*Sri Lanka Journal of Social Sciences 2000 **23**(1&2) and 2001 **24**(1&2): 1-16*

STRUCTURAL RE-ADJUSTMENT PROGRAMMES IN DEVELOPING COUNTRIES: THE CASE OF THE TRANSPORT INDUSTRY IN SRI LANKA

J.W. WICKRAMASINGHE*

Abstract: The human costs of trimming the public sector and re-structuring state industries, under the IMF-IBRD-MONETARIST policy reform package for the developing countries (minimalism), are examined in this paper. Since costs involved are quite high, an alternative restructuring package, which increases supply to meet the excess demand while keeping employment unchanged, has also been explored. However, IMF-IBRD-MONETARISTS choose the former, as they believe that the latter creates a macro-imbalance which would erode the comparative advantage. The price of implementing the second option, macro-imbalance, must be weighed against the benefits of reducing human suffering. It appears that the benefits overweigh the price.

Almost all the developing countries are currently seeking foreign resources for economic development from, among others, the two most important international financial institutions, the IMF and the IBRD. These two institutions in turn channel such assistance from the developed countries, through aid consortia. Suitability of this so called overseas development assistance (ODA) has become a prominent debate among economists and development planners the world over, as these two institutions have been demanding the implementation of a structural re-adjustment package as a condition for lending foreign resources.

The purpose of this paper is not so much to examine the total structural re-adjustment package in the light of its likely impact on the economies of the developing countries, but to examine the human costs involved in the implementation of one ingredient in that package, the trimming of the government activities and re-structuring of the public sector ventures.

* The author wishes to thank Dr. Premadasa Udagama and another anonymous referee for their comments on an earlier version of this paper.

The trimming of the government sector is attempted at least by two methods, *viz*;

(a) by advising the government to restrict its expenditure on welfare activities, such as health, education and food subsidy, as a means of reducing total government expenditure.

(b) by pressurising the recipient government to privatise the existing public sector economic units, irrespective of their economic efficiency *vis-a-vis* the private sector, to minimise the state's role in economic activities [(a) & (b) together are called Minimalism)].

The accepted rationale of trimming the government sector and the privatisation of the public sector ventures is that,

(a) developing countries are capital constrained, hence their growth is relatively low. What is required in these countries is to divert more resources into investment. Welfare expenditure is a luxury which these countries can ill afford. Hence, the sensible approach is to transfer the resources from these welfare activities to investment in physical capital*, particularly in the private sector, keeping the provision of welfare gestures for the future, when the country can afford to do so;

(b) the public sector is relatively inefficient in management and hence productivity is low. The sustenance or expansion of ventures in that sector by over-looking the more efficient private sector is a misallocation of resources. Further, the expansion of the public sector results in deprivation of funds for the more efficient private sector (crowding out), despite the money supply having expanded as a result of an expanding budget deficit. This would push the interest rate up and 'crowd out' private investment and push the inflation rate upwards;

---

*Recently the World Bank has given priority to the accumulation of human capital as well, albeit with reservations.

(c) the management decisions of the public sector institutions are invariably based on political expediency. Consequently, among other things, over-staffing in the public sector institutions is a common phenomenon. Contrarily, in the private sector, which is more profit oriented through minimising of costs, over-staffing is discouraged. Over-staffing is not only a wastage of resources, but also makes the cost of production unusually high, eroding the comparative advantage of the country.

There is a general consensus among economists that the IMF recommends monetarists' prescriptions, whose main focus is on monetary and financial discipline as a means of demand management to achieve economic growth. The Keynesian prescription of expansion of investment, government activities or income, to increase aggregate demand as a means of economic growth, is discarded by the monetarists. The main pre-requisite for economic growth, according to the monetarists, is prudent monetary management, which ultimately keeps demand and prices stable. As the objectives of the monetarists and the structural re-adjustment programmes are almost the same, it is reasonable to assume that the latter, recommended by the IMF for the developing countries, are underpinned by monetarists' philosophy in which economic institutions are tailored to suit the managed demand. Invariably, this results in an initial reduction of employment in the sectors which are re-structured.

