History of Global Arms Transfer, 13 (2021), pp. 43-56

Rethinking Development Assistance Based on Structural Adjustment Programs (SAPs) experience in India in the 1990s[†]

By Go Shimada*

Even if the intention of development aid is based on altruism, there is an imbalance of power between donor and recipient countries. This paper examines the structural adjustment programme (SAP) of the Bretton Woods Institutions in the 1990s. This neo-liberal economics-based programme started in the 1980s, transforming the traditional theoretical background and institutional roles. Under this programme, lending was used to incentivize the recipient government to commit to economic reforms. These reforms included deregulation, reduction of subsidy, and privatisation, among others. For example, in India's food subsidy, the food price was raised, food supply quantity was reduced, and households' entitlement was also lowered. As a consequence of this policy, inequality has widened significantly since the introduction of the SAP. Until recently, instead of forcing conditions, the World Bank used the ease of doing business index, ranking all countries based on their commitment to neoliberal economic reforms. This is a more sophisticated way to drive developing countries toward market liberalization, but the power imbalance between developed and developing countries remains.

This paper aims to rethink development aid from a political economy perspective, focusing on the power imbalance between donor and recipient countries. There are several imbalances of power in development aid, such as developed and developing countries.[1] This paper will pay special attention to the donor-recipient relationship among those imbalances, focusing on the neoclassical-based aid policy by the Bretton Woods Institutions (BWIs). This neoclassical-based (or neo-liberal) aid policy was called the 'structural adjustment policy (SAP)'. These market liberalization policies have been widely adopted in developing countries by the BWIs since the debt crisis in the 1980s.[2]

Under the SAP, the world bank imposed several conditions on the economic policies of recipient countries before lending to them. The recipient countries needed to follow the

---

† This paper is based on author's discussion at the online symposium 'Past, Present and Future of Humanitarian and Development Aid: Rethinking the Aid Sector' with Binalakshmi Nepram on 4 Feb. 2021. The significant comments from participants are appreciated.

* Author's affiliation: Go Shimada, Associate Professor, School of Information and Communication, Meiji University.

1 Enomoto, 'Racism in the development and humanitarian sector'.

2 Higuchi and Shimada, 'Industrial policy in Asia and Africa'; Hosono et al., eds., *Workers, managers, productivity*; Shimada, 'Does environmental policy make African industry less competitive?'; Shimada, 'Inside the black box'; Shimada, 'Economic implications'; Shimada and Sonobe, 'Impacts of management training on workers'; Shimada, 'A quantitative study'; Shimada, 'The role of social capital'; Shimada and Motomura, 'Buililding Resilience'.

World Bank's conditionalities, as there were no other lenders for the economically difficult situations facing developing countries in the1980s. With such a weak position against the BWIs, it was tough to negotiate the loan terms, so countries had to just accept the conditions proposed by the BWIs. If developing countries refused to accept the terms, it meant they would have a financial problem shortly as they would lack enough financial resources for their economy. Thus, there was a clear imbalance of power between developing countries and the BWIs. As we will see at the end of this paper, this problem persists in World Bank operations today. However, it is in a different format, such as 'doing-business index' and 'investment climate change.'[3] In other words, the conditions changed from 'hard' conditions to more 'soft' conditions, but the imbalance of power did not alter.

As a case, we will examine the World Bank's aid in the 1990s and Indian policy on subsidy, especially on food. The food subsidy system is called the public distribution system (PDS). The PDS is a policy for poverty alleviation that the government of India employs. In the 1990s, the cost of the PDS had been the subject of controversy and one of the prime targets for the SAP of the World Bank.[4] The reformers advocated the liberalization of the food market and were more concerned with the fiscal problem than the poor's food security.

The rest of this paper is organized as follows. Sections I and II discuss the genesis and theoretical background of the SAP of the BWIs. Then, sections III and IV examine the SAP in India in the 1990s, focusing on the PDS. Section V explores the consequences of the programme on inequality. Conclusions are drawn and summarized in the final section.

I The Genesis of the Structural Adjustment Programme (SAP)

Why and how did the BWIs start the SAP in the 1980s? What is the nature of it exactly? This section examines these points. Table 1 shows the traditional division of labour between the International Monetary Fund (IMF, the Fund) and the World Bank (the Bank). The IMF's traditional role had been to support the 'short-term' balance of payment problem in member countries, providing temporary financial support subject to certain conditions on the drawee country's policies.[5] In contrast, the traditional role of the Bank is financing development projects in developing countries with a relatively long-term framework compared with the IMF's three to five years framework. The theoretical approach of the Bank was not well-grounded, but most of the causes are based on a variant of the two-gap growth model or a Harrod-Domar model of an open economy.[6]

---

[3] September 16, 2021, the World Bank decided to discontinue the doing business report because an independent external review reported data irregularities in the 2018 and 2020 Doing Business reports.

[4] The following words are quite often used to address the issue of the PDS: 'streaming of PDS', 'revamping of PDS', and 'making PDS visible'.

[5] Meier and Rauch, . Each member country has a basic drawing right of foreign exchange and a stand-by arrangement or external finance based on their quota. Under the first tranche, borrowing countries can borrow up to the amount equivalent to the country's initial deposit without any discussion. Beyond that amount, conditions are imposed. The IMF also has various facilities, such as a buffer stock financing facility, a compensatory and contingency financing facility, an enlarged access policy, and an enhanced structural adjustment facility.

