue collection, expenditures and personnel; and increase the number of items subject to the value-added tax. It also included conditions related to financial-sector reforms and reductions in tariffs and non-tariff barriers. The loan conditions related to social-sector reform were limited to evaluating the compensatory program and implementing a new, targeted poverty alleviation program. Many of these policy prescriptions mirror those implemented in Mexico over the past decade, where adjustment has led to financial, economic, social and political instability.

In February 1995, President Armando Calderón Sol announced the central elements of his government's new economic program: a fixed exchange rate; gradual reduction in tariffs; privatization of state-owned enterprises; an increase in the value-added tax; and improvements in tax collection. He was forced to slow tariff reductions because of widespread public opposition. A public opinion poll taken at the time showed that 61 percent of Salvadorans who knew of the plan disagreed with it, and 60 percent of those polled responded that only the richest would benefit from the plan. Since then, the Calderón Sol Administration has announced plans to increase social spending, which it says will be financed through improved tax collections. Except for its determination to fix the exchange rate, however, it continues to push the same economic model that has increased poverty and inequality throughout the Americas.

The Alternative is in the Process

FUNDE insists that the time has come to open a national debate on the current economic model, its consequences and the solutions needed to correct the resulting problems. Its "New National Economic Agenda for El Salvador" has been presented to local academics, businesspeople, and NGO and popular-movement leaders, as well as to the international donor community as a first step in this debate. FUNDE is careful to insist that its proposal is not a ready-made blueprint for El Salvador, but rather a new approach to economic planning that is intended to foster a broad alliance of national productive sectors.

This strategy is based on three principles: *inclusion* of those excluded from the current model; *reactivation* of production, creating the necessary conditions for producers to achieve profitability; and *conversion* of the economy, leading to improvements in economic, social and ecological productivity. It stresses the importance of developing specific policies appropriate for small, medium-sized and large industrial and agricultural producers, as well as for cooperatives, consumers, and salaried and public-sector workers. In contrast to structural adjustment policies, which tend to treat the poor as targets of social spending, in this proposal the poor are considered to be underutilized actors with the potential to increase production, markets and income for all Salvadorans. In order to implement this strategy, FUNDE presents a set of six interrelated social and economic goals and the policies necessary to achieve them.

Spreading Wealth and Income throughout the Economy

In order to *reduce the country's severe concentration of wealth*, FUNDE proposes that the privatization of public enterprises be designed to promote the redistribution of assets, insisting that workers and affected sectors of the population be afforded complete and timely information on the sale of public assets and on available financial and technical support to make it possible for them to participate in those sales. It also recommends passage of a "free competition" law to break up monopolies and oligopolies that distort competition and lead to speculative pricing of essential goods and services. In addition, credit would be provided to producers who are currently excluded from the banking system because of the small scale of their operations. The financial system itself would be opened up to promote competition, with interest rates set to stimulate productive rather than speculative investment.

Besides these measures designed to improve the distribution of wealth, FUNDE proposes policies to *redistribute income by strengthening unions and raising wages* throughout the country. Union organization would be promoted in at least half of the businesses with over 100 employees, and a new legal framework would be established for collective bargaining, enabling unions to bargain more effectively to raise wages to match increases in productivity. Rather than treating wage increases as constraints to growth, as structural adjustment policies tend to do, FUNDE considers them levers to increase local demand. This purchasing power would in turn generate increases in production runs and in the number of work shifts until the country's existing productive capacity is fully utilized.

While these policies would serve to reduce poverty levels over time, FUNDE proposes several *short-term measures intended to reduce poverty rates quickly* and, again, stimulate local demand and production. An emergency program of temporary employment is proposed to benefit those sectors already hard hit by adjustment measures. These would be complemented by policies to promote both public and private investment throughout the country, particularly much neglected investment in agricultural production, which would also serve to generate employment in rural areas. This investment, as well as credit and technical assistance, would be targeted at agricultural and agro-industrial production, as well as microenterprise activities with high potential for generating improvements in productivity levels and achieving better utilization of domestic resources.