It is time that we examined the suitability of the monetarists' prescriptions to a developing country, where poverty and malnourishment are widespread. In a developed economy where the majority enjoy a reasonably high standard of living, the monetarists' prescription may be appropriate, as shock therapy is available to the majority who are subject to shock waves emanating from drastic structural adjustment activities.

Public expenditure on education, food subsidies and health services are currently considered as human capital formation, rather than welfare outlay (Sen, 1981). Moreover, the majority of the people in these countries live in poverty and suffer from malnutrition. The survival of these people, to a great extent, depends on the provision of government assistance. When the government's expenditure on food subsidy, free health and sanitation and free education is reduced, these people fall from the proverbial frying pan into the fire. Does economic development mean increasing poverty and malnutrition for the majority?

The apologists for this type of reform point out that the polarization that is taking place in developing countries as a result of the application of this IMF-IBRD-MONETARIST policy package is only temporary. When the distortions in the economy are corrected by such policies, the economy would eventually grow and the polarization would get reduced (Kuznet Curves). However, the question remains whether further deterioration in the economic status of the poor masses is feasible and tolerable.

On the other hand, is there any country which having implemented this package has not experienced political violence after its implementation? These policies are the breeding ground for riots and other social disturbances.

Then the question boils down to whether resources should be used to feed and sustain people or to suppress them in order to maintain a certain system of distribution of income. Has anyone estimated how much resources have to be devoted to public security to protect the government which implements this policy package? Resources devoted to suppress the riots have to be compared with the allied distortions attached to maintain the *status quo*.

When an alternative approach, i.e., an expansionary path, is available, one cannot grasp the rationale of sticking to this more painful and politically risky approach. Let us examine these two alternatives in the context of developing countries.

Over-staffing which amounts to the presence of 'disguised unemployment' cannot be justified on economic grounds. If any unit of a factor of production cannot produce the value, at least equivalent to the reward it gets, such a unit is subsidised. Such a subsidisation attempt cannot be sustained in the long run without generating serious distortions in the economy. However, our bone of contention here is not so much the existence of a 'subsidy economy' but the procedure adopted to remedy the situation.

Is this demand management the only available remedy? Have the costs involved in terms of human misery and discontent been taken into account when assessing the positive results of the structural re-adjustment package? This aspect of cost in a developing country is particularly severe as the majority is poor, malnourished and destitute. No unemployment insurance or social welfare scheme for the unemployed is available. Once a person is unemployed he/she falls into a worse state of misery. Why doesn't the IMF organise funds to expand the activities of the 'sick industry', as a means of reducing disguised unemployment and cost of production while keeping the existing workforce intact, rather than recommending the contraction of the 'industry' under the guise of re-structuring, which creates widespread unemployment? An attempt is made here to highlight the availability of this less painful alternative for structural re-adjustment in developing countries.

Alternative methods of restructuring: input curtailment and production expansion

An industry may be running at a loss because there is an over-production that cannot be marketed and the only remedy available is to reform that industry by curtailing production to suit the available market, through the reduction of input use, mainly by retrenching labour. Secondly, the loss may also be due to under-employment of certain factors of production due to lack of cooperating factors, so that the former are either not used productively or they are used only partially productively, in the face of unquenched demand for the products or the services of that industry.

The reduction of inputs in the first case would reduce the total cost of production, though sometimes the unit cost may go up with low output. However, what is produced can be marketed with a profit by charging a higher price. But the remedy for the second problem would be the expansion of output by optimising the use of the scarce factors, so that some of the surplus factors could now be used more effectively. As this optimisation process has a limit, the availability of extra employment opportunities by optimal use of existing stock of capital also has a limit. If this limit is reached, making some employees redundant while a slack in demand still persists, the remedy has to be the expansion of the capital stock. This would result in an expansion of production. Through realisation of internal economies, such an expansion would result in the reduction of the unit cost up to the point where the production becomes profitable.

