ECONOMIC REFORMS AND ECONOMIC GROWTH: EFFICIENCY AND POLITICS IN LATIN AMERICA

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"A pragmatist turns away from abstraction and insufficiency, from verbal solutions, from bad a priori reasons, from fixed principles, closed systems, and pretended absolutes and origins... It means the open air and possibilities of nature, as against dogma, artificiality and the pretense of finality in truth." William James, "Pragmatism." In *Pragmatism and the Meaning of Truth*. (Cambridge: Harvard University Press, 1975).

Introduction

Stabilization and other market-oriented economic reforms face a double challenge in new democracies: they have to be economically effective and politically feasible. Economists usually emphasize the former aspect, political scientists the latter, but the two are interdependent and equally important. It is an error to believe, as political scientists often do, that economists know how reforms are to be designed and it is also mistaken to assume, as economists like to think, that all that is necessary for the success of reforms is a technically correct program. On the one hand, some economic programs are just wrong because they start from a false assessment of the problem to be solved or because they entail unnecessarily high economic and social costs. On the other hand, political obstacles, particularly populism and all kinds of dogmatism, repeatedly impede badly needed reforms. The recent Latin American crisis is eloquent on both accounts. Political obstacles are particularly troublesome for new democracies, where the risk of populism is ever present, but it is important to remember that the present crisis is the heritage of authoritarianism.

In the 1980s Latin America faced the worst economic crisis of her history--a crisis defined by stagnation and high rates of inflation. In the middle of this crisis several countries turned to democracy and ever since then they have been striving to

Table 1: Macroeconomic variables in the 1980s.

	1980	1985	1989	1990
GDP Growth (index)	100.0	102.3	111.6	111.5
GDP per capita (index)	100.0	92.3	92.6	90.6
Investment/GDP	23.2	16.2	16.0	15.6
Resource Transfers/GDP	-5.9	2.7	3.2	2.5
Debt/Exports	2.2	3.5	3.0	2.9
Inflation (%)	54.9	274.7	1157.6	1260.1

Sources: ECLA (Economic Commission for Latin America), *Panorama Económico de America Latina 1990 and 1991;* The World Bank: *World Development Reports,* various issues; Interamerican Development Bank: *Economic and Social Progress in Latin America: 1990 Report*.

reform their economies. In the early 1990s some countries began to overcome the crisis but it is premature to say whether a new wave of growth is underway. In 1991 growth of the region was negative; for 1992, a modest GDP increment, inferior to population growth, is forecast by the multilateral agencies.

The crisis affected Latin America as a whole (see Table 1). The performance of individual countries, however, has not been uniform. Some are already growing. Others achieved price stability but did not resume growth. What prevails is stagnation, if not decline, of per capita incomes. Moreover, in the past years, several countries entered an inflationary spiral recurrently interrupted by price freezes. In Bolivia (1985), Peru (1988-89), Nicaragua (1988-89), Argentina (1989-90) and Brazil (1990), the rate of inflation exceeded 50 percent per month at some moments, thus reaching hyperinflation: an unprecedented phenomenon in Latin America.

Why was the crisis so profound? Why did income per capita in Latin America fall by 7.4 percent between 1980 and 1989? Why did inflation, which in 1980 averaged 54.9 percent, climb to 1157.6 percent in 1989? Why did the share of investment in GDP plunge from 23.2 to 16.0 percent in the same period? Can a sufficient explanation be found just in the populist practices of politicians and in an immoderate state intervention, as it is common to hear? What is necessary to do to overcome this crisis? Is it enough to achieve stabilization, to privatize and to liberalize, for growth to resume automatically?

To understand this crisis and to formulate solutions, two alternative interpretations can be distinguished: on the one hand, the neo-liberal or "Washington" approach and, on the other hand, a pragmatic approach which focuses on the fiscal crisis of the state. These approaches share several diagnoses and some recommendations. In particular, both are critical of populism and national-developmentalism that prevailed for long in Latin America. Yet I believe that the pragmatic approach presents a more realistic view of the Latin American crisis, that it is less dogmatic with regard to the policies to be followed and more efficient, since it promotes reforms with smaller costs than the neo-liberal approach. Nevertheless, since the neo-liberal approach emanates from Washington--the dominant source of foreign political power for the region--future policy will most likely consist of a mixture of both approaches.

Although the focus of this essay is on new democracies, I do not limit my analysis to them. I examine eight countries, of which five (Peru, Bolivia, Argentina, Brazil and Chile) experienced a transition to democracy in the recent decade, two (Colombia and Venezuela) have been stable democracies for long, and Mexico is a semi-authoritarian regime that recently shows signs of democratization. In all these countries the transitional costs of adjustment and reform were high when the crisis broke out in 1982. One question I try to answer is if and in what way the new democracies reacted differently from the old ones, from the regime that remained authoritarian (Mexico), and from the country where the transition to democracy took place after the reforms were completed (Chile). This means that I discuss not only the economics of reforms--their effectiveness--but also the politics involved.

The paper is divided in three parts. In Part 1, I review the Latin American economic crisis as seen from the perspective of the two approaches. In the first two sections, the neo-liberal approach to Latin American crisis--the "Washington consensus"--and the "pragmatic" approach are defined; in the third and forth sections, I analyze the Latin America fiscal crisis and its origins; the fifth section distinguishes "market orientation" from "market coordination," the sixth section outlines the appropriate reforms.

The reforms undertaken in eight Latin American countries are analyzed in Part 2. These country studies evaluate the usefulness of the two approaches.

Part 3 focuses on the politics of reforms and their effectiveness. The first section analyses the dilemma between a frontal attack on the fiscal crisis and a confidence building strategy, in which the more powerful sectors of society are spared the transitional costs involved in the fiscal adjustment. The second section discusses the endemic populist threat to reforms, distinguishing populism in general and "the populist pact" from economic populism. In the third section, the consistency of democracy with reforms is discussed. This section questions the common assumption that economists know what must be done and the only problem is to mobilize the required political inputs. In the fourth section, a model is built to discuss transitional costs at the moment reforms are undertaken: the costs of adjustment are compared with the costs of muddling through the crisis. The question in this part concerns the political power governments must acquire to reform the state and to recover the confidence in the national currency guarantied by the state.[1]

In the conclusion, besides a summing up, I show that although the neo-liberal and the pragmatic approaches coincide in several respects, the focus on the fiscal crisis of the state leads to a number of distinctive recommendations. While the neo-liberal approach attributes the economic crisis in Latin America to the existence of a state too big and too strong, the pragmatic approach acknowledges that the state grew too much, in a distorted way, but explains the crisis rather by the weakness of a state hampered by the fiscal crisis than by its excessive strength. The state was crippled by the fiscal crisis and lost the ability to perform its role of complementing the market in the coordination of the economy. The neo-liberal approach, adopted by the policy-making capital of the world, paradoxically limits economic policy to a negative role: that of reducing the state apparatus. Moreover, it ignores an essential characteristic of Latin American inflation since the 1970s: its inertial character. As a consequence, stabilization programs that follow the orthodox approach, when they are not simply ineffective, tend to generate high costs and, once stabilization is achieved, growth takes long to be resumed. This ineffectiveness is aggravated by the dependence of multilateral agencies upon the developed world and particularly the United States, whose interests not always coincide with those of Latin American countries; a dependence that became particularly clear in the soft approach to the debt crisis.[2] In contrast, the pragmatic approach emphasizes the need--given by the gravity of the fiscal crisis--to reduce or cancel public debt and it stresses the importance of recovering public savings. As a pragmatic approach, it emphasizes policy making, discarding the pessimistic neo-liberal view that state intervention is always promoted in the personal benefit of policy makers. It asserts the need for a broad and flexible development policy once stabilization is achieved: a strategy in which state coordination has a subsidiary but significant role and the national interest criterion replaces nationalism.[3]

Neo-liberal or pragmatic approach?