These measures would be complemented by increases in social spending designed to permit greater access by the poor majority to food, education, health, housing and basic infrastructure, thus improving the quality of their lives. Efforts to decentralize these services would be undertaken with the active participation of local communities in order to take into account their particular needs and capacities and to rectify the current lack of adequate services in those areas. All of these efforts would be coordinated on a regional level, as well. As described below, changes in tax policy would help to provide the necessary funding for these programs.

Environmentally Sustainable Development

Clearly, no economic program will be sustainable without measures to *eliminate growing disequilibria in the country's ecosystem*. As a first step, FUNDE proposes the initiation of a massive program of reforestation and soil conservation. This would be accompanied by a program to protect the country's watershed, which would include limitations on urbanization and agricultural production in areas close to strategic water resources. Environmental education and research and the use of appropriate environmental technologies would be expanded, as would efforts to diversify agricultural production and promote the use of products that would save water. These production changes would be supported by special credit lines for agroforestry and by incentives for farmers who set aside a portion of their land for reforestation. Trade agreements, according to FUNDE, should include provisions restricting the importation of products that are harmful to human health and the ecosystem and should establish differential market access for cars according to their fuel efficiency.

Resolving the country's environmental crisis would also require changes in the country's institutional and legal structures. National and municipal governments would coordinate their environmental policies to ensure better management of natural resources, and environmental legislation would be strengthened. Included would be measures to up-date existing municipal regulations and to establish mechanisms guaranteeing their enforcement throughout the country. Improvements in the majority population's standard of living would also help them participate more effectively in the recuperation of the country's natural resource base.

Attending to Local Needs and the Real Economy

In its proposal, FUNDE also stresses the importance of *reducing dependence on external resources and increasing space for a truly national development program*. Production for export would serve as a tool for expanding local employment and improving technological levels, not simply as a means of generating foreign exchange. In addition, FUNDE proposes a careful and selective process of import substitution, providing temporary import protection and incentives for strategic national industries in order to avoid massive bankruptcy as they begin to compete with transnational corporations. The program would include preferences for local businesses in government purchasing, the creation and improvement of public technical-support services for local industries, and measures to improve the efficiency of state-owned enterprises. These policies would be supported through changes in fiscal policy, such as the implementation of a luxury tax to establish a national fund for public investment, as well as through the strengthening of the administrative capacity of the Ministry of Finance to collect taxes.

These efforts to improve the efficiency and *increase the productive capacity of national industry* would be complemented by a program to expand markets in Central America and move toward *regional integration*. This program would include coordination of appropriate macroeconomic and investment policies, the free movement of labor in the region, and the promotion of joint construction and infrastructure projects. All sectors of the population would be given the opportunity to actively participate in the definition of these policies.

Finally, *improvements must be made in local infrastructure*. Public agencies charged with the planning and construction of infrastructure and the regulation of urban services should be modernized, and mechanisms should be established to ensure that they coordinate their efforts with each other. The national budget should be redirected to reduce dependence on foreign assistance for public investment projects.

Conclusion

All of these measures are geared to achieve progress in the real economy, not just improvements in macroeconomic indicators. The serious structural problems in the economy will not be resolved by an approach that reduces economic policy to controlling inflation, especially when such external factors as the inflow of dollars and the presence of oligopolies are major causes of price increases. Instead, *economic policy should be directed toward achieving a structural transformation of the economy, with financial and monetary disequilibria contained to sustainable limits*. Monetary policy should be directed toward increasing production, particularly by the popular sectors, instead of consumption and speculative endeavors. Likewise, fiscal policy should be directed toward improving the tax system so that sufficient resources are available to invest in the country's development while holding the deficit to manageable levels.

