Measuring Progress Towards Structural Adjustment

Since time immemorial, structural maladjustments have been the distressing prerogative of the less developed world. After the oil-shock five years ago, however, structural problems have emerged in all their vigour in industrial countries as well.

We in the economic profession cannot deny that it was the cyclical, rather than structural, disequilibrium which absorbed our attention in the past decade. If — as seems essential — structural analysis should enjoy a new lease on life, economists should at least begin to devise — among other things — non-traditional ways of measuring, *statistically*, the progress of an industrial country on the road to *structural* adjustment. It is in an effort to fill this gap, at least in part, that this paper has been written. It proposes an analysis based on the "income-share" or "resource-share" approach. It is offered as an alternative to or complement of the more commonly used — but cyclically oriented — approach, generally focused on the *rate of change* of such variables as prices, money supply, domestic credit. An application to the Italian case is also presented as an illustration of this unfamiliar type of analysis.

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The external payments deficit is the traditional measuring-rod of a cyclical imbalance. Of course, it is almost impossible to separate the cyclical from the structural elements in the forces shaping the balance-of-payments results. Owing to our deeply ingrained inclination towards cyclical analysis, we interpret a movement from deficit to surplus as progress towards adjustment, and vice versa. The other "measuring-rod" is the rate of price increase: a deceleration is a sign of an improvement, while an acceleration indicates a failure in the fight against inflation.

These are highly simplified conclusions. In the case of a structural disequilibrium of an industrial country, such traditional measuring rods seem to lose much of their significance. Actually, they may turn out to be misleading.

An improvement in the trade balance may or may not indicate progress toward structural adjustment. It certainly will not, if obtained at the cost of a deterioration of the industrial base, and/or of the financial and profit position of the most important business corporations. The same can be said of a deceleration of inflation, as measured by the trend of prices, because prices are often artificially kept below equilibrium by Government fiat, as the need for "opération vérité" in France clearly reveals.

The resource-share approach would in part avoid these analytical traps. It seems particularly suitable to a long-term analysis of an industrial country which has plunged into a temporary position of structural disequilibrium. For example, it can be used in the case of countries which in 1973-74 suffered a sharp deterioration in their price-terms of trade (usually about 25%), as a result of the decline in the prices of the manufactures — which they export — relative to those of energy, raw-materials and food — which they import. These are typical cases of structural maladjustment in industrial countries. It is for them that the income-share approach appears particularly useful in providing a measure of the adjustment process.

As often noted, the adjustment can only take place through an internal resource shift, from *consumption* to *exports*, in order to narrow the payments gap, and from *consumption* to *fixed-investment*, in order to provide for the required re-orientation of the industrial base.[1]

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The approach here suggested simply focuses on the changing distribution of available resources between consumption, investment and exports. Progress toward adjustment is obviously measured by progress toward the distributional objectives mentioned above, subject to the two important conditions that: (*a*) the rate of GDP growth should be close to capacity; and (*b*) that the resulting payments gap should be financed from abroad. An important correction

1 Conservation of energy, food production and switch to export industries with a larger value added. All these objectives imply the abandonment of some existing fixed assets.

may have to be made for changes in relative prices, since an increase in the share of income of one of the aggregates may merely reflect an increase in its relative price.

The "capacity growth" requirement is a recognition of the employment targets that most Governments must pursue for reasons of social equilibrium. It is obviously in conflict with the dictates of the Phillips curve. To put the point differently, the short-cut to balance-of-payments adjustment via economic stagnation is definitely ruled out by this basic condition.

The second requirement is self-explanatory. It assumes that international lending will move less timidly into the medium and long-term sectors and that international banks will carry out a greater volume of "transformation business", after adopting a different approach to country risk and to the debtor's economic performance.

The Italian Case

The "capacity growth" condition was not fulfilled in Italy during the first five-year adjustment period (1974-78). The average rate of growth fell from 4.3% during 1968-72 to 2% during 1974-78, chiefly because of the balance-of-payments constraint. It is doubtful whether capacity growth was achieved even in the 1968-72 period, and also whether the 4% target rate selected for 1979-81 is adequate, considering the unemployment backlog built up during the past years of near stagnation.

The trade balance is obviously a function of the growth rate, chiefly because of the rather high elasticity of import demand observed in Italy. This explains why the deterioration from a surplus, equivalent to 1.4% of resources in 1968-72 to a deficit of 0.4% in 1974-78 was mild given the 25% drop in the country's terms of trade. Clearly, Italy would have developed a much larger trade gap had it adopted "capacity growth policies", and it would have been clearly impossible to finance such a gap.[2]

This is not to deny that great progress was made by Italy toward reducing the share of resources used for consumption (−4.1 percentage points) and increasing that of exports (+4.7 percentage

2 Assuming a 6% rate of growth, the share of imports to total resources (22.7% on average during 1968-72) would presumably have been 2 or 3 percentage points higher (implying a payments deficit of about 4 or 6 trillion lire).

points). But, unfortunately, there was no progress in increasing the crucial gross investment share (−0.6).

In conclusion, it can be stated that progress toward adjustment was curbed in Italy during 1974-78 by the *balance-of-payments constraint*. The achievements were lop-sided and below requirements. This conclusion clashes with those arrived at on the basis of traditional analysis, which only stresses the change from deficit into surplus of the balance of payments and the marked deceleration of inflation (see Table).

ITALY: TRENDS IN INCOME SHARES

Description	1968-1972	1974-1978		1979-1981	
	As % of total resources	As % of total resources	Change	As % of total resources	Change
Private consumption	53.0	49.7	−3.3	n.a.	n.a.
Government consumption	11.6	10.8	−0.8	n.a.	n.a.
Total consumption	64.6	60.5	−4.1	58.9	−1.6
Stocks	0.7	1.6	0.9	1.7	0.1
Fixed investment	17.1	15.6	−1.5	15.5	−0.1
Gross investment	17.8	17.2	−0.6	17.2	—
Exports (1)	17.6	22.3	4.7	23.9	1.6
Imports (1)	16.2	22.7	6.5	24.1	1.4
Export surplus or deficit (−)	1.4	−0.3 (*)	−1.7	0.5 (*)	0.8
	Growth and inflation rates, in percent				
Real growth	4.3	2.0		4.0	
Price inflation	5.2	17.2		10.0	

(1) Travel, capital, investment and labour income included.

(*) The government assumes an improvement in the price terms of trade and for this reason the surplus between exports and imports is larger than calculated on the basis of the assumption of unchanged terms of trade as in this table.

Source: Elaborated from: Budget Ministry, *Annual Reports* and *Relazione Previsionale e Programmatica 1979.*

What does the future hold in store? The Government has made an attempt to define its targets for the next three years. Even if these objectives were achieved, progress toward structural adjustment would again be rather slow, and even slower than in the

previous five years. The share of consumption would decline further (by 1.6 percentage points), but that of investment would remain unchanged.

To sum up, the balance-of-payments constraint is expected to remain, even during the next three years, the major obstacle to the adoption of full-employment policies. Apparently, the same constraint is likely to slow down the process of structural adjustment. The latter is in fact likely to require a larger volume of fixed-investment than contemplated in the Government's 1979-81 program. But in that case there is a real danger that the saving flow would fall short of requirements and that monetary reserves could be quickly wiped out.

The only way out of this dilemma seems to lie in a deliberate expansion of long-term capital imports by countries suffering from a structural disequilibrium. Simultaneously, there is need for a new and more far-sighted attitude on the part of the international banking community vis-à-vis countries which make real progress on the road to structural adjustment.

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