[6] Khan et al., 'Adjustment with growth'. In most cases, the Revised Minimum Standard Model (RMSM) is used. The RMSM is basically an accounting framework, which links the national accounts and the balance of payment for medium-term development.

Table 1: Traditional Demarcation between the IMF and the World Bank

	IMF	World Bank
Approach	Macro (Program-based)	Micro (Project-based)
Target	Adjustment/Stabilization	Development
Focused Market	Financial Market	Goods Market
Target Period	Short-term	Long-term

Source: Author

This traditional demarcation started to change in the 1980s. The decade began with harsh external circumstances for developing countries, which led to the changes of the BWIs. Those circumstances include the following: (1) economic recession, (2) declining primary product prices, (3) increased oil prices, (4) high real interest rates, and (5) reduced market access for export. These disturbances led to severe balance of payment problems and financial crises.

These external shocks led the BWIs to recognize the importance of the underlying economic conditions to achieve both economic growth and stability. Because of these problems, the BWIs introduced the SAPs. The SAPs aimed to influence the economy's equilibrium configuration itself through market liberalization. This market-friendly policy is often called the 'Washington Consensus.'

The IMF

The BWIs adopted this market liberalization policy aiming to achieve economic growth and macroeconomic balance at the same time. This change started when the IMF established three-year (mid-term) lending, called extended finance facility (EFF), in 1974. The EFF is longer-term credit, rather than the IMF's short-term traditional 'stand-by' credit.[7] So, the IMF's focus changed from short-term to longer-term development problems, which is the World Bank's territory. So, the establishment of the mid-term lending facility, EFF, by the IMF meant a change in the traditional division of roles between the IMF (short-term stabilization) and the World Bank (longer-term development).

In the 1980s, the Fund started to pay attention to a broader area of development other than the balance of payment, such as unemployment, income, and resource development. Then, the Fund changed their target from the balance of payment to growth-based stability.[8]

Two new EFF programs were added in 1979 and 1980, the full-scale start of structural adjustment lending. Further, the Fund established the structural adjustment facility (SAF)

[7] The repayment period for the EFF is 10 years (the grace period is 5.5 years). To withdraw the EFF, a recipient government needs to meet the performance criteria, which are set every three months. The government also needs to review the achievements every half-year. The duration of the EFF can be extended from three to four years.

[8] Hansen, 'Macroeconomic policies'; Opschoor and Jongma, 'Bretton Woods intervention programmes and sustainable development'; Perkins et al., .

with concessional terms (which the EFF had not featured) in March 1986.[9] Under the SAF, the recipient government was obligated to make a three-year policy framework paper (PFP) with structural adjustment priorities and objectives and to implement it.

In December 1987, the following year, the Fund created the extended SAF (ESAF) for poor, indebted least developed countries (LDCs), pursing stabilization and adjustment policies that had more severe conditions. Still, the loan amount was much more than that of the SAF.[10]

The World Bank

In tandem with the IMF, after about thirty years of only project financing, the World Bank also established quick-disbursing programs such as sectoral adjustment lending (SECAL) in 1983 and structural adjustment lending (SAL) in 1990. The program's target is the macro-economy level to restructure macro economies or specific sectors, rather than a single project level (e.g., support to a power station construction). The first SAL was sanctioned as a $200 million programme with Turkey.[11] The SAL was designed originally as a 12–18-month program, but it was later stretched to 3–5 years to accommodate long-term adjustment measures for institutional and policy reforms.[12] An important point here is that as the target year was extended, its conditions were also increased.[13]

II Nature of the Structural Adjustment Programme (SAP)

Theoretical Background of the SAP

The BWIs introduced the SAP for the following two reasons. First, the cause of the balance of payment deficit and debt crisis in developing countries in the late 1970s was not from temporally short-term liquidity problems but more structural long-term solvency problems.[14] The traditional IMF approach was called the Polak model, a monetary approach to the short-term balance of payment. The introduction of the SAP meant the IMF changed its theoretical background from the Polak model to market liberalization. The main focus is to remove market distortion factors.[15]

Second, the Bank also realised the 'project approach' limitations because of the following three concerns.[16] The first was the fungibility problem. The Bank considered that fungibility misrepresents the impacts of aid on development because the recipient government can increase military expenditure or finance low-priority projects using the aid money. The second was budget pressure from the recurrent cost of projects. Even though the fund is financed by grant in aid, the recipient government needs to bear the recurrent cost, which is difficult to meet for the financially fragile recipient governments. The third

9 The SAF aims to support International Development Association (IDA)-eligible countries.

10 Mosley et al., ;Opschoor and Jongma, 'Bretton Woods intervention programmes and sustainable development'.

11 Mosley et al. (,pp. 32–36), however, reported that, at that time, the executive board of the Bank was suspicious about the new programme. The board felt that the introduction of the new programme would indicate a failure of the past development policies and projects. They also feared that it would damage the political neutrality of the Bank. It was then President R. Macnamara and a small and desperate group of senior officials who took the lead. The country-desk officers also welcomed the new scheme.

