SAPRIN / EL SALVADOR

THE IMPACT OF ECONOMIC STABILIZATION AND STRUCTURAL ADJUSTMENT PROGRAMS IN EL SALVADOR

EXECUTIVE SUMMARY

FORWARD

The analysis and findings presented here by the Citizen Network for Development (SAPRIN) are the result of a long process of research and consultations regarding the impacts of stabilization and structural adjustment programs in El Salvador.

Since 1998 and with the support of a team of three economists/researchers, the SAPRIN Steering Committee has carried out a process of citizen consultation and research. This participatory process has made it possible to gain further knowledge of the impact of Structural Adjustment Programs in El Salvador, has provided an important analysis of its operational mechanisms and set the basis for alternative solutions to the problems that these programs have not been able to resolve.

The consultative research carried out by the SAPRIN network was characterized from beginning to end by a participatory spirit, in spite of the difficulties and limitations that participatory processes generally encounter in countries like ours. There were many initial workshops and meetings with various sectors of Salvadoran civil society that allowed the definition of the issues and economic policies to be included in the process. Three main issues were selected: the impact of financial-market liberalization on small and medium-scale producers, the impact of the privatization of electricity distribution on the population's quality of life, and the impact of certain *de facto* labor-market flexibilization practices on conditions for working people.

Subsequently, numerous sectoral consultations were complemented by statistical and secondary sources, allowing in-depth studies on the impact of economic policies derived from the adjustment program. Finally, the analysis and conclusions resulting from information gleaned from consultations and secondary sources were validated through additional workshops and meetings.

The participatory research process took a political-economy approach, which is not limited to describing impacts but delves into their causes and reveals the social relations, economic and power structures, the institutions and interest groups that are behind the relations among economic variables. It was also gender and environmentally sensitive, showing the differentiated impacts that economic policies have on men and women, while recognizing that these policies also affect ecosystems.

The results of the participatory research process generally show that the net impact of the economic policies in question was negative, although some positive results were recognized.

This conclusion has given rise to the search for socioeconomic policies that serve as alternatives to neo-liberal policies and adjustment programs. Thus, the following report provides a basis for moving towards a new stage of developing proposals to solve the important problems that Salvadoran society and the economy are suffering. This will be the main task of SAPRIN in the coming months.

We would like to thank the governments of Norway, Sweden, Belgium and the Netherlands and the European Union for their contributions to the global SAPRI initiative that have made this participatory process and research effort possible in El Salvador and in other Latin American, African and Asian countries. We would also like to thank all those international aid agencies that have supported and expressed interest in the Network's activity in El Salvador, particularly NOVIB (Holland), OXFAM UK, Save The Children (Sweden), UNICEF, UNDP, Capacity 21/UNDP, the Böll Foundation (Germany) and the Charles Stewart Mott Foundation (U.S.A.).

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EXECUTIVE SUMMARY

THE IMPACT OF ECONOMIC STABILIZATION AND STRUCTURAL ADJUSTMENT PROGRAMS IN EL SALVADOR

INTRODUCTION

The participatory assessment of economic stabilization and structural adjustment programs (ESP/SAP) carried out by SAPRIN in El Salvador had three transversal elements: a political-economy approach, a gender dimension and an environmental focus. A central aspect of the methodology has been its participatory nature, ensured through the organization of workshops and public fora in which various sectors of civil society expressed their perceptions of the impact of stabilization and adjustment policies on their lives.

The **political economy** approach looks at the structures and the social and institutional fabric within which policies are formulated and implemented and through which policy impacts are felt on society and people's lives.

This approach was used in each thematic study to analyze how the concentration of resources and of benefits has developed and how it is made possible through access to and control of markets, goods and services, as well as through the web of social and institutional relations. Also analyzed was how these type of relations influence the formulation and implementation of the measures applied, as well as how they impact various sectors and aspects of society.

SAPRIN's research also analyzed the scope of the objectives of the stabilization and adjustment programs, as well as their level of success or failure. It tried to identify the causes of these results and how the implementation and outcome of policies were influenced by political, economic, social, cultural, environmental and gender-related factors.