The Washington Approach

The Washington approach to the Latin America crisis crystallized in the last ten years. John Williamson (1990) has recently published a paper in which he defined what he called "the Washington consensus" and, while the expression "consensus" may be too strong,[4] it is quite clear that some kind of concordance on the Latin American crisis does exist in Washington and more broadly in the OECD countries.

The origins of this perspective are reasonably clear. Its roots rest in the collapse of the Keynesian consensus (Hicks, 1974; Bleaney,1985) and in the crisis of development economics (Hirschman, 1979). It is marked by the rise of a new right — neo-liberalism — which is represented in the domain of economics by the Austrian school (Hayek, Von Mises), monetarists (Friedman), the new-classics (Lucas, Sargent), the free-traders (Krueger, Balassa) and by the public choice school (Buchanan, Olson, Tullock, Niskanen). These views, tempered by some degree of pragmatism, are espoused by multilateral agencies in Washington, the Fed, the U.S. Treasury, the finance ministries of G-7, and the chairmen of the most 20 important commercial banks.[5] They form the "Washington consensus": the neo-liberal approach that, having Washington as geographical origin, has a powerful influence over governments and elites in Latin America.

According to this approach, the causes for the Latin American economic crisis are basically two: (1) excessive state intervention, expressed in protectionism, over-regulation and an oversized public sector and (2) economic populism, depicted as fiscal laxity, the unwillingness to eliminate the budget deficit. Following this assessment, economic reforms should in the short run combat economic populism and control the budget deficit, while in the medium run they should embrace a "market-oriented" strategy of growth, i.e., reduce state intervention, liberalize trade and promote exports.

In Williamson's (1990: 8-17) version, "the Washington consensus" comprises ten measures: (1) fiscal discipline should be imposed to eliminate the fiscal deficit, (2) priorities in state expenditures should be changed to eliminate subsidies and to enhance education and health expenditures, (3) a tax reform should be implemented, with increasing rates if unavoidable, but with the admonition that "the tax base should be broad and marginal tax rates should be moderate", (4) interest rates should be market determined and positive, (5) the exchange rate should also be market determined, (6) trade should be liberalized and outward oriented (there is no priority for liberalization of international capital flows), (7) direct investments should suffer no restrictions, (8) state owned enterprises should be privatized, (9) economic activities should be deregulated and (10) property rights should be made more secure. Note that the five first reforms could be summarized by one: stabilization by orthodox fiscal and monetary policies, in the IMF style, where the market performs a major role. The remaining five reforms constitute different ways of saying that the size and the role of state should be severely reduced. Thus the implicit diagnosis is transparent: the Latin American crisis originated from fiscal laxity (populism) and statism (protectionism and nationalism).

It is worth noting that the Washington consensus says nothing about the foreign debt crisis and ignores the problem of public savings,[6] while economic populism and state intervention are not historically situated: the implicit suggestion is that these problems have always been serious handicaps for Latin America.

The Washington approach assumes that growth will automatically resume once macroeconomic stabilization, trade liberalization and privatization are completed. There is no doubt about the priority of stabilization. Moreover, market- oriented reforms will probably improve resource allocation and increase the efficiency of the economic system. Yet, in no Latin American country was the neo-liberal ideal of a minimum state reached. Even in Chile and Bolivia, where more was done in this direction, the economic role of the state remains crucial. In Colombia, no structural reforms were undertaken and yet fiscal discipline was achieved and the country presented the best economic performance of the group in the 1980s. In turn, countries that succeeded in stabilizing and are implementing liberal structural reforms, Bolivia and Mexico, present unsatisfactory rates of growth (Table 2). Both Williamson and Rudiger Dornbusch (1989) analyzed this fact, while Pedro Malan (1990) noticed that this situation was provoking a clear malaise in Washington.

The Fiscal-Crisis, or Pragmatic, Approach

The assumption that it is enough to stabilize and to reduce state intervention for growth to follow is false. While liberalizing reforms do foster market coordination and improve resource allocation, making the economic system more efficient is not enough for growth. If growth is to resume, it is necessary to combat the fiscal crisis, to recover the public savings capacity and to define a new strategic role for the state, so that total savings are increased and technological progress can be promoted.

The fiscal-crisis or "pragmatic" approach relates the Latin American economic difficulties to the debt problem as much as to economic populism.[7] Both had as consequence a fiscal crisis of the state that expresses itself in high rates of inflation. As prices and wages tend to be informally indexed, this high inflation has a chronic or inertial character. In the light of this approach, stabilization programs, besides adopting orthodox fiscal and monetary policies, should include incomes policies and reduce the outstanding public debt. Once stabilization is achieved, market-oriented reforms should ensue, but the state that emerges from these reforms, while smaller and reorganized, should have not only a political and a welfare but also an economic role, particularly in the area of targeted industrial policy oriented to export promotion.

Table 2: Latin America: Per capita GDP growth and inflation in the 1980s in selected countries (percentages)

	Per capita GDP			Inflation		
	1985-9	1989	1990	1985-9	1989	1990
Argentina	-2.1	-5,6	-1.8	468.6	4923.8	1344.4
Bolivia	-1.8	-0.1	-0.2	192.8	16.6	18.0
Brazil	2.2	1.2	-5.9	489.4	2337.6	1585.2
Chile	4.4	8.0	0.3	19.8	21.4	27.3
Colombia	2.7	1.5	2.1	24.5	26.1	32.4
Mexico	-1.3	0.9	1.7	73.8	19.7	29.9
Peru	-2.6	-13.2	-6.8	443.2	2775.8	7649.7
Venezuela	-1.1	-10.1	3.2	32.5	81.0	36.5

Source: ECLA (Economic Commission for Latin America): *Panorama Economico de America Latina 1990* and *1991*.

The pragmatic approach has as its antecedent the dependency approach that was dominant in the late 1960s and throughout the 1970s. The major difference lies in the fact that the dependency approach took the causes of underdevelopment to be structural, whereas the pragmatic approach assumes that they are to some extent strategic. Yet both are concerned with the importance of international variables, presently the debt crisis, and both are critical of diagnoses and recipes that ignore the specificities of Latin American countries.[8]

Since the onset of the debt crisis, the adjustment programs sponsored by Washington called for balancing budgets through both current expenditure and investment reductions. The alternative of eliminating the budget deficit through an increase in taxes and a reduction of the public debt received less attention.[9] In practical terms, balance of payment and price adjustments are regarded as so important that the quality of fiscal adjustment is not taken into account. Fiscal adjustment that hurts investments is considered as good as the one that cuts current expenditures. Expenditure cuts are treated as superior to tax increases, ignoring that expenditure cuts will usually be regressive while tax increases can be a tool of income distribution.[10] Debt reduction is systematically left aside as a last resource.

And the idea that the recovery of public savings is an essential part of reforms is usually disregarded.