12 Reed, .

13 The number of conditions were increased from 27 on average in 1985 to 56 in 1989.

14 The IMF initially responded to the external shock by widening the range of financing facilities.

15 Cook and Kirkpatrick, ; Polak, ; Polak, 'Monetary analysis of income formation and payments problems.'

16 Mosley et al., .

concern was the influence of the macroeconomy on the operation of the projects. Even if the internal rate of return (IRR) for a project is high enough for feasibility studies, quite often, these studies do not take macroeconomic policies into account. In this regard, the ability of the government to adopt appropriate policies on external economic shocks should also be taken into account. Considering these three issues of project approach, the Bank also started to change its operation from project-based aid to the market liberalization policy of the SAP, which is the macro approach.

Policy Conditions as a Forced Intervention upon the Sovereign States

As discussed, traditionally, the IMF and the Bank had two different roles. Due to the economic situation change, the two institutions' roles became closer, which created tensions between them. Both institutes began to formulate a development policy, engaging the SAP.[17]

This kind of change happened because both institutions recognised that economic growth is the essential precondition for project funding and economic stabilization.[18] This led both the Bank and the Fund in the same direction. Actually, the expansion of flexible finance with EFF was not welcomed by the Bank's staff since it took the Fund into medium-term lending, which overlapped with the Bank's operation. Mosley et al. pointed out that the executive board of the Bank might have thought that SALs were a countermarch into traditional IMF territory.[19] The introduction of structural adjustment policy expanded the Bank's operation to non-project (program) lending, which overlapped with the Fund.[20] The conditions of the Fund are quantified by macroeconomic indicators and are precise. On the other hand, those of the Bank is highly qualitative. These differences are confusing for the recipient government.[21]

Still, the most critical change for developing countries was that they needed to follow the market liberalization prescription of the BWIs under the harsh economic circumstances mentioned earlier. They needed to accept and implement those policies to be able to borrow badly needed financial resources from the BWIs. This could be considered a violation of national sovereignty if the BWIs were countries. Of course, they are not a country, but they are powerful enough to make the recipient government obey their policy prescriptions.

Policy Prescriptions of the SAP

Now, let us look at the scope of the economic liberalization prescription under the SAP in detail. First of all, the SAP aims to create a competitive market, correcting the market's distortions.[22] The distortions are considered to be caused by government regulation, licensing, and price control. One example of the distortions is financial repression by credit ceiling (in development economics, this financial repression is called the 'McKinnon–Shaw hypothesis'). According to general 'textbook economics', a market price achieves an ideal resource allocation reflecting scarcity. So, the economic policy under the SAP tries to

17 Feinberg, 'The changing relationship'; Williamson, 'On seeking to improve IMF conditionality'.

18 Opschoor and Jongma, 'Bretton Woods intervention programmes and sustainable development'.

19 Mosley et al., .

20 The article of lending agreement, however, bound itself such that non-project lending is an exceptional case.

21 The Asian Development Bank (ADB) also adopted programme lending in 1987 to support sectoral development programmes, and it became an important instrument for the ADB.

22 Why is a competitive market necessary? The theoretical background of it is based on the neo-classical paradigm of competitive market with the assumptions of small firms as price-takers, no externalities, and no government interventions (Meier and Rauch, *Leading issues in economic development*; Browne, *Foreign aid in practice*; Tarp, *Stabilization and structural adjustment*; Nixson and Colman, *Economies of change in less developed countries*).

remove all kinds of government interventions. Those interventions include price control, quantity restrictions, and investment and import licensing *inter alia*, imposing conditions that influence the micro-and macroeconomic policies of the countries involved.

The policy conditions package of the SAP includes reforms such as (1) balance of payment reform (e.g., trade reform and devaluation), (2) fiscal reform (e.g., tax reform and subsidy reform), and (3) privatisation of state-owned enterprises. Later, we will see the subsidy reform in the case of India. Here, let us briefly examine privatisation policy to highlight the nature of neoclassical economics.

Contents of the Market Liberalization Policy

Privatisation policy intends to downsize government control over economic activities, privatizing public enterprises. Under the privatisation program, public corporations are sold to private investors. In other words, it shifts resources from government to private hands. Market-oriented strategies change the role of the government from regulating its economy to ensuring the basic foundations for private sector activities. Those foundations include legal, regulatory, financial, institutional, and physical infrastructure for the private sector.[23] However, from the neoclassical economics perspective, a government should not take an active role in creating a favourable environment for a particular sector or firm by the industrial policy because it will undermine market competition.[24] In other words, neoclassical economics assumes that privatisation will promote efficiency and rapid economic growth.[25] Therefore, the measures the World Bank used to encourage market liberalization are as follows: (1) elimination of legal monopoly and other market preferences and (2) reform to privatising (contract out or improve the performance of public enterprises).[26]

Most privatisation has been done in the sector of manufacturing and services. The World Bank discussed that privatisation is a better measurement than public enterprise reform.[27] First, privatisation is much easier to implement than reforming public enterprise. Second, public enterprise reform is challenging to coordinate among ministries, financial institutions, and enterprises. Third, the Bank's experience shows that reform introduces crisis in the public enterprises and hardly sustains its improvement.[28]

In this section, we examined the genesis of the SAP and what the policy prescriptions are. The most crucial point here is that the SAP imposes conditions on the recipient countries. The contents of the requirements are market liberalization in recipient countries, removing or weakening all government interventions in the market. Therefore, the questions are how exactly the SAP worked in a specific country and its results. In the next section, we will take India as a case study.