Efforts were made throughout the process to integrate a **gender perspective**, together with this political-economy approach. From a gender perspective, the specific situation and conditions of men and women in society must be analyzed in order to assess the differentiated impacts of stabilization and adjustment programs on men and women in various spheres of activity, such as production, reproduction and community. Such an approach requires taking into account the fact that men and women participate in and are affected by economic adjustment policies in different ways. This reality is rarely acknowledged or identified because existing social relations have led to a tendency to make generalizations based on the male as the model or prototype.

A participatory methodology was utilized to test the hypothesis in each research theme, assessing whether or not the stabilization and adjustment policies implemented in El Salvador were successful in achieving their objectives: What happened to the lives of men and women of different age levels? Were the impacts those that had been expected? What factors may have had an influence on changing the outcome?

The results of the consultation workshops were fundamental in identifying the groups and sectors that were most affected by the policies under study. In addition, documents from secondary sources and statistics provided useful information.

Using a multidisciplinary approach, the research process also included an environmental perspective. This meant taking into account the impact of economic policies on the existence and degradation of natural resources (natural capital), as well as on El Salvador's environment as a whole and its possibilities for sustainability in the future.

The research process also integrated qualitative and quantitative methods. The first phase involved consultations, which provided a qualitative analysis based on the input and ideas of a broad range of sectors that participated in the workshops and activities. The second phase of research focused on quantitative analysis using statistics and secondary sources.

During the final phase of the research process, initial findings were presented to the different sectors affected by the policies under study. Participatory methods were used to seek feedback and outline the primary conclusions and recommendations from the research process. The results are summarized below.

I. PRIVATIZATION OF ELECTRICITY DISTRIBUTION SERVICES

María Eugenia Ochoa[1]

The process of privatization in El Salvador is part of a set of policies that comprise the Economic Stabilization and Structural Adjustment Programs (ESP/SAP). These programs had two primary objectives, to liberalize the economy (deregulation and liberalization policies) and to redefine the role of the State (privatization and resource targeting), which were promoted as part of the process of **Institutional Reform** designed to modernize the state.

The privatization process in El Salvador began in 1989 as a necessary condition to liberalize the financial system. The process assumes that the private sector is more efficient and has greater income-generating capacity than the public sector, and that privatization is required in order to activate and modernize the financial sector.

The re-privatization[2] of the banking sector constitutes the **first generation** of economic reforms that are seen as inevitable requirements for national economic growth, free trade and macroeconomic stability[3]. In this context, ARENA's approach during the presidencies of Alfredo Cristiani (1989-1994) and Armando Calderon Sol (1994-1999) was to promote privatization as a mean of reducing the size of the state, decreasing the fiscal deficit, improving service delivery and providing the government with immediate resources to pay down the debt and invest in social infrastructure (the social budget) in the short term.[4]

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[2] See this document's Liberalization of the Financial Sector , page 7.

[3] Privatization: Modernization s economic fanaticism , editorial. ***ECA***, Number 593, March 1998.

[4] Ibid.

The **second generation** of reforms in the area of privatization took place between 1990 and 1993 and included the sale of state-owned companies that did not provide strictly public services (cement producers, hotels and sugar mills, among others). These privatizations, together with the re-privatization of the banking system, produced only two million colons[5] in income for the public sector. This amount actually represents a small sum when it is taken into account that the state, through its Central Reserve Bank, had to cover the write off of loans in the banks' portfolios, that is, the unrecoverable liabilities of the former national banking system valued at about 700 million colons[6].

The privatization of public services, such as electricity distribution, telecommunications and the pension system, characterizes the **third generation** of reforms, which began in 1996 (although the preparatory stages began in 1993 with proposals for legal frameworks and the design of mechanisms for implementation). Transnational companies, particularly telecommunications and energy companies, showed great interest in investing in these sectors from the beginning, while international institutions such as the World Bank, IMF and Inter-American Development Bank actively promoted the privatization of these services as part of the structural adjustment program.

SAPRIN s participatory research process reached the following conclusions through its findings regarding the privatization of electricity distribution services.

- The objective of the privatization of public services was, in theory, to increase public savings by improving efficiency, raising fees for service delivery and eliminating subsidies. Almost two years after the sale of electricity distribution companies and in spite of the gradual upgrading of technology and equipment on the part of the four companies involved, there have been no significant improvements in terms of service quality and coverage. Furthermore, rural areas have been seriously affected both directly and indirectly by the increase in fees for electricity as a result of price increases in other services that depend on electricity, such as deep-well pumps for potable water used in many communities.