The bone of contention boils down to a decision whether to reduce labour to suit the available capital stock leaving some unsatiated demand or to enhance the capital stock to suit the employed labour force to meet this demand. What is practised is the former.

Of the two alternatives, the first is the easier and quicker method. However, such a strategy would place the whole burden of economic re-structuring on the owners of the displaced factors of production. On the other hand, the second method is more difficult and sometimes takes much longer than the first method, under normal circumstances owing to difficulties attached to expanding the existing market or capturing new markets.

This can be explained with the help of a diagram (Figure 1). The upper section of Figure 1 shows a fixed co-efficient production function. This type of production function suits the transport industry as the capital: labour ratio is more or less fixed in that industry. K_1 shows the available stock of capital which could employ only L_1 of labour. However, the total employment in the industry is shown by L_2 which shows that L_2-L_1 is overstaff. Definitely this excess labour which does not have sufficient co-operative capital, pushes the cost up. That is one of the major reasons why the IMF and other organisations prescribe removal of this excess labour.

If we turn to the lower part of figure 1, we see that the total demand in the economy for transport service is D_2 whereas the existing capital stock permits satisfaction of only D_1, which is only a fraction of the desired amount. This imbalance, as we have shown earlier could be rectified either by cutting down the labour and bringing down the cost or increasing the capital stock and expanding the supply allowing gainful employment of already existing surplus labour. When this happens average cost could fall due to the acquisition of the benefits of large scale operation. Although there is a depreciation and interest component involved in the purchase of new capital assets, the most probable scenario we can expect is that the average cost will remain unchanged as the reduction in cost due to large scale operations will absorb the increased interest and depreciation cost. We do not see any reason as to why this option is not recommended by these international organisations.

However, the question of market does not apply in this case, as excess demand is already present in the market. Therefore, it is hard to grasp the logic of the choice of the first method, despite having the choice of the second in which human suffering in terms of loss of employment or means of livelihood is minimal. However, the resource requirement for the second method is much larger and mostly is of foreign origin.

There is no valid reason to believe that the unit cost of production in the second alternative is going to be higher than the first. Rather, the reverse should be the case, according to the principle, the larger the enterprise the higher the internal economies available. Hence, the comparative advantage of such an industry should improve rather than deteriorate.

However, such a policy may be criticized on grounds of the adverse consequences it could bring about to the macro economic balance in the economy. This procedure increases aggregate demand through an expansion of government expenditure and money supply with its alleged distortions in the economy. Inflation will be the outcome, and as a result, the comparative advantage would be eroded. Exports would suffer, further deteriorating the already present balance of payment problem.