---

23 Cook et al., *Privatization, enterprise development and economic reform*.

24 Fischer and Thomas, 'Policies for economic development'.

25 Kirkpatrick and Lee, 'Market liberalisation and environmental assessment'; Todaro, 'Economic development'.

26 Cook et al., *Privatization, enterprise development and economic reform*. These policies are also encouraged by the World Bank's sister organization, the International Financial Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA).

27 World Bank, *World development report 1992*.

28 Cook and Kirkpatrick, *Privatisation in developing countries*; Cook et al., *Privatization, enterprise development and economic reform*; Parker and Kirkpatrick, 'Privatisation in developing countries'.

III The Structural Adjustment Programme (SAP) in India in the 1990s

This section will see what kinds of economic liberalization the government of India implemented in the 1990s that might have changed vulnerable people's living standards. As discussed in the last section, subsidy reform is one crucial policy prescription under the SAP because it is easier to reduce public expenditure by cutting back subsidies. We will pay special attention to the subsidy reduction policy in India, especially to the public distribution system (PDS). The prices of foods and essential goods are heavily subsidized under the PDS. Hence, market prices were considered to be distorted by government intervention from the Washington Consensus perspective. This section examines why and how India began economic reform.

Political Meanings of International Aid in India

India started its economic reforms gradually in the 1980s, and the reform became drastic in the 1990s. In the 1980s, India was suffering from several issues. Those issues are (1) the drought-affected harvest, (2) the high inflation rate, (3) the balance of payment deterioration, and (4) the influences of the second oil shock in the previous year. Because of these serious situations, Indira Gandhi's government began to seek substantial support from the IMF and the World Bank and collected 5 billion SDR from the Fund with conditions.[29] This movement led to the economic policy change from regulation to liberalization.

Indira Gandhi's movement was very special in three ways. First, up to this period, India had traditionally implemented a very active industrial policy focusing on heavy industry, called the Nehru–Mahalanobis model. Those industrial policies include subsidies and regulations by the government. The second point is related to this first point. The government of India (GOI) started this very active industrial policy because it wanted to be independent of the British empire. How to be independent was the most daunting task for India soon after official independence was established.

Third, due to the Second Indo-Pakistan Border conflict in 1965, aid inflow to India from the United States was cut off as a political sanction. Due to the policy change of the United States, assistance from the Bank also ceased. The GOI was suspicious of the United States and international organizations controlled by the States. After taking up the Prime Minister's post in 1968, Indira Gandhi started an anti-US campaign. This campaign led to India'ss econd stage of economic development, focusing on self-sufficiency in food (Green Revolution) to achieve 'an independent economy'. This policy change in the 1980s had massive importance for Indira Gandhi and Indian economic policy, even if it involved limited deregulation and halted liberalization.

Economic Crisis and Market Liberalization under the SAP

Then, in 1991, India started drastic economic reforms led by then Finance Minister Manmohan Singh due to the liquidity crisis (in mid-January 1991 and late June 1991) caused by various factors such as interest payment increase in the 1980s. Moreover, the Gulf War was also a cause of the crisis because it caused remittances from Indian workers overseas to decline drastically.[30] As a result, the foreign exchange reserve went down to

---

[29] Lipton and Toye, *Does aid work in India?*

[30] The reform was initiated by the Congress party in 1991 and followed by the United Front Coalition (1996–97) and BJP (Bharatiya Janata Party)-led coalition (1998–).

about seven hundred million dollars by mid-1991, which could cover only two weeks of imports. As a result, the inflation rate hiked up to 17% in August 1991.

Further, India experienced a severe fiscal (10% of GNP) and trade deficit and a high external debt service ratio. The total internal debt also amounted to Rs. 2,601,000 million, which constituted 50.2% of GDP in 1990/91. Lastly, the political situation at the centre was unstable, and the uncertainty adversely affected the confidence of external creditors, including non-resident Indians (NRI).[31]

Under this situation, in November 1991, the Rao government entered into a stand-by arrangement with the assistance of the IMF ($2.3 billion for two years). As a result, the economic reforms had started in the areas of (1) industrial policy, (2) trade and exchange rate policies, (3) foreign investment policy, (4) tax policy, (5) financial sector reform, and (6) public sector reform.[32]

Background logic for the reform was based on neoclassical economics that indicated the source of the crisis was the Nehru-Maharanobis type planning of the past.[33] It was discussed that heavy industry-focused policy with import substitute policy had made India ineffective, technologically backward, and a high-cost economy. It was also pointed out that the ineffectiveness was encouraged by the licensing system because it created a monopoly and prevented newcomers from entering the market. The licensing policy led to the crisis for the following three reasons. First, it produced three results: (1) an incapability to compete internationally; (2) shortage of foreign exchange; (3) and misallocation of the scarce domestic resources among economic sectors. Second, the public sector's deficit had been mainly financed by an indirect tax on intermediate and capital goods and debt from the central bank. This way of finance had misallocated scarce domestic resources and crowded out the private industries. Third, high public expenditure in the 1980s had deteriorated the balance of payment because of increased import by high demand as well as real exchange appreciation by inflation, which was caused by the demand-supply imbalance.[34] Based on the notions above, economic reforms started.