  Initial agreements between the state regulatory entity (SIGET) and the four distribution companies were intended to gradually reduce and finally eliminate subsidies in one year. The price level for electricity was based on real costs calculated to include the minimum profitability needed by the companies to ensure service coverage in rural and poor urban areas. The government, however, had to create a special fund in order to expand services to rural and marginal urban areas. Additionally, it continued to subsidize low-level residential electricity consumption through a social fund, since the operational costs of the companies caused a drastic increase in fees for services.

  Furthermore, the public savings that were supposed to have been achieved by privatizing electricity services are now in question. This is due not only to the subsidies provided through social funds established to guarantee electricity services in areas not deemed profitable for private companies, but also because the creation of the new regulatory entity for privatized services, SIGET, generated new costs.

[5] Ibid.

[6] See Part II of this document: Liberalization of the Financial Sector (Background and regulatory context).

- The second main objective of privatization was to improve the cost effectiveness of public investment by revising investment priorities. This seems contradictory since most of the income received from the privatization of electricity distribution has been used to cover fixed costs in the public sector. Although it is premature to do a quantitative cost-benefit analysis of the impact of privatization of electricity distribution on public finances, the costs of supervision and social subsidies make it questionable whether there has been a positive effect on public finances.

- Privatization was also intended to reduce the size of the state and improve its efficiency. Although an important number of jobs were transferred from the public to the private sector, many new public posts were created in the new supervisory and regulatory entities and social funds. Therefore, the reduction in the size of the state has not been very significant.

- The process of privatization has not succeeded in creating an open market with free competition, characterized by the free mobility of consumers. The four distribution companies compete for only a 20% share of the market's consumers that includes large industries and commercial and service companies that may find it profitable to invest in moving their equipment and operations to areas outside the territorial jurisdiction of a particular electricity distribution company. The remaining 80% of consumers have no possibility of changing providers, even though they may seriously question the level of service they are receiving. This is a particular challenge for the system of free competition, which has been a central purpose of privatization.

- The current register of consumers indicates that approximately 80% are men and only 20% are women. This is based on unofficial assessments by the companies, as they do not disaggregate data by sex. This structure reflects gender inequities, with women being a clear minority in terms of access to resources, housing and business ownership.

- Price increases for service provision have affected the quality of life of the population overall and, particularly, of low-income families. The impact on rural families has been twice as hard, as they also need electricity to pump potable water. Furthermore, the tripling of fees has caused conflicts to develop between some rural communities and the distribution companies.

- Most of the sectors that participated in this consultation process -- including leaders of rural and urban communities -- coincided in their views that low-income women have been those most affected due to the multiple roles they perform (head of household/primary provider, housewife/mother and active community member). In 80% of the cases analyzed during the workshops, women expressed that they had to increase their daily domestic work by 20% (approximately three additional hours of work) in an attempt to substitute for or save on consumption of electricity. This negatively affects women's quality of life and accentuates gender inequities.

- The first generation of reforms in the area of privatization (involving privatization of the banking system) was widely criticized because of the lack of transparency in its administration and implementation. There was more public debate during the second generation of privatizations. The opinions expressed and material reviewed, however, reveal some dichotomies. On the one hand, the state is defended as the best resource provider while, on the other, only private companies are seen as capable of efficient and profitable administration of any economic activity.

A more generalized view of those consulted suggests that the population neither received information nor was sufficiently aware of the measures that were adopted, the regulatory context, supervision standards, fee regulation, and so forth. Hence, many sectors still believe there is a lack of transparency and see no opening for civil-society participation in decision making and oversight of privatization processes.

II. LIBERALIZATION OF EL SALVADOR S FINANCIAL SYSTEM

Oscar Dada[7]

The main objective of the participatory research was to assess the impact of financial system liberalization in El Salvador on micro, small, and medium-scale businesses.

To assess the impact of financial-sector liberalization from the perspective of the development of micro, small and medium-scale enterprises, the research process began by determining whether the efficiency of financial intermediation has favored these sectors and observing whether the competitiveness of these enterprises improved compared with their condition before this process began.