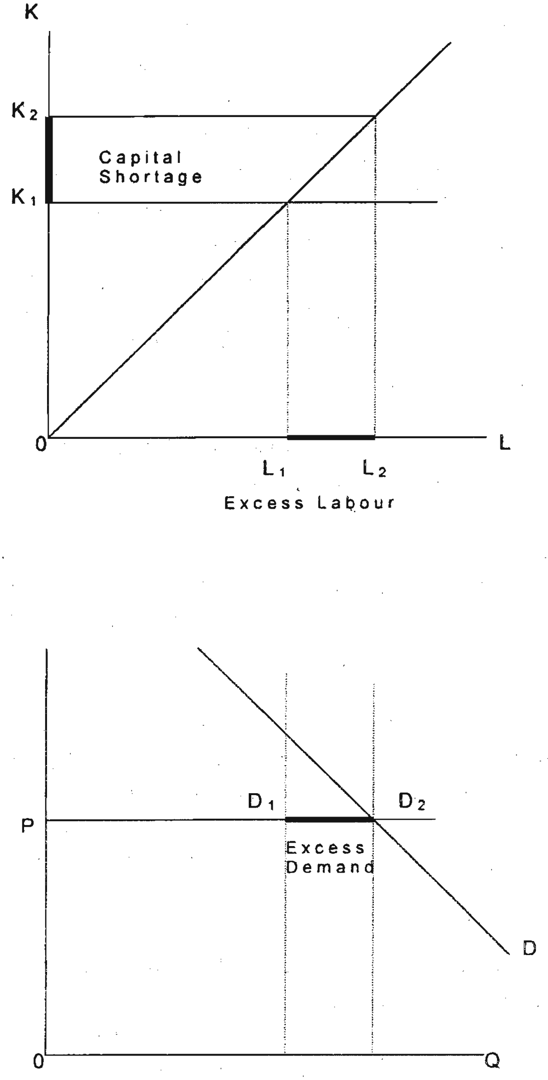

Figure 1: Capital shortage, excess demand and overstaffing in an industry.

The alleged disturbance to the macro-economic balance in a developing country has to be assessed against the human sufferings that are associated with the re-structuring package. Even if the alternative re-structuring package, which is discussed here, has a likelihood of disturbing the macro balance, there are other methods available for countering such an eventuality, by curbing the explosive demand arising out of skewed distribution of income. With the liberalisation of the economy, certain sectors, in particular consumable non-tradables, spurt, making the already skewed distribution of income further worsen as a result of expansion of non-tradables (Wickramasinghe, 1994). This skewed distribution of income generates a lopsided growth in the aggregate demand.

The majority of the people in these counties are poor, malnourished and destitute, because the benefits of growth have not reached this category. However, there is a small class of 'super rich' who grab the bulk of the increased income. The increase of consumption expenditure originates from this class of people (Wickramasinghe, 1995). The growth in aggregate demand can easily be contained by siphoning off income from this group by fiscal measures. They can afford to bear such a loss.

The counter argument against this type of re-adjustment is that when the rich are deprived of a larger plum of the output they are discouraged and thereby new investments may suffer. But new investments which make the rich richer and the poor poorer is not development. The 'trickling down' of the benefits of economic growth to the lower strata of people has not occurred in practice.

There is serious danger in terms of social disruption involved in the first method of restructuring. When the entire burden of economic re-structuring is placed on the employees of these ventures, the emergence of social unrest in the form of civil disturbances, riots and coups against the government cannot be prevented. Even if such social tensions were to be crushed or contained, the resource cost for that attempt would be quite burdensome. Such social unrest make completion of restructuring all the more difficult.

Case study - Public Transport in Sri Lanka

Liberalisation in Sri Lanka has been financed by the IMF and the IBRD. The agreement entered into with the IMF included a clause to contain state expenditure on food subsidy and other welfare activities. The consequences were quite clear. The polarization process intensified, creating widespread poverty, malnutrition and destitution (Wickramasinghe, 1994).

In Sri Lanka, the first phase of liberalisation (1977-88), did not display any substantial trend towards privatisation. The monopoly position of the state owned Transport Board was relegated by allowing the private sector also to have its own service competing with the state transport system. The government realised that the public transport service was unable to meet the total demand, despite having received subsidies from the state; and experiencing 'over-employment'.

The state transport system found it difficult to cope with the competition from the newly established private sector firms owing to the lack of dynamism in facing market situations. This resulted in the loss of the market share of the state transport system and voluntary retrenchment of a large number of people. Employment figures are given in Table 1.