IV The Subsidy Reforms under the Structural Adjustment Programme in India

This section looks closely at the contents of the reforms, especially on subsidy reform. The high public expenditure in the 1980s had worsened India's budget deficit. Hence, India started fiscal reform, increasing the government's revenue and bringing down its expenditure. The reduction of subsidies had been highlighted as a measure to decrease

[31] The Government of India ('Economic survey 1991–92', p. 10) stated, 'By June 1991, the balance of payment crisis had become overwhelmingly a crisis of confidence in the Government's ability to manage the balance of payments. The loss of confidence had itself undermined the Government's capability to deal with the crisis by closing off all resources to external credit. A default on payments, for the first time in our history, had become a serious position in June 1991.'

[32] Since the economic reform, India has achieved rapid economic growth. Its real GDP growth rates were 7.8% (1994), 7.6% (1995), 7.8% (1996), 5.0% (1997), and 5.4% (1998).

[33] Ahluwalia et al., *India's economic reforms & development*; Bhagwati, *In defense of globalization*; Joshi and Little, *India's economic reforms, 1991–2001*. Bhagwati (p. 48) summarized as follows: 'I would divide them into three major groups: intensive bureaucratic controls over production, investment and trade; inward-looking trade and foreign investment policies, and a substantial public sector, going well beyond the conventional confines of public utilities and infrastructure. The former two adversely affected the private sector's efficiency. The last, with the inefficient functioning of public sector enterprises, impaired additionally the public sector enterprises' contribution to the economy. Together, the three sets of policy decisions broadly set strict limits to what India could get out of its investment'.

[34] Naastepad, *The budget deficit and macroeconomic performance*.

expenditure.

As a part of the reform, the export subsidy, which had always been a part of the Indian policy, was reduced in 1991.[35] However, fiscal reform was a politically tricky task. It is because, first, at that time, the rate of tax, especially indirect taxes such as customs duty, was too high. Therefore, it was hard to raise the tax to increase the revenue. Second, there was opposition to reducing expenditure, especially subsidies, from the beneficiaries such as public enterprises and farmers regarding the expenditure side.[36]

Among these fiscal reform agendas, the prices of fertilizer and agricultural goods were the centre of the discussion because these are heavily subsidized and had been major political issues. The expenditure on subsidy had been increasing over the years despite the effort to decrease the deficit. It had been discussed that the expenditure on subsidies, especially on food through PDS, was the primary source of fiscal deficit in India. The following section focuses on the PDS reform.

Historical Background of PDS

The PDS is a poverty alleviation strategy the GOI employed.[37] The prime objective of the PDS was to increase food security at both national and household levels. The PDS distributed essential commodities like rice, wheat, sugar, edible oil, kerosene, and coal through a network of 420 thousand PDS retail outlets called the FPS (fair price shop).

Under the PDS, food grain price was kept down by subsidy. For India, this policy was important not only for food security but also for industrial development. The PDS supported the industrial working class and middle class in the urban area during the second (1956–61) and third five-year plan (1961–66).[38] These plans emphasized the building of industrial sectors based on the so-called Nehru-Mahalanobis model. Mahalanobis, who was influenced by a textile-first strategy like Japan, worked out the plan on the persuasion of Nehru.[39]

The Mahalanobis model focused on the need to achieve self-sufficiency in the production of capital goods as the priority and assumed a closed economy and divided industrial sectors into two categories: (1) goods for producers' production sector and (2) consumer goods production sector.[40] The model stresses that the more investment in the former sector, the more economic growth will be achieved in the long term. Hence, the prime strategy for the model was 'industrialization' (heavy industries), making solid linkages between 'backward' and 'forward' industries. Thus, this plan emphasized (1) industrialization, (2)

---

35 Chelliah, *Towards sustainable growth*; Rodrik, 'Taking trade policy seriously'. Indian exporters had started to access export subsidies in the late 1950s, and this practice was later enhanced in the early 1960s. One of the major subsidies was an import entitlement scheme, which was awarded to the licensees based on the value of their exports.

36 Chelliah, *Towards sustainable growth*.

37 Mooij, 'Food policy and politics'; Chelliah, *Towards sustainable growth*; Mooij, 'Food policy in India'; Ramachandran, 'On Kerala's development achievements'. The origin of the PDS can be traced back to the year 1939. The responsibility of the PDS operation is shared between the central and state governments. The central government is in charge of the objective of PDS, which is to increase food security at both the national and the household levels. The responsibility of procurement, stock, and supply goods to state governments is the job of state governments to distribute through retail PDS shops across the state.

38 The Mahalanobis model can be perceived as a variant of Lewis' model (Lewis, 'Economic development with unlimited supplies of labour') in the sense that it has two-sector disaggregation. Mahalanobis is a founder of Indian Statistical Institute (founded in 1931) and created National Sample Surveys (NSS) and Central Statistical Organization (CSE), which enable us to conduct various empirical studies with their detailed database on India.

39 Chakravarty (*Development planning*) stated that there were constraints for planners such as Nehru at that time because they needed to balance between pre-independent and existing powers.

40 Desai, *Development perspectives*.

increased production of iron and steel, (3) heavy chemicals including nitrogenous fertilizers, and (4) development of the heavy engineering and machine-building industry. Further, the agricultural sector was regarded as a 'bargain' sector to finance necessary funds for heavy industry investment.