The main findings of the research are as follows.

a) The stated objective of democratizing shareholder participation in the process of privatization of financial institutions never took place. To the contrary, the process allowed the concentration of banking assets within the country's traditionally powerful families, which have benefited the most from the privatization and liberalization of the financial system.

   A review of the privatization process, which also involves the purchase of shares of other financial institutions (insurance companies, pensions, securities institutions), reveals that the concentration of capital in the financial system has been the primary economic development of the last decade of the century. At the same time the financial sector has become the strategic core and most important sector of the Salvadoran economy.

   The above confirms the oligarchical nature of the financial system in which two or three banks control the majority of the financial market. Nevertheless, it must be recognized that competitiveness has improved in the last few years.

b) Until 1998, financial indicators showed significant growth of banks and commercial financial institutions. Financial assets performed well and were accompanied by an increase in public deposits (an increase in savings), as well as in loan amounts for various of the country's economic sectors. Yet loans were primarily granted to the commercial and service sectors, to the detriment of agricultural and industrial activities.

   Debt levels were very low during the first half of the 1990s, showing a suitable relationship between loan repayment and banking assets. Thus, the liquidity and solvency indicators for

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commercial banks were satisfactory, as were the efficiency and profitability indicators. Yet in the last half of the decade, debt levels of banking institutions began to rise significantly.

c) One of the primary objectives of liberalization, obtaining real positive interest rates, was achieved, and the difference between active and passive rates is quite favorable for the banking institutions. Yet El Salvador has some of the worst credit conditions for borrowers due to the large difference between interest and inflation rates.

d) Despite the achievements mentioned, efforts to improve long-term financing have been minimal and the financial system has done little to facilitate business transformation and restructuring and the technological changes necessary to achieve greater competitiveness and efficiency required by the country to compete in world markets. In terms of the environment, financial-system investment to address the degradation of natural resources has been practically non-existent.

e) There has been a progressive dismantling of the agrarian development bank, which has been gradually phasing out its services without establishing alternatives for the sectors it has traditionally served. Second-tier banks utilize criteria that are questionably development oriented and have significantly favored commercial banks.

Micro and small-scale enterprises have been quite adversely affected by these changes, although the impact has been somewhat mitigated by a significant increase in activity in the non-formal financial sector (Workers' Bank, NGOs). The important role that development banks play in terms of social investments needed by societies in the global South has been little understood.

f) The financial-system superintendent's office has played a questionable role, being very passive and operating primarily in the interests of major shareholders of the financial institutions. Therefore, the majority of financial indicators provided by the superintendent's office, and used in this report, should be looked at with much caution, as they are not a good representation of the true accounting of finance companies. Revealing examples of this problem are the cases of Finsepro, Insepro, Fincomer and Credisa, whose deceptive accounting figures provided no warning of the sudden bankruptcies or serious operational problems that these financial institutions have faced in recent years.

g) The Salvadoran financial system has operated with an almost exclusive focus on accumulation, far from what economic development requires. It has become a dominant sector of the Salvadoran economy, generating a process of economic transfers from other sectors towards the financial system primarily through interest rates, commissions and surcharges on loans at the sectoral level.

It can thus be concluded that El Salvador's financial system has been efficient in its administrative development and profitability, while at the same time it has been largely inadequate in terms of meeting the country's needs to achieve true development. To a considerable extent, the financial system has become an obstacle to achieving national competitiveness and long-term economic efficiency.

h) The implementation of current adjustment and stabilization programs, regardless of the objectives of the international institutions (the World Bank and IMF), is subject to the interests of those who control the nation's economy. It is the behavior of those persons who maintain economic control that distorts the objectives of the programs referred to.

Financial-sector liberalization during the first half of the 1990s was partially successful in stabilizing the performance of the financial system and allowing it to operate in a more rational and competitive manner. Nevertheless, the global objectives set out were not satisfactorily met since the country registered higher levels of poverty, little progress in competitiveness at the sectoral level, a greater concentration of wealth and low levels of productivity.

i) In early 1999 the Central Reserve Bank (BCR) gave a large loan of 1.3 billion colons (about 150 million U.S. dollars) to three important banks in the country that had previously tried to save the CREDISA bank. This action by the "monetary authorities" went counter to the newly assigned role of the BCR and shows how the management of this institution is closely related to the interests of financial capital.