However, the problem with the domestic transport system under state ownership in Sri Lanka was not the result of inadequate demand (Diandas 1988). There may have been inefficiency, mismanagement and political interference in the system, but they explain only one aspect of the problem. Cost increase was mainly the result of a lack of capital assets, i.e., buses to meet the existing demand. However, there was a heavy demand for its services which the Central Transport Board (CTB) could not meet. The crux of the problem lay in the inadequacy of the available imported capital equipment, namely buses. Thus the Central Bank's *Review of the Economy 1988* states, 'Another major factor responsible for the decline in the scale of operation was the general run-down state of the vehicle fleet of the Sri Lanka Transport

Table 1: CTB performance 1964-1981

Year	Buses operated	Bus miles per day	Number of employees	Staff p/b*	Passenger miles per capita	Bus miles per emp.	Passenger miles per gallon	Load factor
1964	2716	140	23854	8.8	415	16	330	63
1965	3019	145	26089	6.9	437	17	291	61
1966	3256	149	28441	8.7	490	17	302	60
1967	3599	157	32165	8.9	529	18	284	57
1968	3686	157	34936	9.5	568	17	303	60
1969	3790	157	42617	11.2	582	14	307	61
1970	4409	147	47441	11.4	608	14	317	62
1971	4494	147	49959	11.3	599	13	317	60
1972	4788	154	47999	10.1	691	15	333	63
1973	4590	150	46976	10.1	731	15	368	72
1974	4302	149	46976	10.9	625	14	362	67
1975	4469	151	46945	10.5	652	14	352	67
1976	4426	153	47531	10.9	701	14	385	73
1977	4583	150	53306	11.4	730	13	406	77
1978	5097	152	59923	11.5	840	13	426	79
1979	5376	153	61380	11.5	902	13	433	82
1980	5670	155	64033	11.3	910	14	418	77
1981	5496	153	61370	11.0	716	14	368	65
New York	3378	88	14815	4.4	137		92	46

* p/b per bus

Source: Friedrich - Ebert - Stiftung, 1988

Board. Of the total fleet, approximately 54% was not roadworthy. Further, nearly 1500 buses were non-operative due to lack of spare parts'. If the necessary capital equipment were available this imbalance could well have been rectified.

The public sector corporations may be relatively less efficient, but that could well have been remedied by re-structuring without retrenching labour. Even after providing the necessary amount of buses to meet this demand, if there was further overstaffing, such excess labour had to be redirected to other sectors. It is hard to understand the rationale behind the adoption of the re-structuring, the way it was done, before meeting this excess demand for transport services. The actual figures of the CTB suggest that alleged inefficiency is mostly exaggerated.

Table 1 gives the number of buses, bus miles, staff, passenger miles, load factor and passenger miles per gallon of diesel in relation to the Central Transport Board of Sri Lanka, with comparative figures from New York.

The fleet of buses rose from 3621 in 1964 to 8005 in 1984. The daily operated number rose from 2716 to 7138 during the same period. Bus miles per employee per day too are given in the Table. In 1967, it was 18 but came down to between 13 and 14 in recent years. This may be due either to reduction in work efficiency or improvement in work conditions, such as reduced working hours or days or expanding house work such as body building, engine overhaul, tyre retreading and driver training.

Transport is a public good with strong externalities, hence its losses cannot be treated as a real loss to society. Table 2 gives the share of the total cost of operating the transport system borne out by passengers and the state respectively in different countries. Sri Lanka has the lowest state contribution to the cost in that list. Passengers pay 85% of the cost and the state pays only 15%. That too is for the subsidised school service and for running uneconomical night services. However, the CTB sources claim that there was no cash flow at all from the government in 1981.

Table 2: Distribution of the cost between passengers and the States

Place	Passenger	State
Milano	22	78
Brussels	27	73
Stockholm	31	69
Paris	45	55
Munich	60	40
London	69	31
CTB	85	15

Source: Friedrich - Ebert - Stiftung 1988

The non-operative fleet or idle percentage ranged between 37% in 1966 to 20% in 1972 and 1975. Subsequently it was around 25%.

The operation efficiency is measured by bus miles per operated bus per day. Miles per operated bus per day or average utilization rose to 120 in 1958, which was higher than the pre-nationalisation period of 100. This rose to 157 in 1967, but thereafter it fluctuated around 148. These figures were higher than even the subsequent figure for private sector buses, 97 miles (or 149 kilometers) and 117 miles (or 180 kilometers) in 1985. This has been achieved mainly by efficient scheduling and progressive route network and by operating more between and after peaks.