This neglect of the agricultural sector caused imbalanced growth in India and led to the second stage of development, taking up the Green Revolution as a strategy.[41] In other words, agriculture was neglected and subordinated to the industrial sector to finance investment and support individual workers. The goal of the PDS during this time was to provide food at a reasonable price.[42]

At this time, no free market was permitted because private trade was considered exploitative, so urban people were not only entitled to get food from the FPS but also obliged to buy from the FPS. This enabled the supply of food to rural areas by controlling the demand from urban areas.[43]

PDS under the SAP

The food subsidy in India reduced substantially once the SAP started in 1991. According to Swaminathan (1996),[44] India took the following four ways to reduce the subsidy.

1. The food price was substantially increased, reducing the subsidy in a short period.
2. The quantities of food and goods supplied by the PDS was reduced, and also, in some cases, households' entitlement was reduced.
3. The expansion of the PDS was kept slower than it should be to support the poor.
4. The share of the budget to PDS in the overall budget stalled.

As the PDS is a system of income transfer from the rich to the poor, subsidy reduction may have unfavourable consequences. What is more, under the SAP, the reduction of subsidy is not just food subsidy. It was a very comprehensive and systematic subsidy reduction. This means the market-liberalization-based subsidy reduction policy would have negative impacts on the poor.

V Impacts on Inequality

As we have seen, in the 1990s, the BWIs adopted the SAP as a strategy for their assistance to developing countries. The question is what kind of impacts the SAP had on inequality.

One of the theoretical backgrounds of the SAP was the Kuznets curve, which is a U-shaped curve.[45] In brief, the Kuznets curve tells us that, first, in the initial stage of economic development, the inequality worsens. However, as the economy develops, economic growth leads to more equality in the economy in the later stage of development.

---

[41] The Third Five-Year Plan (1961–66) aimed to make self-sustained economic growth. The objectives included the following: to achieve self-sufficiency in food grains, to expand basic industries to utilize manpower, to expand opportunities for employment, and to establish greater opportunities. The development strategy changed after the Third Five-Year Plan to an Annual Plan during 1966–69, abandoning the method of five-year planning. This was due to the sharp decline of food production, which was caused by the demand–supply imbalance of food and the climatic changes in 1965 and 1967.

[42] This was also very much facilitated by US Public Law-480 (PL-480) conditions, under which India could import cheap wheat. For the United States, PL-480 was a means to dispose of surplus wheat and also a way of supporting US farmers (Mooij, 'Food policy and politics'; Mooij, 'Food policy in India'; Sukhatome and Aber, 'Economists and food price policy distortions').

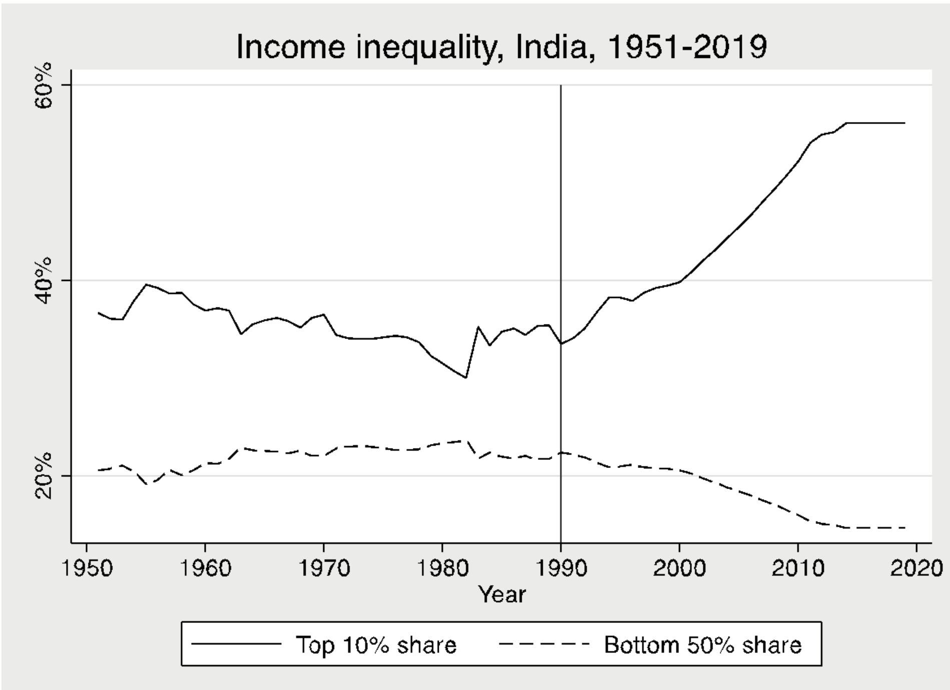
[43] Parikh, 'Food Security'; Radharkrishna and Subbarao, *India's public distribution system*.

[44] Swaminathan, 'Structural adjustment'.

[45] Kuznets, 'Economic growth and income inequality'.

The policy implication of this Kuznets curve is that it is not necessary to worry about rising inequality because it is just an issue in the short term. In the long run, it will be resolved, and the economy will start to grow to benefit everybody. The question is whether this Kuznets curve is true or not. If the Kuznets curve is true, even if it looks like the SAP worsens the inequality in the short run, it will be just fine in the long run. In light of this, let us look at the inequality trend in India during the last seven decades.