The loan was subsidized and had an interest rate of one percent with a long-term repayment period. This practice contradicted and violated the logic and principles of stabilization and adjustment programs, which affirm that the market and conditions of competitiveness are the appropriate means to determine businesses operations. It thus becomes clear that these criteria were not used to assess the efficiency of the financial system. At the same time, other economic sectors have suffered cuts in subsidies and are forced to adhere to certain behavior to which the dominant companies in the financial system are exempt.

Based on the above research findings, the following recommendations are made.

a) Development banks must be given an important role in the financial system, based on a broader conception of development that goes beyond liberalization policies under stabilization and adjustment programs.

b) Second-tier banks should be strengthened in order to achieve the objectives of economic growth and the generation of employment and incomes. The operation of second tier banks should benefit the most vulnerable groups, taking into account their diverse needs and interests. To this end, competitiveness and efficiency should not be the only criteria for the operation of these banks, which should be separated from the formal banking system in order to reduce their intermediation costs.

c) Modernization of development banks should be a priority, as these serve important population sectors that the commercial banks do not traditionally reach because they are structured in a very different manner than the "modernized" groups. These banks can and should be seen as one means of social and economic compensation for the perverse effects of adjustment programs.

d) It is necessary to modernize and strengthen oversight of the banking system with competent personnel who have no conflicts of interest within the banking system they will be supervising. This will help guarantee accurate information and transparency in the financial system and, thereby, allow citizens to make appropriate decisions involving the management of their capital and ensure proper functioning of the private financial system.

e) The international institutions should formulate their policies taking into account that underdeveloped countries do not behave in the same manner as northern countries. They must understand that the criteria of efficiency and competitiveness have different characteristics in underdeveloped countries.

f) International institutions responsible for implementing stabilization and structural adjustment programs should better explain their approach to liberalization. At the same time, they must understand that the traditional business sectors in Latin America are not representative of the range of conditions and characteristics of societies in countries where adjustment programs are being implemented. In most cases, the business sectors utilize adjustment programs to improve their levels of profitability and accumulation, thereby significantly distorting the stated objectives of these adjustment programs.

III. LABOR MARKET FLEXIBILIZATION

Mario Montecinos[8]

Although recent governments have not defined labor market flexibilization policies, their general economic plans and official reports imply that three basic measures are necessary in order to make the labor market more flexible:

- Real wages need to be stabilized at a very low level in order to bring them nearer to equilibrium rates. This implies the establishment of a minimum-wage policy that allows for little variation with inflation.
- The existing regulatory framework should be applied in a flexible manner so as to reduce labor costs and stimulate employment.
- Laws that do not contribute to this flexibilization process should be amended or eliminated.

Thus, the de facto policy of labor-market flexibilization, along with the Ministry of Labor's passivity and indifference towards the weakness of organized labor that thwarts collective bargaining, has sustained a wage regime that lowers labor costs.

The minimum-wage policy is regarded as a factor of labor-market rigidity. It is apparent from analyzing the law that while the Constitution and labor legislation refer to revising the minimum wage, it is stipulated that this be done every three years. Yet in reality, this allows wages to be frozen for anywhere from one-and-a-half to more than three years, thereby decreasing the real wage due to the effect of prices and thus reducing the real cost of labor.

Other means of affecting real wages involve payment by task, by piece, by geographical area, or for domestic work, and so forth. Legal loopholes involving remuneration in this manner allow employers to reduce labor costs.

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Short-term contracts are a common means of reducing labor costs by allowing for lay-offs. Although the law clearly states that these contracts should be regarded as indefinite if the company's main activity is indefinite, employers tend to apply the exceptions written into the law to use short-term contracts in order to reduce their costs for lay-offs, severance and re-hiring.

Furthermore, employers tend to take advantage of loopholes in legislation involving the length of the work day, overtime, shift work and labor mobility in order to extend the work day, avoid overtime payments, etc.

In spite of the presumed rigidity of non-wage labor costs in El Salvador, the country has one of the lowest indicators of labor costs among Latin American countries with high levels of labor-market flexibility.

Labor-market flexibilization affects labor rights, particularly the right to organize. Employers exert pressure to prevent the organization of unions through tactics such as individualizing the bargaining process (for example, offering annual bonuses instead of severance pay), promoting competition in productivity among workers and taking advantage of legal loopholes.