The dramatic crisis in Mexico, along with the less striking but pervasive failure of the neoliberal model throughout the Americas, highlights the urgent need for a re-examination of current policy prescriptions. As FUNDE stresses, economic policy should not be formulated simply by setting targets for improvements in certain macroeconomic indicators, but rather through an active dialogue among all sectors of society. Countries like El Salvador can no longer afford to squander scarce human, financial and environmental resources on a model that will only deepen the desperate poverty and appalling concentration of wealth and income that have caused such social strife in the past. FUNDE's alternative development proposal, and the process of dialogue that it has initiated, represent a critical first step in the definition of policies that could, if implemented, lead to equitable and sustainable development for all Salvadorans.

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SUMMARY AND CONCLUSION

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The present financial crisis in Mexico has served as a wake-up call to people throughout the hemisphere. While the World Bank and IMF continue to insist that structural adjustment will eventually resolve the region's economic problems, serious doubts have emerged among citizens' groups, government officials and international organizations. Throughout Latin America, leaders who had been told that the neoliberal economic program implemented in Mexico was the model that all should emulate have begun to wonder if their countries too could suffer Mexico's fate.

In each of the countries described in this report, and indeed throughout the Americas, structural adjustment programs have failed to steer economies onto courses of development that are equitable and sustainable. Rather, these policies have led virtually everywhere to a series of new economic woes marked by growing disparities in wealth and income, increased poverty, diminished productive capacity, and extensive environmental damage, with a disproportionate impact on women. The experience to date suggests that SAPs, given their primary focus on opening still-developing economies indiscriminately to increased international investment and trade, can produce no other outcome and that a major rethinking of both the process of economic decisionmaking and the content of economic policy is in order.

Productive Capacity and Quality of Life Deteriorate

In their overwhelming emphasis on production for export and on international competitiveness based on low wages and weak labor standards, ***SAPs have gutted local productive capacities and local markets***. In Bolivia, trade-liberalization measures abruptly opened the economy to competition from cheap imports, which has resulted in the bankruptcy of more than 120 factories since 1985. Many Mexican small and medium-sized firms, which employ over 80 percent of the work force, have been forced to become retailers of U.S. imports or to close their doors due to a flood of imports and skyrocketing interest rates. Drastic reductions in the availability of credit and technical assistance to small farmers in Costa Rica have resulted in the nation moving from near self-sufficiency in food production in the early 1980s to importing more than one half of all basic food grains consumed today.

Instead of investing in what the Bank and the Fund consider to be "inefficient" local enterprises, many countries in the region have shifted under adjustment to non-traditional agricultural and maquiladora production. Both of these activities are highly dependent on foreign investment, often compelling governments to offer exceedingly generous incentives. In some cases, these incentives have taken the form of subsidized interest rates or tax holidays, often at the same time that the SAPs are forcing cuts in subsidies and hikes in interest rates that affect local producers, as well as reductions in government social-sector spending. In others, the chief attraction for investors has been "flexible" labor markets, with low wages and low levels of unionization. It is difficult to imagine how the deplorable wages and working conditions for which the maquiladoras are famous in countries like Mexico, El Salvador and Guatemala, coupled with new restrictions on the ability of workers to form unions, could ever lead to stable, decent-paying jobs in the future, and yet the proponents of adjustment measures continue to tell workers to wait for the benefits of investment and growth to trickle down.

Overall, ***there has been a trend towards falling wages and poor working conditions in many of the countries that have implemented structural adjustment programs***. Real wages in Bolivia, Mexico and Nicaragua have fallen substantially in the past decade. In Chile, a country with high economic growth and low unemployment rates and hailed as a model for the rest of the Americas, 45.5 percent of workers have incomes that are lower than the minimum required to maintain a family.

Governments have been willing to adopt wage-suppressing measures due to their desperation to create jobs. Nevertheless, ***high rates of joblessness have been another hallmark of SAPs***. In Mexico, there has even been an inverse relationship between foreign investment and employment, with the former increasing by nine percent during the past three years while job creation has fallen. In Nicaragua, just as employment opportunities had reached their lowest point in years due to stabilization and adjustment measures, over 285,000 military and other public-sector workers were laid off. Over two-thirds of the population is currently either un- or underemployed.

