2 Review of the Relevant Literature

2.1 DISTRIBUTIONAL EFFECTS OF FUND-SUPPORTED PROGRAMS

The origins of the debate over the distributional impacts of IMF stabilisation programs can be traced to Cheryl Payer's vociferous critique of Fund-supported adjustment policies. Payer (1975) starkly asserted that IMF-supported stabilisation programs inherently promote sharp, regressive income shifts. She pointed to the regressive movement of real wages in response to cutbacks in government-sponsored consumer subsidy programs and to reductions in nominal wage indexing. She also discussed the adverse effects of stabilisation programs on unemployment. Other works that set forth similar criticisms of Fund activities have included Hayter (1971), Weissman (1976), and Girvin and Bernal (1982).

Several works analysing the distributional aspects of Southern Cone (southern South America) stabilisation programs during the 1970s also reported a tendency for IMF-supported adjustment policies to encourage regressive income movements. Diaz-Alejandro (1981) and Foxley and Whitehead (1980) both concluded that the net effect of adjustment programs on income distribution in the Southern Cone appeared to have been regressive.

Other studies, however, have indicated that there is no inherent theoretical economic reason for income to become more or less concentrated after the onset of an adjustment program. Ahluwalia and Lysy (1981) argued that income can become either more or less equitably distributed depending on the conditions of several external variables. In their five-sector simulated model, they found that the price elasticity and supply elasticity of exports were particularly important in determining the distributional outcome of stabilisation policies. They argued that variation in these elasticities could produce distributional movements ranging from progressive to regressive.

Foxley (1981) has also argued that a priori economic assumptions about the distributional impacts of Fund-supported adjustment programs should be avoided because there is no reason to believe that
such programs will either increase or decrease income equality. Rather than dismissing the possibility that such programs can have regressive effects, he outlined several ways in which particular adjustment policies can promote regressive income movements. First, deregulation of prices can deleteriously affect money holders, in the likely event that prices would increase. Price deregulation would thus act as an effective tax on the poorer segments of the economy, since the poor are more likely to hold assets in the form of money than are wealthier people. Secondly, deregulation of interest rates can make it increasingly difficult for small and medium-sized firms to gain access to credit. Large, more-established firms, particularly multinationals, are more likely to gain access to foreign capital markets, where interest rates are often one-half to one-third less than those prevailing in domestic markets after deregulation. This, Foxley argues, can lead to an increased concentration of assets. Thirdly, in the event that nominal wages are held relatively constant by restrictions imposed by the government, currency depreciation can lead to a decline in real wages as the price of traded goods approaches the price of non-traded goods, raising the overall price of goods. Finally, Foxley (1981) argues that fiscal policies that involve the reduction of education, housing, health, and consumption subsidies can disproportionately hurt middle and lower-income groups. Also, reductions in government investment projects can result in the loss of potential jobs for poorer, less-skilled labourers. Foxley concluded that the distributive consequences of fiscal adjustment really depend on the particular instruments chosen. The imposition of export taxes, for instance, would be a progressive measure, because it would be more likely to affect wealthier commodity exporters. Foxley presents evidence from the Southern Cone, however, that suggests that regressive-type policies have generally been favoured over others.

In an attempt to explain the general bias towards selecting regressive-type policies, Foxley argued that the answer lies in the nature of the long-term development strategy favoured by the regime in power. He contended that in the Southern Cone, authoritarian regimes have typically supported development models which favour a reduced public sector and an increased role for private investment, with a concomitant decrease in private domestic consumption. The poorer groups, he argued, tend to take the brunt of government attempts to reduce consumption.

Johnson and Salop (1980) corroborated much of Foxley's argument by concluding that Fund-supported adjustment programs have no theoretically inherent distributonal effects in one direction or