In contrast, the fiscal-crisis approach starts from the hypothesis that growth does not automatically resume after stabilization, either because stabilization is achieved at the cost of public investment or because reforms does not tackle the public savings question. This approach asserts that growth will only be resumed if stabilization and market-oriented reforms are complemented with the recovery of the public savings capacity and with policies that define a new strategic role for the state. For the fiscal crisis means not only that the state has no credit, being unable to finance its activities, but also that it had lost the capacity to invest and push forward long-run policies oriented to industrial, agricultural and technological development. Once the fiscal crisis is overcome, public savings will have to be restored in order to finance a growth strategy.[11]

The neo-liberal approach assumes that private savings and investments will substitute for public investment. True, historically this has been the trend. While the state performed a decisive role, directly investing in industry, in Germany and in Japan at the end of the nineteenth century, since then this role did not cease to be reduced and transformed. Yet it is not realistic to expect that such a transformation would take place abruptly. The substitution of private investments for investment directly undertaken or induced by the state must necessarily be a gradual process. The state, particularly in the present stage of development of Latin America, performs a supplementary but nevertheless strategic role in coordinating the economy and promoting economic growth. When the state is paralyzed because of a fiscal crisis, the whole economy tends to be immobilized.

The pragmatic approach supports trade liberalization, but not as a magic formula. As Collin Bradford Jr. (1991: 88) observes, the recent literature on development strategies presents two alternatives to achieving international competitiveness: (1) "structural reform of the national economy for domestic competitiveness which results in dynamic growth and an increased supply exports" or (2) "trade policy reform for international competitiveness which allows the economy to respond to external demand". The last alternative is characteristic of the Washington approach. Its representatives enumerate several "pre-requisites for a successful outward-oriented strategy" (Krueger, 1985) but it is quite clear that the essential pre- requisite in their view is to liberalize trade and open the economy. The first alternative is preferable in the light of the pragmatic approach.[12] While trade liberalization alone may be an appropriate strategy for small countries like Singapore, Hong Kong, or Uruguay, for the large countries of Latin America, trade liberalization should be just one ingredient in a development strategy encompassing public savings, investments in education and in technology as well as export promotion. The import substitution strategy is over, having exhausted long time ago its potential. This strategy does not assure international competitiveness. But it makes little sense to believe that it is enough for the state to stabilize, to liberalize trade and to promote public education for growth to automatically resume. In the words of Bradford (1991: 93):

> The export-led growth [neo-liberal] idea is based on the notion that if conditions are right, exports will occur, but the theory does not specify the agents of dynamic export growth beyond the efficiency gains form the static allocative effects of getting prices right. The growth-led export [pragmatic] idea is based on a richer range of elements which activate the growth process. These focus on knowledge generation process both domestically through education, training, literacy, R&D support and the like as well as the crucial absorption of technologies from abroad through open economic policies.

The pragmatic approach should not be viewed as a rejection but as an alternative to the Washington consensus that shares many views. Both are opposed to the "national-populist" posture that still exists in Latin America, although with progressively less credibility and support.[13]The pragmatic approach accepts the need for reducing the size of the state, which grew exorbitantly in the last 50 years, and agrees that this expansion generated serious distortions, since the state tended to be captured by the special interests of rent-seekers. Our approach emphasizes, however, that the crisis of the Latin American state is due to the fact that the form of state intervention--import substitution strategy of industrialization--is exhausted, rather than to the sheer size of the state. It does not accept the neo-liberal axiom that says: "since state failures are worse than market failures, the solution is to reduce to a minimum state intervention." While state failures may be as bad as market failures, economic reforms and, more broadly, economic policies, represent an attempt to limit and overcome these failures. Sometimes reforms imply less state intervention, but sometimes more.

Hence, with these caveats, the pragmatic approach supports the liberalizing, state-reducing reforms embodied in the neo-liberal posture. Yet the neo-liberal assessment of the causes of the crisis is incomplete and partially mistaken, particularly since it confuses a deep fiscal crisis with a voluntaristic conception of fiscal "indiscipline." As a result, the reforms entailed in the Washington consensus are insufficient.

The neo-liberal diagnosis of the origins of the Latin American crisis of the 1980s is historically inaccurate. This crisis cannot be attributed to solely to economic populism, since populism always existed in Latin America. It cannot be ascribed to a

Import-substitution strategy, since for many years this strategy yielded excellent economic results. It cannot be attributed to the intrinsically erroneous character of state intervention, because during many years this intervention was successful. Latin American economic development between 1930 and 1980 would never had been so intense were it not for the active role of the state.

According to the pragmatic approach, the Latin American crisis can be explained by the cumulative distortions provoked by years of populism and national-developmentalism, by the excessive and distorted growth of the state, by the exhaustion of the import substitution strategy and by the central consequence of all these accumulated trends: the financial crisis of the state--a crisis that immobilizes the state, transforming it into an obstacle rather than an effective agent of growth.

The concept of the fiscal crisis of the state should be clearly distinguished from mere fiscal laxity or budget deficit. The fiscal crisis is a structural phenomenon, rather than a short-run, circumstantial one. Persistent public deficits certainly engender a fiscal crisis, but once the deficits are eliminated, the country confronts a more serious problem. James O'Connor (1973) introduced the concept of fiscal crisis of the state,[14] explaining this crisis by the increasing incapacity of the state to cope with the growing demands of several sectors of the economy and corresponding social groups.

In the 1980s, the fiscal crisis of the state had five ingredients in Latin America: (1) a budget deficit, (2) negative or very small public savings, (3) an excessive foreign and domestic debt, (4) poor credit-worthiness of the state, expressed in the lack of confidence in the national money and in the short term maturity of the domestic debt (the Brazilian overnight market for Treasury bonds)[15] and (5) a lack of credibility of the government.

A public deficit and public savings insufficiency are flow characteristics of the fiscal crisis, while the size of public debt--be it internal or external--is a stock property. The lack of credit and credibility are socio-psychological phenomena directly related to the real characteristics, but with some autonomy in relation to them. A country may have a high public deficit and also a high public debt, but the state need not lose credit and its government credibility. This is the present case of the United States and Italy, where in spite of the deficit and the debt, there is no fiscal crisis or at least one much milder than those prevailing in Latin America. The loss of credit by the state--its inability to finance itself except through seignorage (money creation)--is the quintessential characteristic of fiscal crises. There is thus a direct relation between a fiscal crisis and the hyperinflationary regime that tends to prevail as its consequence.

Most characteristics of the fiscal crisis are self-explanatory. Yet I believe that it is important to stress the issue of insufficiency of public savings. Particularly in a developing country, this factor has a fundamental strategic role. Negative public savings tend to be a direct cause of low investment rates and the stagnation of per capita incomes. Public savings, SG, are equal to current revenue, T, less current expenditure, CG, where interests are included:[16]

$$SG = T - CG.$$

Public savings are a distinct concept from public deficit, DG, that is equal to current state revenue less all expenditures including investments, IG, and corresponds to the increase in the public debt:

$$- DG = T - CG - IG.$$

Given these definitions, and not considering real seigniorage, public investments are financed either by public savings or by public deficit:

$$IG = SG + DG.$$

These distinctions are important. They are part of the standard national accounts system but with a shortcoming: state-owned enterprises are excluded from the calculation of public savings. Few economists include public savings among their tools.[17] Under of the fiscal and monetary adjustment approach adopted by the IMF, the stabilization literature refers almost exclusively to the public deficit. Yet to analyze the economy of any country, public savings are a concept at least as important as the concept of public deficit.