The combination of austerity, low wages and joblessness has led to worsening poverty rates and income distribution in many countries in the region. In Bolivia, rural people were hit by a combination of trade liberalization and cuts in credit and fuel subsidies. A recent study by the International Fund for Agricultural Development revealed that 97 percent of the country's rural population lives below the poverty line. In Nicaragua, poverty has risen to over 70 percent of the population.

This is not to say that no one has gained from SAPs. Rarely, however, has it been the poor, workers or even large segments of the middle class. Exporters and those connected to the financial-services sector have gained disproportionately in many countries. In Costa Rica, the gap between the wealthiest and poorest ten percent of the population doubled between 1970 and 1990. During the Salinas Administration in Mexico, from 1988 to 1994, the number of billionaires rose twelve-fold. Meanwhile, the World Bank estimates that the number of Mexicans living in poverty has increased by nearly ten million over the past 15 years.

Women have been especially hard hit by adjustment programs. In Costa Rica and Nicaragua, they have often been the first fired in public-sector cutbacks, including those associated with privatization programs. The lack of job opportunities in Mexico, El Salvador and throughout the rest of Central America, coupled with the need to increase declining family incomes, have led many young women to consider employment in the maquiladoras and the informal sector as their only real economic options.

In many countries, cuts in health-care, education and other social-service budgets, as well as environmental deterioration resulting from the adjustment programs, have forced women to spend more time than ever attempting to meet their own and their families' needs. In El Salvador, the reduction in water supplies caused by increases in agricultural production and deforestation affects most those rural women and women from poor urban zones who must haul water every day. Urban women in Mexico have felt compelled to organize community soup kitchens to ensure that their children get enough to eat. The result has been that many women now work a "triple shift", one at their jobs, one at home, and one in their communities. They are caught in an impossible and clearly unsustainable situation, squeezed between their increasing responsibilities and decreasing resources.

All of these factors have contributed to a ***growing sense of hopelessness and social disintegration in many countries in the region***. In Nicaragua, former contra and Sandinista soldiers have taken up arms to demand access to land, credit and other resources. The Zapatista uprising in Chiapas occurred in large part because of the worsening economic situation in that Mexican state and local disillusionment with the overall national economic program. ***Street crime has risen dramatically in many countries, including Mexico, as have reports of domestic violence and alcoholism.*** Even Costa Rica, a country previously well known for its peace and tranquility, has suffered an alarming increase in crime rates in recent years.

Resignation and violence, however, have not been the only response to the worsening social and economic conditions. ***There has been a wave of labor unrest throughout the region over the last year*** as unions refuse to accept the imposition of further layoffs and reductions in wages and benefits. The unions, however, are not simply demanding that their current circumstances be maintained; they are insisting on a seat at the bargaining table that would allow them to determine the direction of economic-reform programs, particularly the nature of privatization and other measures that will directly affect them.

Other constituencies, including farmers, environmentalists, small and medium-scale businesses, and women, are also moving from protest to proposal and demanding that they be included in the determination of economic policy. In all five countries analyzed in this report, popular discontent over the impact of the adjustment measures has been matched by sectoral and, in some cases, multisectoral alternative development proposals. Furthermore, in recent presidential elections in Costa Rica, Honduras and Venezuela, voters demanded an end to structural adjustment measures and the charting of a new course. Unfortunately, as the experience of Costa Rican President José Maria Figueres demonstrates, the IFIs have not allowed the renegotiation of the terms of adjustment loans that would give governments the flexibility required to respond to their citizens' demands.

Macroeconomic Indicators Shaky at Best

The World Bank and IMF continue to point to improvements in macroeconomic indicators to prove that adjustment programs are working. In hyperinflationary situations such as those that existed in Bolivia and Nicaragua, the reductions in inflation rates have been dramatic. In Bolivia, inflation dropped from over 8,000 percent in 1985 to just nine percent in 1994, and in Nicaragua it fell from more than 13,000 percent in 1990 to 12 percent last year. ***These reductions in inflation were achieved, however, through severe policy-induced recessions***, with negative or flat economic growth rates accompanying the drops in inflation.