The following figure shows the long-term trend of income inequality from 1951 to 2019. The horizontal line shows the years, and the vertical line shows the percentage of share of income occupied. There are two lines. The straight line shows the top 10% of peoples' share in overall domestic income, while the dashed line shows the bottom 50% of peoples' share in overall domestic income. For instance, in the mid-1950s, the top 10% of people's income share was 40%, and the bottom 50% was 20%. The gap between the straight and dashed lines shows the degree of equality. As the two lines show, from the 1950s to the 1970s, the gap between the two lines stabilized or slightly narrowed. This means that during this period, inequality was narrowed. The gap widened in the early 1980s, then stabilized. This situation suddenly started to change in 1990 when India began accepting the SAP and engaging in market liberalization. Inequality has dramatically worsened since 1990 up to around 2015. Now, the top 10% of people occupy more than half the national income, and the bottom half is just a little bit above 10%. It seems the gap is not socially justifiable at this point. India has not reached the end to narrow the gap as the Kuznets line predicted 25 years after the introduction of the SAP.



Source: By this author based on WID.World.[46]

[46] WID.World. 'The world inequality data'.

Conclusion

This paper examined how the BWIs developed the SAP and how the policy changed into market liberalization. As the IMF and the World Bank both went in the same direction, the economic policy imposed became only market liberalization for the recipient government. There was no policy space for the recipient government but to accept the market liberalization policy prescriptions. Under severe economic conditions, India accepted the SAP from the BWIs in the 1990s. However, it resulted in worsening inequality, reducing subsidies such as food. This is because the BWIs (and donor countries in general) are so powerful for recipient countries.[47] Nevertheless, we should keep in mind the fact that India is a politically powerful country. Most developing countries, such as African countries, are much weaker than India against donor countries. So, the impact of the SAP on income inequality in African countries is even more problematic.

Lastly, as we mentioned in the beginning, the BWIs no longer use the SAP as a lending tool, as the forced nature was so unpopular. This, however, does not mean the BWIs' policy on market liberalization has changed. Instead, the conditions have now become more sophisticated and are no longer imposed on recipient countries. Instead, the BWIs use the index called 'doing business' as a 'soft' condition[48]. These ranks countries based on how they engage in market liberalization such as deregulation and reduction in subsidies. Countries are only ranked, and no policy prescriptions are imposed on developing countries. However, the BWIs influence on investors' decisions is enormous. So, doing business can be considered a 'soft' condition for developing countries. Even if the SAP itself is no longer used, market liberalization continues in a more sophisticated way. Therefore, it is essential to consider changing the neo-liberal-based aid policies to narrow inequality in the future.

---

[47] They quite often call recipient countries 'partner countries.' It is an excellent way of referring to others, but the most fundamental issue is not how we should refer to others but the actual power structure between parties.

[48] September 16, 2021, the World Bank decided to discontinue the doing business report because an independent external review reported data irregularities in the 2018 and 2020 Doing Business reports.

References

Ahluwalia, I. J., Little, I. M. D., and Manmohan, S., eds., *India's economic reforms & development: essays for Manmohan Singh, Oxford India Paperbacks* (New Delhi, 2012).
Bhagwati, J. N., *In defense of globalization* (New York, 2004).
Browne, S., *Foreign aid in practice* (1990).
Chakravarty, S., *Development planning* (Oxford [Oxfordshire], 1987).
Chelliah, R. J., *Towards sustainable growth: essays in fiscal and financial sector reforms in India* (Delhi; New York, 1996).
Cook, P. and Kirkpatrick, C., *Privatisation in developing countries* (2000).
Cook, P., Kirkpatrick, C., and Nixson, F., *Privatization, enterprise development and economic reform* (1998).
Desai, M., 'Development perspectives: was there an alternative to Mahalanobis?', in I. J. Ahluwalia, I.M. D. Little, and S. Manmohan, eds., *India's economic reforms and development: essays for Manmohan Singh* (2012), pp. 43-52.
Enomoto, T., 'Racism in the development and humanitarian sector', Paper presented at the Past, Present and Future of Humanitarian and Development Aid: Rethinking the Aid Sector with Binalakshmi Nepram, Online Seminar 2021.
Feinberg, R. E., 'The changing relationship between the World Bank and the International Monetary Fund', *International Organization* (1988), pp. 545-560.
Fischer, S. and Thomas, V., 'Policies for economic development', *American Journal of Agricultural Economics* 72, no. 3 (1990), pp. 809-814.
Government of India, 'Economic survey 1991–92', in M. o. Finance, ed., (New Delhi, 1991).
Hansen, S., 'Macroeconomic policies and sustainable development in the Third World', *Journal of International Development* 2, no. 4 (1990), pp. 533-557.
Higuchi, Y. and Shimada, G., 'Industrial policy, industrial development, and structural transformation in Asia and Africa', in K. O. a. K. Sugihara, ed., *Paths to the emerging state in Asia and Africa*, (Singapore, 2019), pp. 195-218.
Hosono, A., Page, J., and Shimada, G., eds., *Workers, managers, productivity - Kaizen in developing countries* (Singapore, 2020).
Joshi, V. and Little, I. M. D., *India's economic reforms, 1991–2001* (Oxford, 1996).
Khan, M. S., Montiel, P., and Haque, N. U., 'Adjustment with growth: relating the analytical approaches of the IMF and the World Bank', *Journal of Development Economics* 32, no. 1 (1990), pp. 155-179.
Kirkpatrick, C. and Lee, N., 'Market liberalisation and environmental assessment in developing and transitional economies', *Journal of environmental management* 50, no. 3 (1997), pp. 235-250.
Kuznets, S., 'Economic growth and income inequality', *The American Economic Review* 45, no. 1 (1955), pp. 1-28.
Lewis, W. A.' 'Economic development with unlimited supplies of labour', *The Manchester School* 22, no. 2 (1954), pp. 139-191.
Lipton, M. and Toye, J. F. J., *Does aid work in India?* (New York, 1990).
Meier, G. M. and Rauch, J. E., *Leading issues in economic development*. Vol. 6 (Oxford, 1995).
Mooij, J., 'Food policy and politics: the political economy of the public distribution system in India', *The Journal of Peasant Studies* 25, no. 2 (1998), pp. 77-101.
Mooij, J., 'Food policy in India: the importance of electoral politics in policy implementation', *Journal of International Development: The Journal of the Development Studies Association* 11, no. 4 (1999), pp. 625-636.
Mosley, P., Harrigan, J., and Toye, J. F., *Aid and power: the World Bank and policy-based lending*. Vol. 1 (1995).
Naastepad, C., *The budget deficit and macroeconomic performance: a real-financial computable general equilibrium model for India* (Oxford, 1999).
Nixson, F. and Colman, D., *Economics of change in less developed countries* (Oxford, 3rd revised edition edn, 1994).
Opschoor, J. B. and Jongma, S. M., 'Bretton Woods intervention programmes and sustainable development', *Environment and Development Economics* (1996), pp. 183-202.
Parikh, Kirit S. 1991. "Food Security: Issues and Options." 1991 Conference, August 22-29, 1991, Tokyo, Japan.
Parker, D. and Kirkpatrick, C., 'Privatisation in developing countries: a review of the evidence and the policy lessons', *Journal of Development Studies* 41, no. 4 (2005), pp. 513-541.