Public savings will be a particularly important tool if we adopt a broad concept of public investment. According to this concept, public investments cover, on one side, (1) investment proper, which includes (1.1) investments in projects in which the private sector did not show interest (infrastructure), (1.2) social investments (education, health) and (1.3) investments in security (police, prisons) and, on the other side, (2) subsides or incentives to private investment (agricultural and industrial policy).

When public savings are near zero, the state will have only one alternative if it wants to invest: to finance them through public deficit. However, if the objective is to reduce public deficit--an intrinsic part of any program to resolve a fiscal crisis--a likely outcome will be a cut of public investments. If the state invests, its indebtedness will be increasing and its credit diminishing; if the public deficit is eliminated, investment will be cut. And if public savings are negative, the state will have a deficit even if public investments are zero. The deficit will finance current expenditures, most of it typically interests. In any event, the state will be paralyzed, unable to formulate and implement policies that promote growth. And this paralysis, more than anything, reveals the relation between fiscal crises and economic stagnation.

The Fiscal Crisis in Latin America

Since the early 1980s, when the foreign debt crisis erupted, Latin American countries have engaged in adjustment and reform strategies in accordance with the neo-liberal approach. The results in terms of stabilization are modest; in terms of growth, with the exception of Chile, practically none. The proponents of the neo-liberal approach will certainly say that these efforts were not enough: fiscal adjustment should be more rigid, monetary policy firmer, interest rate higher. I accept that it is impossible to stabilize without incurring costs. But the efforts must have a return. Yet in many cases, these efforts, particularly the stabilization initiatives, proved to be perverse, self-defeating, since they did not attack the core of the crisis: the fiscal crisis and consequent immobilization of the state (Bresser-Pereira, 1989). And the other core of the crisis--the exhaustion of the import substitution strategy--was also not solved, because of the paralysis of the state.

Governments in Latin America, which between the 1930s and the 1970s performed a major role in structuring the national interest and in promoting economic growth through the appropriation and utilization of forced public savings, were hurt by the fiscal crisis, and eventually immobilized. In Table 3 we selected eight Latin America countries. In spite of its deficiencies, Table 3 is quite clear on the fiscal crisis.[18] In most countries public investment was kept at the level of early 1980s; in the cases of Mexico and Peru, it fell strongly. The data on public savings are impressive. In 1980, among the eight selected countries, only Bolivia presented negative public savings; in 1988 only Chile and Colombia (exactly the two countries that do not face a fiscal crisis) exhibited positive public savings. Public deficit was reduced in practically all countries, but it remains high. The only exception is Chile, which presents a surplus since the beginning of the decade. The deficit in Colombia is small. Mexico, which in this Table still shows a deficit, was finally able to control its public finances by achieving an extraordinarily high primary surplus.[19]

Table 3: Latin America: Investment, savings and public deficit in selected countries.

	Public Investment (% GDP)[a]		Public Savings (% GDP)[a]		Public deficit % GDP)[b]	
	1980	1988	1980	1988	1980	1988
Argentina	8.9	7.9	2.3	-2.2	7.6	8.6
Bolivia	1.2	2.7	-6.7	-2.0	9.1	5.5
Brazil	2.4	3.0	1.1	-2.6	6.7	4.8
Chile	2.6	3.5	6.4	11.4	-5.4	0.5
Colombia	6.6	7.7	0.7	1.1	2.5	2.2
Mexico	9.6	4.4	1.5	-0.9	3.8	3.5
Peru	3.0	0.5	2.0	-3.6	3.9	7.6
Venezuela	1.3	3.2	7.3	-0.4	-4.0	8.6

([a]) Bolivia,Peru and Venezuela: Central government only; Chile: central government, decentralized entities and municipalities; Brazil: state-owned enterprises not included. Argentina, Bolivia, Chile and Venezuela: public investment does not include capital transfers.
([b]) Bolivia: 80, only central government.
Source: Interamerican Development Bank: *Economic and Social Progress in Latin America: 1990 Report*. ECLA (Economic Commission for Latin America): *Panorama Economico de America Latina 1990* and *1991*. For the public deficit (PSBR) also Central Bank of Brazil and Bank of Mexico.

Table 4 presents some data related to the foreign accounts of the eight selected countries: debt/export ratio, debt/GDP ratio and interest burden of central government (external and internal).[20] The Table clearly shows that the debt ratios remain very high, except for Colombia and Chile. In all countries the debt/export ratio deteriorated between 1980 and 1988. Transfers of real resources continue to be, on the average, very high. When they are small (Peru) or even negative (Venezuela, 1988), this may just denote a bad performance of the trade and real services balance and a significant current account deficit. Data relative to interest are not fully trustworthy. Interests paid by the Mexican central government seem to be excessive but they are consistent with a primary surplus of 7 percent of GDP and a public deficit (PSBR) of 5 percent of GDP.

Origins of the Fiscal Crisis

As the data on Table 3 and 4 indicate, the efforts to adjust the Latin American economies during the 1980s were impressive. Yet, they were basically self-defeating. The only country which was able to adjust and overcome the fiscal crisis was Chile, and this happened earlier, in the 1970s. Moreover, during the 1980s, Latin American countries strived not only to adjust, but also to implement structural reforms. Yet the results in term of growth were again unsatisfactory, except again for Chile and perhaps recently Mexico. These two countries are being offered as show cases of the Washington approach. For Chile this may be true, but even this country, since 1983, did not follow strictly neo-liberal recipes. As for Mexico, it is important to remember that stabilization was achieved through a combination of fiscal policy and a heterodox shock, and that industrial policy remains on the Mexican government agenda. Anyway, Mexico is usually viewed as nearer to the Washington than to the fiscal crisis approach, particularly because the Mexican government was the first to sign a debt agreement according to the Brady Plan.

Table 4: Public external debt ratios in Latin America (selected countries)

	Debt/Export Ratio			Resource Transfers (% GDP)		
	1980	1988	1989	1980	1988	1989
Argentina	2.8	5.3	5.4	-2.2	5.2	6.4
Boliva	2.3	6.1	4.0	5.4	8.3	-3.3
Brazil	3.2	3.1	3.1	-3.3	6.2	4.9
Chile	1.9	2.1	1.7	-4.2	5.6	4.0
Colombia	1.3	2.4	2.2	0.6	6.7	3.0
Mexico	2.4	3.5	2.9	-2.3	8.4	0.9
Peru	2.1	4.5	3.7	0.0	1.9	3.2
Venezuela	1.5	3.0	2.3	7.0	-4.8	4.4

Sources: ECLA (Economic Commission for Latin America): *Panorama Economico de America Latina 1990* and *1991*. Interamerican Development Bank: *Economic and Social Progress in Latin America: 1990 Report*.

The fiscal crisis of the state in Latin American was the result of two factors: on one hand, the excessive foreign indebtedness of the 1970s; on the other hand, the delay in replacing the import substitution strategy of industrialization by an export led one. The two origins may be reduced to one if we note that the high indebtedness of the 1970s was the vicious way Latin American governments and business enterprises found to artificially prolong a strategy of development that was already wearied down in the 1960s. Fanelli, Frenkel and Rozenwurcel (1990: 1), in their critique of the Washington consensus, observed that the Latin American crisis

> "did not originate in the weaknesses of the import substitution strategy but rather in the dynamics of the adjustment to the external shock that took place in the beginning

> of the 1980s. In fact we consider that the principal constraints to growth today originate in the long-lasting features of the external and fiscal imbalances induced by the debt crisis that has still not reversed after ten years of adjustment."