Proponents of adjustment measures also continue to point to increases in exports as evidence of the success of the programs, while failing to acknowledge that ***sharp increases in imports resulting from trade liberalization have caused trade balances to deteriorate in nearly every case***. The Costa Rican trade deficit increased from US$134.9 million in 1984 to US$651 in 1994, while in El Salvador the deficit doubled from US$524 million in 1989 to US$1.125 billion in 1994. Meanwhile, Mexico's trade deficit increased 2100 percent between 1990 and 1994, and similar increases were experienced in Nicaragua and Bolivia.

Chronic trade and current-account deficits have been problems for years in many Latin American countries. Rather than increasing national productive capacity, however, adjustment programs have simply led to a change in the sources of financing for these deficits. Now, instead of being financed by foreign debt, ***the deficits are covered by inflows of foreign investment, aid, remittances and, in some cases, drug monies***. Recent experience demonstrates that each of these sources is highly unstable and unlikely to resolve the underlying structural problems that have led to the growth of the deficits. As FUNDE indicates in its alternative development proposal for El Salvador, this model "has favored consumption over investment, speculation over productive investment, the production of services over goods, demand over supply, and imports over exports".

FUNDE has joined a chorus of voices throughout the region insisting that the time has come to embark upon an alternative approach to determining economic policy. Rather than allowing economists at the Bank and the Fund to set a country's program, governments could draw on the knowledge and experience of their citizens by conducting broad-based consultations in order to determine the appropriate mix of measures designed to achieve equitable and sustainable development in each country. More democratic processes would yield programs that would likely balance the pursuit of improvements in growth and inflation rates, as well other macroeconomic indicators, with meeting the demands of the "real" economy. While lowering inflation rates and budget deficits are important objectives, they need not be achieved at the expense of undermining the creation of stable jobs at decent salaries or of expanding a country's productive capacity.

The Immoral Decade?

Latin America is a powder keg ready to explode. During the first half of the '90s, official Washington has gradually and reluctantly come to acknowledge the expanding poverty, the increasingly skewed income distribution, and the growing social conflict in the region. It has refused to concede, however, that a principal cause of these phenomena might be the very policies that it has foisted on the governments and people of the region. At the same time, the fear of reprisal has kept many officials in these governments and in international institutions silent on this critical issue.

The warning embodied in Mexico's economic collapse has not yet been heeded. One of the IFIs' show-case countries in the hemisphere, Mexico suffered from fundamental weaknesses in its "real" economy and relied on speculative capital and the patience of its citizens to sustain an economic program that was destroying its productive capacity and polarizing its society. While those seeking to protect economic-reform programs in Latin America have now joined the calls for a "new social policy" that emphasizes enhanced education, health-care and poverty-alleviation programs, they have successfully contained efforts to consider a "new economic policy" as part of official policymaking processes. The focus has been on the symptoms of what has become a very invasive and destructive cancer.

To those in the region, it is no secret that the economic model of adjustment is not working. Furthermore, there is serious concern from Mexico to Argentina that its failure will have explosive consequences unless there is soon a constructive change of course that more fully involves local populations. Recently, top United Nations officials from UNCTAD, UNDP, UNICEF and other agencies have joined many NGOs and popular organizations in the boldness of their remarks in this regard. Still, there remain far too many people of influence, particularly in the North, who refuse even to whisper what they know to be the truth about the emperor's new clothes.

Today, the problem is not that the crisis is not understood. It's that there is, in a very real and disturbing sense, a pervasive lack of courage to challenge vested interests and to act. The "lost decade" of the 1980s might be blamed on bad judgment. Should we fail now to help the people of Latin America free themselves from a patently and demonstrably disastrous economic policy imposed from afar, an objective assessment of the 1990s will undoubtedly render a much harsher judgment on our collective character.

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