Perkins, D. H., Roemer, M., and Harvard Institute for International Development, *Reforming economic systems in developing countries, Harvard Studies in International Development*, ([Cambridge, MA], United States, 1991).
Polak, J. J., 'Monetary analysis of income formation and payments problems', *Staff Papers-International Monetary Fund* 6, no. 1 (1957), pp. 1-50.
Polak, J. J., *The International Monetary Fund monetary model at forty* (Washington, DC, 1997).
Radharkrishna, Rokkam, and Kalanidhi Subbarao. 1997. India's Public Distribution System: A national and international perspective. Vol. 380. World Bank Publications.
Ramachandran, V. K., 'On Kerala's development achievements', in J. Drèze and A. Sen, eds., *Indian Development*, (Oxford, 1997), pp. 205-356.
Reed, D., *Structural adjustment and the environment* (1992).
———., *Structural adjustment, the environment and sustainable development* (2013).
Rodrik, D., 'Taking trade policy seriously: export subsidization as a case study in policy effectiveness', *New directions in trade theory* (1995), pp. 347-384.
Shimada, G., 'The economic implications of a comprehensive approach to learning on industrial policy - the case of Ethiopia', in A. Noman and J. E. Stiglitz, eds., *Industrial policy and economic transformation in Africa* (2015), pp. 102-122.
Shimada, G., 'Inside the black box of Japan's institution for industrial policy–an institutional analysis of development bank, private sector and labour', in A. Noman and J. Stiglitz, eds., *Efficiency, finance and varieties of industrial policy* (New York, 2017), pp. 156-190.
Shimada, G., 'Does environmental policy make African industry less competitive? - the possibilities in green industrial policy', in R. Kanbur, A. Noman, and J. E. Stiglitz, eds., *The quality of growth in Africa* (New York, 2019), pp. 350-372.
Shimada, G., 'A Quantitative Study of Social Capital in the Tertiary Sector of Kobe – Has Social Capital Promoted Economic Reconstruction since the Great Hanshin Awaji Earthquake? ', *International Journal of Disaster Risk Reduction* 22 (2017), pp. 494-502.
Shimada, G., 'The Role of Social Capital after Disasters: An Empirical Study of Japan Based on Time-Series-Cross-Section (TSCS) Data from 1981 to 2012', *International Journal of Disaster Risk Reduction* 14 (2015), pp. 388-394.
Shimada, G. and Motomura, M. 'Building Resilience through Social Capital as a Counter-Measure to Natural Disasters in Africa: A Case Study from a Project in Pastoralist and Agro-Pastoralist Communities in Borena, in the Oromia Region of Ethiopia', African study monographs. Supplementary issue. 53 (2017), pp. 35-51.
Shimada, G. and Sonobe, T., 'Impacts of management training on workers: evidence from Central America and the Caribbean region', *Review of Development Economics* 25, no. 4 (2021), pp. 1492-1514.
Sukhatme, V. A. and Abler, D., 'Economists and food price policy distortions: the case of India', *Economic Development and Cultural Change* 46, no. 1 (1997), pp. 79-96.
Swaminathan, M., 'Structural adjustment, food security and system of public distribution of food', *Economic and Political Weekly* (1996), pp. 1665-1672.
Tarp, F., *Stabilization and structural adjustment* (New York, 1993).
Todaro, M. P., *Economic development. Sixth Edition* (New York, 1997).
WID.World. 'The world inequality data', in *The World Inequality Database*, (Paris, 2021).
Williamson, J., 'On seeking to improve IMF conditionality', *The American Economic Review* 73, no. 2 (1983), pp. 354-358.
World Bank, *World development report 1992*, (Washington, DC, 1992).