These three Argentinean economists underestimate the exhaustion of the import substitution strategy, but their definition of the origins and nature of the crisis is an excellent example of the fiscal crisis approach.[21]

Secondly, the political origins of this crisis are not primarily due to economic populism, as it is usually thought in Washington.[22] Populist economic policies undoubtedly play a role, but populism always existed in Latin America and, before the 1980s, it did not represent an impediment to reasonable price stability and growth. The new historical fact that led the Latin American economies to a fiscal crisis never experienced before, was a non-populist decision taken in the 1970s, mostly by the military regimes, to underwrite an enormous foreign debt, and, subsequently, to have it nationalized. Populism is blamed by the neo-liberal approach for something that was not primarily its fault (Bresser-Pereira and Dall'Acqua, 1989; Cardoso and Helwege, 1990). It was not by chance that the only country in Latin America which presented satisfactory rates of growth in the 1980s was the one that previously did not engage in a large foreign debt, Colombia.

Inability to finance the state by taxes, particularly income taxes, is an essential feature of the Latin American countries that endure a fiscal crisis. Wealthy people do not pay taxes in Latin America. The tax burden tends to be systematically low, not only when compared with developed countries, but also with Asian countries with about the same level of development (Kagami, 1989). Most taxes in Latin America are indirect, so the tax systems tend to be regressive. The state in Latin America was originally financed by export taxes. In the second period, when rents from primary products exports were reduced, by indirect taxes and by taxes geared to the set up special investment funds. In the third period, in the 1970s, when these sources of revenue for the state were exhausted or demonstrated to be insufficient, foreign debt proved an easy alternative for financing the state. With the suspension of this source of financing, inflationary tax increased its role in financing the state. Income taxes always represented a minor fraction of tax collections.[23]

As Przeworski observes, "the crucial question is whether the particular state is capable, politically and administratively, of collecting tax revenue from those who can afford it: in several Latin American countries, Argentina notably, the state is so bankrupt that the only way it can survive day-to-day is by borrowing money from those who could be tax-payers" (1990a: 20-21). This feature could be attributed to populism, but I would rather identify it with the authoritarian character of the Latin American capitalist state, which entails a subjection of the state to the rich.

The fact that governments in Latin America usually tax insufficiently while incurring budget deficits, initially financed by borrowing and later by an inflationary tax, may have a third explanation besides populism and authoritarian rule. Some authors, involved in a "new political economy," relate this phenomenon to political instability and political polarization. The perspective of political alternance (instability) and the highly conflicting social systems (polarization) existing in Latin America as a consequence of an extremely uneven distribution of income induce governments to incur deficits today that will be paid in the future by another government probably representing others interest groups. (Alesina and Tabellini, 1988; Alesina and Edwards, 1989; Edwards and Tabellini, 1990).

"Market-Oriented" Reforms

If the pragmatic approach embodies a more correct assessment of the causes and the nature of the Latin American economic crisis than the neo-liberal view, the economic reforms that are necessary are also somewhat different. It is not enough to fight populism and to reduce the state. While fiscal discipline is an essential goal, as is a smaller state, state intervention is not intrinsically bad.

The state did turn into an obstacle to growth in Latin America, but in an earlier phase it was a strategic agent of this same growth: the distortions of this intervention strategy eventually exceeded their benefits. The resulting inefficiency of state action plus the persistent budget deficits and the consequent public debt led Latin American economies to fiscal crises. Hence, the fundamental economic reform is to solve the fiscal crisis, that is, to reduce the public debt and to recover the savings capacity of the state. This is the condition that will allow the Latin American countries to re-establish the confidence in national money and stabilize prices in the short run and to replace the import substitution strategy by a new, export-led, market-oriented industrial policy in the medium term.

Reforms should be "market oriented," but this concept should be re-examined. In the 1980s, the expression "market oriented" became a magic formula. This fact is expressed in phrases like: "Economies, to be successful, should be market oriented." "Only market-oriented economies, like Japan, Korea, Germany, are able to sustain high rates of economic and technological growth." "Market-oriented economies are economies controlled by a self-regulating market." Particularly in Asia, policy makers, who in fact practice state intervention, often use this expression to conceal these same practices, knowing, as they do know, that these practices are not accepted in the international forums. Ask a Japanese, a Korean, or a Singapore policy maker how he would define their respective economies and the answer will be, promptly: "market-oriented economies". Yet when they say this, they obviously are not thinking of an economy "controlled by a self-regulating market". As is well known, the state had in the past and still has a major role in the development of the East and South-East Asian countries.[24] Saying that their economies are market-oriented, they are stating something that is true--they are, indeed, outward-market oriented--while they pragmatically avoid ideological discussions.

But what is a market-oriented economy? Is it synonymous with an economy coordinated by the market, where the state has practically no economic role? Certainly not. In order to clarify this question, controlling minimally the ideological interferences, the concepts of market orientation and market coordination should be distinguished. Market orientation and market coordination are different phenomena.

Capitalist economies are, by definition, market-oriented. They can be inward-oriented, as they were in Latin America during the period of import substitution strategy of industrialization, or outward-oriented, as have been the East Asian "tigers" since the 1960s. Only statist economies, like Soviet Union, are not market-oriented. The state enterprises in these economies do not produce primarily for the market but for the plan. Capitalist economies, however, are coordinated not only by the market but also by the state: by policy, by some form of planning.[25] Every capitalist economy is a mixed result of market and state coordination.[26] These ideas are organized in Table 5.

Since the 1940s, when development economics began to be formulated, the basic development strategy was based on state intervention. The "big push" strategy, the theory of unbalanced growth, the surplus theory of labor, the theory of uneven exchange, the two-gap model and the import substitution strategy were all based in some form of state intervention. These academic theories were widely pursued by developing countries. Washington adopted them, and used the World Bank, an institution that was supposed to lend only to governments, as its main instrument to promote growth. For at least a quarter of century (1945-1970), the developing countries and the World Bank successfully challenged the old international liberal order. But in the 1960s some Asian countries realized that the import substitution part of the over-all strategy was exhausted, and abandoned it. They decided to copy the Japanese model of intervention based on case by case industrial policy rather than on protectionism. But the role of the state in promoting growth remained crucial.

Table 5 - Some countries classified according to the market-orientation and market coordination criteria

		Market orientation	
		Inward	Outward
Market coordination	Mixed	Latin America	Korea Japan France/Germany
	Market		England United States

In the 1970s, at the very moment when development economics and the Keynesian consensus collapsed, the developing countries launched the New International Order movement, a systematic political attempt to challenge the liberal international system. It was a wrong moment. By that time, several forms of state intervention had gone too far, had provoked increasing distortions, and facilitated the rise of neo-liberalism.[27] The failure of the New International Order movement a good indication that times had changed. And around 1970, the academic wave of neo-liberalism was beginning, a wave that in the 1980s would be put into practice by politicians and policy makers.