The real output of the CTB can be estimated by passenger miles per gallon. In 1967 passenger miles per gallon was 284 and that rose to 433 in 1979. These figures compare well with the railway which had the highest 352 passenger miles per gallon.

The most controversial factor – the employment figures – is also given in Table 1. The highest number of 64033 people was employed in 1980. Employment expressed as men per operated bus rose from 6.9 in

1965 to 11 in 1981, and in the last few years it stood near 10. In 1987 total employment fell to 46586 and men per operated bus to 7.8; this figure had fallen by more than 17000 or by 27% from the peak year 1980. This was the reason for the World Bank's controversial intervention. This ratio in New York has been 4.4 while in other cities it has been between 2.5 and 5. But this difference reflects the differences in technology applied in different countries.

In developed countries, one man crew buses are a common phenomenon. But this cannot be adopted in Sri Lanka owing to very large numbers of commuters utilising the service at a given point of time. Washing, cleaning and repairing in developed countries are mostly done by machines. But in Sri Lanka such activities are labour intensive. CTB buses showed longer per day operations than in other countries. Hence, the frequency of repairs is also very high. In view of such differences the number of men per operated bus in the CTB cannot be considered high.

However, in the USA, a better all purpose index, revenue vehicle miles per employee per year, is adopted. This measure of productivity fell from 13000 in 1967 to 11800 or by 9.2% in 1980 in USA. In Sri Lanka this fell from 6000 to 5000 or by 16.7% over a similar period.

The load factor, that is the capacity used, increased from 57% in 1967 to 82% in 1979. This took place in the midst of a steady increase in the number of buses operated and bus miles operated. This indicates that the CTB never caught up with the increase in demand for passenger traffic.

Do these statistics justify retrenching labour in the CTB? Why didn't they attempt the alternative method of restructuring?

One important lesson which both the representatives of the international institutions and the decision makers in the developing countries should learn, is the structural difference between developed and developing countries; in particular the meagre amount of resources an average citizen in a developing country has command over. Can such a person stand the misery and agony the IMF-IBRD-MONETARIST package places upon him? Deterioration of health, education and skills, even for a short time as alleged by the apologists, sets back the progress of the economy. Any alleged virtues of the policy package have to be weighed against these costs.

Concluding note

An alternative approach to IMF-IBRD-MONETARIST restructuring policies in economies of the developing countries has been examined in this article. The traditional policy reform package, i.e., IMF-IBRD-MONETARIST prescription has brought misery to a large number of disadvantaged people in developing countries. The achievements in terms of economic progress have not been all that impressive either. The restructuring policy package introduced by these lending institutions, in particular, the trimming of the public sector, made way for the displacement of a large number of employees. However, there is an alternative approach which is less painful but which these institutions have not attempted to implement.

If these institutions are genuinely interested in the progress of developing countries it is time they tried that alternative too. The state transport system in Sri Lanka has been examined in this study. The performance in the state owned transport system in Sri Lanka does not justify the type of restructuring that was implemented. CTB could well have been saved by restructuring supply rather than curtailing demand, as was done.

References

Diandas (ed) (1988). *Private Bus Transport in Sri Lanka*, Friedrich-Ebert-Stiftung, Colombo.

Sen (1981). Public Action and Quality of Life in Developing Countries, *Review of Economics & Statistics*, 43,4.

Wickramasinghe J.W. (1994). *Economic Consequences of the Policy Shift From Import Substitution to Liberalised Imports. The Case of Sri Lanka* (1960-1984), Godage & Bros, Colombo.

Wickremasinghe J.W. (1995). Internal Contradictions in Trade Liberalisation Models. *Indian Journal of Economics*, Vol. LXXV, No. 298, Jan.