Amendments have been made to the Labor Code that make collective bargaining mandatory when union membership includes 51% (or more) of the company's workers and voluntary when the percentage of members is lower. Nevertheless, the impact of this measure has been diminished as a result of the failure of the Ministry of Labor to stop employer pressure from discouraging workers from bargaining collectively.

Women have entered the labor market to a greater extent, due in part to specific measures aimed at reducing gender discrimination. Yet women are those most affected by labor-market flexibility, particularly in the maquila sector. Women are more vulnerable to abuse as a result of social conditions and the fact that they carry most of the domestic burden, making it more difficult for them to organize in unions. Furthermore, the Labor Ministry does not actively protect women's rights.

Structural adjustment policies in general, and labor-market flexibilization in particular, have hindered consensus-building efforts on the part of the Greater Labor Council and the Forum for Economic and Social Consensus. This situation is the result of a policy that regards unions as an obstacle to the normal functioning of markets, a concept that has worsened the anti-union attitude of much of the Salvadoran business sector and the government.

Free-trade zones and the maquila sector are clear examples of how the regulatory framework serves the needs of employers for labor flexibility. These sectors, which employ mostly women, tend to provide workers with unhealthy working conditions, very limited access to health-care services -- often denying the right to leave the work place for a doctor's appointment -- forced overtime without proper compensation, and high-paced activities based on unrealistic output goals that exhaust workers.

The difficulty women face in defending their rights, in addition to the burden of domestic work they also carry, has meant that there is barely any union organizing in the free-trade zones. The indifference of the Ministry of Labor to employers' abuse of worker rights also contributes to this situation.

The policy of labor-market flexibilization has not stopped the continuous decrease in wages. Even with a very low rate of inflation, there has been a very modest increase in nominal wages. As a result, the minimum wage has been insufficient even to cover a family's basic nutritional requirements, much less to meet average living conditions. Although poverty rates have stabilized at 50% of households, it should be noted that this is due to the fact that, faced with a drop in wages, more family members have had to seek work in order to increase household income, often sacrificing their education.

Employment indicators show that these *de facto* flexibilization practices increase job insecurity by increasing the proportion of workers employed in the informal sector and maintaining a high level of underemployment. Furthermore, women receive lower wages than men do. This research has also verified that the *de facto* labor market flexibilization policy has worsened people's living and working conditions; that is, it has damaged the reproduction of the main production factor, and may thus also harm productivity. In other words, when nominal wages cannot cover the nutritional and integral human needs of workers, their productivity is diminished. Stagnation in productivity levels and inequality in income distribution (Gini = 47-49) have made a reduction in poverty through growth ever more difficult. Household income will only increase when more family members seek income-generating activities, generally at the expense of the education and health of the younger generation.

Health indicators, both at the microeconomic level (in the maquila sector) and the macroeconomic level (doctor visits/person insured through the Salvadoran Social Security Institute, ISSS), show that the continuous deterioration in real wages, or the growing inability of wages to cover basic needs, negatively impacts workers' health and, thereby, their productivity.

This stagnation or decrease in productivity tends to decelerate output growth and then cause it to fall. This can be seen by analyzing the behavior of IVAE (Indicator of the Volume of Economic Activity) in recent years. While productivity has continued to stagnate, the growth rate of IVAE has diminished, revealing that one of the factors weakening economic activity is the drop and stagnation in productivity that, among other things, is due to the fall in the productive capacity of workers.

This *de facto* labor-market flexibilization has not helped to reduce or mitigate the problem of migration from rural to urban areas. This is seen by the fact that both urban employment and unemployment have grown significantly over the past decade when compared with the same indicators in rural areas.

El Salvador's labor market has many complex problems that are not easy to resolve. A solution requires a combination of at least three strategies:

1) The establishment of a legal and regulatory framework that includes labor unions as key actors that will engage with businesses and the government in order to ensure labor-market equilibrium and the efficient allocation of resources.
2) Implementation of a gradual and heterogeneous increase in nominal wages until they reach levels that are sufficient to cover workers' nutritional and integral human needs -- that is, the real value of the labor force.
3) The consistent and coherent integration of a gender perspective and environmental protection measures into the previous two strategies.