In the early 1970s, the expansion phase of the state that began in the 1930s was over, and a new phase of state reduction was beginning. The cyclical and ever-changing pattern of state intervention once more manifested itself (Bresser-Pereira, 1988a). The distortions provoked by the excessive and disorganized growth of the state provoked a fiscal crisis, indicating that it was time for debt restructuring and debt reduction, privatization, deregulation and trade liberalization.

The neo-liberal wave, however, has obvious limits. The attempt to exclude the state from the economy proved to be more rhetorical than real in the industrialized countries. Protectionism increased while neo-liberalism was preached. In Britain, where the neo-liberal rhetoric was particularly loud, some privatization was achieved, but the economic role of the state remained important. The European Community, controlled by a bureaucracy based in Brussels, is a case of contemporary successful state intervention. In East and South East Asia, while some liberalization took place, the role of the state continues to be fundamental. These economies are outward market- oriented but not market-coordinated.

Thus, economic reforms in Latin America do not necessarily have to be exclusively neo-liberal, purely market-coordinated. Certainly, they will have to be market-oriented. More specifically, given the exhaustion of the import substitution strategy, they will have to be outward market oriented. But their coordination should be mixed, as all the more recent successful strategies of growth are. The condition for success is that reforms overcome the fiscal crisis of the state, so that it recovers its capacity to intervene, plan and implement policy.

The same is true for Eastern Europe, including Soviet Union. The year of 1989 was the year of the democratic revolution. It was also the year when it became dramatically evident that statist social formations, where a technobureaucratic mode of production is dominant, where the economy is centrally commanded rather than centrally planned, is unable to coordinate the economy in the long run. What was not clear is that this is particularly true if the state is bankrupt, a victim of the fiscal crisis. This is the case of the communist states in Eastern Europe.[28] Now, after Eastern Europe made its democratic revolution, stabilization and liberalization are certainly a must. But a priority will be, while reducing the state apparatus, to overcome the fiscal crisis, to empower the state to assume a positive role in development. The following years will be years of hardship. If statism is inefficient and socialism, unfeasible, capitalism is irrational (Przeworski, 1989).[29] Markets do not function out of nothing. They are institutions that depend on other institutions, particularly on a strong state and a respected government.

The Appropriate Reforms

Thus the appropriate economic reforms are not only those suggested by the Washington approach: (1) to stabilize and (2) to reduce the role of the state. According to the pragmatic approach, it is necessary to add two other directions: (3) to overcome the fiscal crisis, and (4) to define a new (although reduced) strategy of growth, i.e., a new pattern of state intervention.

To stabilize the economy is to control inflation and the balance of payments. The essential requirement is fiscal discipline. The basic tools are macroeconomic: fiscal policy, monetary policy and incomes policy (wage and prices policy).

To reduce the state apparatus is to reduce its size and the intensity of its intervention. The basic tools are privatization, trade liberalization and deregulation. Privatization is necessary not only because state-owned enterprises grew too much and proved to be vulnerable to the external (to the enterprise) political and internal technobureaucratic interests, not only because they do not respond fast enough to market stimuli, but also because their sale may help to solve the public debt problem. Leslie Armijo (1991: 34), after studying the privatization process in Argentina, Brazil, Mexico and India, admits that this last consideration is the real motive of privatizations, but she adds that the four countries acted on privatization under the strong pressure from the Washington consensus. This last motivation is obviously perverse.

Trade liberalization is not a panacea, but protectionism was so strong in Latin America that a movement in the opposite direction is necessary. Besides, experiences in trade liberalization have proved generally positive.[30] This positive result, however, should be attributed not only to the intrinsic advantages of free trade — after all, free trade is not an effective practice among developed countries--but also to the fact that these experiences are a response to excessive earlier protectionism. The same argument holds for deregulation.

To overcome the fiscal crisis of the state means not only to generate a budget surplus (or a much smaller public deficit) but also to reduce the public debt (internal and foreign), to recuperate the credit of the state and the credibility of government, and to recover public savings. The basic reform is to restructure the internal and the foreign public debt overhang and the respective interest payments, reducing its total amount and increasing its maturity.

Given the objective to rebuild the ability of the state to formulate and implement a growth strategy, a restoration of public savings is an essential part of economic reforms. Besides the reduction of the public debt, tax reform aiming to increase the tax burden (together with the improvement of tax collection) is the basic strategy to be followed. Internal and external resistance to these measures will be great. The standard argument against debt reduction, which can be achieved internally through a capital levy and externally through some kind of a unilateral decision, is that such measures would harm the credit of the state. The argument against tax reform is that increasing taxes would harm investment.

Undoubtedly, state expenditures and subsides must also be reduced. There are expenditures that just feed a corrupt bureaucracy and privileged business sectors, particularly suppliers to the state. But the limits to the reduction of state expenditures are quite narrow: economic limits besides political ones. Salaries and wages in the public sector are usually very low. Excess personnel in some departments are counterbalanced by shortages of public officers in other departments. Besides its classical law-and-order role and its social and economic promotion functions, the state in Latin America has always performed the role of sustaining a middle class of bureaucrats. This bureaucracy, usually protected by constitutional rights, is far from idle. Administrative reforms should organize and utilize this bureaucracy more rationally. But this is a long- term reform rather than a short-term measure that would overcome the present crisis.

Once public savings are recovered, an essential reform is to define a new pattern of state intervention. The old pattern was based on trade protection, direct investment in state-owned enterprises and subsidies to private investment. The new pattern will probably exclude direct investment and trade protection, as it relies on privatization and trade liberalization. But it will not ban subsides of all kinds. The major coordinating role will be performed by the market, but the state will have its part. In the words of the 1990 Report of the Inter-American Dialogue: “The objective, in short, should not be to strip the state of its economic role. The challenge instead is to redesign and improve that role and to expand and strengthen the contribution of the private sector and the market at the same time” (1991: 29). Public savings will be primarily used to stimulate strategic private investments and technological developments, to protect the environment and to insure health and education standards.

The neo-liberal paradigm dismisses industrial policy. Yet, not only successful past experiences in Latin America but also the current performance in Asia and even in the OECD countries show that no government, even Thatcher's government in Britain, can afford not to pursue such policies. Industrial policy, while often disguised, is part of everyday practice in the developed world, particularly in relation with high technology industry. And an increasing number of studies show the need for industrial policy when markets are not perfect, as it is the rule in high technology industries, when there are large fixed costs of entry, substantial economies of scale, steep learning curves, potential spillovers across firms due to externalities, and asymmetry of information between suppliers and buyers.[31]

Industrial and technological policy will not be based on generalized protection and subsidies, but on a case-by-case analysis of projects, aiming at international competitiveness. Following a market-oriented strategy, subsides will be targeted to export promotion and directly tied to the export performance of each individual firm. As Amsden shows,

> The East Asian evidence suggested that in subsidy-dependent industrialization, growth will be faster the greater the degree to which the subsidy allocation process is disciplined and tied to performance standards - exports possibly being the most efficient monitoring device... The Taiwanese and South Korean states only became developmental pragmatically. Once they began not just to subsidize business but to impose performance standards on it (not least of all export targets), then growth increased. (1991:185-286)

In sum, although essentially organized by the price system, resource allocation will continue to be influenced by the state. In particular, a subsidized interest rate for financing priority projects will have to be considered. The market interest rate that is required to attract capital flows or to avoid capital flight in Latin America is substantially higher than the prevailing rates in the developed countries. The spreads required by the local banks to cover the operating costs are also substantially higher than in the developed countries. The resulting market interest rate for loans would be consistent only with extremely high rates of returns on investments: rates that would only be achieved through an enormous and probably unfeasible wage compression. The alternative is to limit this high market interest rate for financing working capital and to non-priority investments, while overtly subsidizing interest rates of priority investments.[32]

Country Studies

Introduction

In the perspective of the two approaches to the Latin American crisis, I now examine what is actually happening in eight major countries. Have they been victim of a fiscal crisis? Which reforms did they undertake: only the Washington reforms or also reforms based on the pragmatic approach? What has been their performance?

Up to 1990, and considering only its eight major countries,[33] Latin America remains basically stagnant. Income per capita is not growing. The exceptions are Chile, Colombia, and possibly Mexico.[34] On the other hand, Brazil, Argentina and Peru faced hyperinflation and continue to confront high rates of inflation. The obvious question is then whether the countries which achieved stabilization and growth did previously undertake the four relevant reforms while the countries that have not been successful failed to pursue these reforms. A distinct question is why some countries were able to undertake the necessary reforms and others were not.

Table 6: Chile: Macroeconomic variables in the 1980s.

	1980-84	1985-88	1989	1990
GDP Growth	0.1	5.3	9.8	2.0
GDP per capita	-1.3	3.5	8.0	0.3
Investment/GDP	15.3	14.3	16.9	17.7
Wages (ind. 1980=100)	102.4	96.1	102.9	104.8
Res. Transf./GDP	-0.7	7.0	4.0	2.2
Debt/Exports	3.4	3.5	1.7	1.7
Budget Deficit/GDP[a]	3.0	1.5	-1.2	-0.5
Inflation	22.1	19.4	21.4	27.3

([a]) minus (-) indicates surplus
Sources: See Table 1.

Chile and Colombia

In the case of Chile, the answer to the first question is positive: the economy was stabilized, the fiscal crisis overcome, state apparatus reduced and trade liberalized. It is only not clear what is the new pattern of state intervention. Chile is not a model of liberal, market-coordinated economy. According to one estimate, during the period 1982-87 subsidies to private enterprises financed by the Central Bank amounted to a 4.3 percent of GDP (Oliveira, 1991). Codelco, the state-owned enterprise that explores the copper mines and remains responsible for 50 percent of Chilean exports, was not privatized. It was restructured, made much more efficient, and today is an example of successful state administration.

Fiscal adjustment and liberalizing reforms were imposed by an authoritarian regime that for many years counted with the political support of the middle class and capitalist sectors in Chile. These reforms were successful. Inflation has been under control for several years. As for economic growth, 1990 was a bad year for the Chilean economy. But between 1985 and 1988, GDP per capita growth averaged 3.3 percent while in 1989 it reached 7.5 percent (Table 6).[35]

Up to 1983 the transition costs were very high. In 1974/75 income per capita fell 26 percent, in 1982/83, 16 percent. Unemployment hovered above 15 percent between 1975 and 1985; in 1983 it reached 30 percent. Thus workers paid a high toll.

Income concentration deepened. Income per capita and real wages in 1988 were not much higher than in 1973. The Chilean society probably would not have tolerated these transitional costs if the regime had been democratic.

Table 7. Colombia: Macroeconomic variables in the 1980s

	1980-84	1985-88	1989	1990
GDP Growth	2.6	5.1	3.5	4.1
GDP per capita	0.5	3.0	1.5	2.1
Investment/GDP	18.0	15.7	15.4	14.6
Wages (ind 1980=100)	106.8	117.9	119.4	115.9
Res.Transf./GDP	-1.4	5.2	3.0	2.2
Debt/Exports	2.2	2.6	2.2	2.1
Budget Deficit/GDP	6.1	1.7	2.4	N.A.
Inflation	22.2	24.0	26.1	32.4

Sources: ECLA (Economic Commission for Latin America): Panorama Económico de America Latina 1990 and 1991. The World Bank: several World Development Reports. Interamerican Development Bank: Economic and Social Progress in Latin America: 1990 Report.

Zhiyuan Cui (1991), commenting a earlier draft of this work, observed that "it is necessary to divide the reform history of Chile into pre-1982 and post-1982 period". Quoting Sebastian and Alejandra Edwards (1987: 215), according to whom "automatic adjustment macroeconomic policy of the early Chicago boys helped unleash the 1982 crisis", and using information from their book, Cui concludes that "the Chilean success in the late 1980s is due to active state policy in macroeconomic management, promoting investment and conversion schemes. So Chile case actually shed some doubts on 'Washington consensus'." Cui's observation is consistent with the evidence cited above that after 1982 the Chilean reforms have not been as neo-liberal as is usually thought.

The situation of Colombia is different. First, in spite of the drug and the terrorist problems, Colombia has been a stable democracy for many years. No political transition took place in the 1980s. Secondly, given that Colombia did not suffer from a fiscal crisis, adjustment was not necessary. Inflation was never high. The budget deficit threatened to grow out of control in early 1980s, it was subsequently reduced. The foreign debt is the smallest in Latin America: Colombia faced the suspension of voluntary loans in 1982 only because it is in Latin America, not because its debt ratios justified a suspension. Like Chile, Colombia did not want to take advantage of the Brady Plan, feeling that this would undermine its credit-worthiness (Bacha, 1991). It was the only Latin American country to avoid debt rescheduling. It is true that the investment rate went down in Colombia during the decade and the per capita rate of growth was moderate. Yet it was consistently positive (Table 7). What was never clearly defined was the long term industrialization strategy: basically, an import substitution strategy was maintained. Liberalization and privatization, although taking place, are very limited in Colombia.

Table 8: Bolivia: Macroeconomic variables in the 1980s.

	1980-84	1985-8	1989	1990
GDP Growth	-1.9	0.5	2.7	2.6
GDP per capita	-4.5	-2.2	-0.1	-0.2
Investment/GDP	12.5	13.3	13.7	12.7
Wages (index 1980=100)	105.9	66.0	78.7	N.A.
Res. Transf./GDP	6.2	4.3	-3.3	-3.6
Debt/Exports	3.2	5.6	4.0	3.9
Budget Deficit/GDP [a]	13.0	6.6	4.2	2.6
Inflation	272.1	268.6	16.6	18.0

([a]) Includes central government only until 1985.
Sources: See Table 1

Bolivia

Bolivia is a new democracy that almost fully adopted the orthodox neo-liberal approach. The only major deviation from this approach in the 1985 stabilization program was a foreign debt moratorium.

The 1985 hyperinflation was the result of a fiscal crisis. Current revenues of the Bolivian state fell from 13.1 percent of GDP in 1980 to 4.6 in 1984, whereas current expenditure increased from 16.5 to 25.4 percent in the same years. The state was literally bankrupt. Inflation reached 11,750 percent in 1985. In September of that year, the consumer price index increased 56.5 percent.

According to Williamson, “Bolivia is perhaps the most extreme case of adoption of the policies that constitute the `Washington consensus'.” (1990: 381). The stabilization program was an orthodox fiscal shock. Government expenditures were strongly curtailed, the budget deficit was controlled, the interest rate turned positive, state-owned tin mines were closed, subsidies were eliminated, trade was liberalized (a flat 10 percent tariff was introduced), the tax system was simplified and made less progressive.

Inflation remained under control since then. In 1989 and 1990, it averaged 17 percent. Nevertheless the economy remained stagnant. Income per capita continued to decline in the aftermath of the neo-liberal reforms. Most probably, this lack of growth can be explained by the fact that the fiscal crisis was not overcome, nor a new strategy of growth defined. The very low rate of investment, around 10 percent of GDP, is an indication that public savings did not recover. The high debt/export ratio provides another signal that the fiscal crisis is still there.

Mexico

The heritage of the populist Echeverria government and the middle-of-the-road Lopes Portillo government was onerous. Yet, since 1983, under President de la Madrid, Mexico began to adjust, and since 1985 to implement market-oriented reforms. A stable and capable group of economists runs the economic policy of the country since then. When one of them, Salinas de Gotari was elected President at the end of 1988, the worst part of the job had been completed. A strong fiscal adjustment was under way, public investment and social expenditures were severely reduced, a primary budget surplus was achieved,[36] a tax reform was undertaken, trade was fully liberalized (at a flat 10 percent tariff), regulations restricting foreign investment were eliminated, and in December 1987 a heterodox shock, the " Pacto de Solidaridad," freezing prices and wages, stabilized the economy.

With the new President, privatization was extended, an agreement with the commercial banks, conforming to the Brady Plan, was signed, and in 1990 Mexico applied to be admitted into the North-American Free Trade Agreement. At the same time, an elaborate social program was introduced, administered directly by the President, who devotes one day per week to it. An innovative feature of the program was its official connection with the privatization program: a fixed, substantial percentage of the revenues the government receives from each privatized firm is reserved for previously specified expenditures within the social program. As a consequence of the good economic results and probably of this program, the government party obtained a landslide victory in the 1991 provincial elections.

What were the results of these reforms? Mexico is being presented today as a show case of the Washington consensus, an example Washington offers to the rest of Latin America.[37] And indeed the actual results are positive. They are positive because the fiscal adjustment was enormous, because market- oriented reforms were implemented and because stabilization was achieved through a heterodox shock. The first two reforms are advocated by the neo-liberal as well as the pragmatic approach, while the last one is specific of the pragmatic approach. Yet, results are far from spectacular, basically because the debt reduction obtained under the Brady Plan was modest and the debt remains a heavy burden in the Mexican economy.

Table 9: Mexico: Macroeconomic variables in the 1980s.

	1980-5	1886-8	1989	1990
GDP Growth	3.0	-0.2	3.1	3.9
GDP per capita	0.5	-2.4	0.9	1.7
Investment/GDP	21.1	16.4	17.3	18.9
Wages (1980=100)	89.7	72.4	75.4	72.5
Resource Transfers/GDP	4.2	9.5	0.9	0.5
Debt/Exports	3.2	3.9	2.9	2.6
Budget Deficit/GDP	3.0	1.3	1.8	0.0
Inflation	58.1	100.7	19.7	29.9

Sources: ECLA (Economic Commission for Latin America): *Panorama Económico de America Latina 1990* and *1991*. The World Bank: *World Development Reports*, several issues. Interamerican Development Bank: *Economic and Social Progress in Latin America: 1990 Report*. Central Bank of Mexico: *The Mexican Economy* 1990.

Between 1986 and 1988 per capita GDP growth was negative; in 1989 and 1990, slightly positive (Table 9). For 1991, predictions are again for a growth rate around 4 percent. Real wages were reduced by 40 percent between 1982 and 1988 and since then increased only slightly. The fiscal situation was very much improved. A large primary surplus, around 7 percent of GDP was obtained but, given the enormous interest payments, the budget deficit (PSBR concept) was not transformed into a surplus but neared zero in 1990. Inflation, which was blocked in December 1987 by a heterodox shock and a social agreement, neared 30 percent in 1990, but in 1991 it is expected to go down to 22 percent. The peso underwent a continuous revaluation since the December 1987 stabilization plan. As a consequence of this fact and of a radical the trade liberalization, trade surplus was transformed into a deficit that in 1991 will reach around 9 billion dollars. Current account is strongly negative, but a large capital inflow (foreign investment and repatriation of capital flight), is attracted by high rates of interest and a new confidence in the economy. Reserves, that reached 15 billion dollars in 1987, are around 10 billion dollars in 1991.

Mexico is a case of confidence building, where complying as much as possible with the Washington approach--sometimes only rhetorically--including, in particular, accepting the Brady scheme to restructure the foreign debt, played a decisive role.

Yet this confidence is not based on solid foundations. The debt agreement was clearly unsatisfactory, involving a only minor effective debt reduction.[38] The public debt and the corresponding interests paid by the Mexican government remain very high. The budget deficit is controlled only due to a very high primary surplus. Public savings have not recovered. The balance of payments situation continues to be fragile, heavily dependent on the capital inflow. In other words, the fiscal crisis of the Mexican state was only partially resolved. The fiscal adjustment was indeed severe, but the Brady debt agreement allowed a debt reduction clearly below Mexico's needs.[39] It is usually believed that the major benefit the debt agreement brought to Mexico was international confidence. But it is important to remember that Mexico first adjusted its economy, stabilized and implemented structural reforms, and only in a second moment, after the fundamentals were put under control, signed the debt agreement.

In any event, this agreement helped in recovering international and internal confidence. The question now is whether the confidence building strategy will be a sufficient substitute for a more direct attack on the foreign debt problem, and, more generally, on the fiscal crisis of the state. In the limit, if foreign direct investment and capital repatriation continue to be strongly positive, this may happen. But confidence must be based on solid facts. In Mexico fiscal adjustment, trade liberalization and privatization are solid facts but the public debt continues to be very high. And, in the words of *The Economist* (December 14, 1991):

> For Mexico, external confidence is everything. If there is one thing that keeps economists awake at night, it is the knowledge that about 75% of the inflow of capital is going into easily liquidated portfolio investment, not into new factories, and that the lion's share of that comes from flight-capital repatriated by Mexicans. One thing is certain about this money: it is hot. If there is a shock of confidence, the inflow could quickly go intro reverse.

Venezuela

Venezuela also suffered from a fiscal crisis. In early 1980s, it underwent a severe adjustment and between 1985 and 1988 it resumed growth with reasonable price stability. Reforms, however, were not undertaken, nor was the fiscal problem resolved. At the end of the decade Venezuela was again in trouble, with inflation rising and the economy stagnant. Yet, as in Colombia, the fiscal crisis was never deep in Venezuela, nor was hyperinflation a real threat. Venezuela is so rich in natural resources, particularly oil, that a reasonable macroeconomic management will do the job of stabilizing the economy and resuming growth.

Table 10: Venezuela: Macroeconomic variables in the 1980s

	1980-84	1985-88	1989	1990
GDP Growth	-2.4	4.0	-7.8	5.8
GDP per capita	-5.3	1.2	-10.1	3.2
Investment/GDP	24.0	19.2	15.7	14.4
Wages (1980 = 100)	83.1	60.9	38.0	36.3
Resource Transfer/GDP	4.8	5.7	4.4	12.1
Debt/Exports	1.8	2.9	2.3	1.6
Budget Deficit/GDP[a]	0.7	3.5	1.1	-0.8
Inflation	12.9	22.6	81.0	36.5

([a])minus (-) indicates surplus
Sources: See Table 1.

In 1989, after a new president, Carlos Andrés Pérez, took office, the decision was taken to fully adopt the neo-liberal approach, including a Brady Plan agreement similar to the Mexican one and an IMF style adjustment program. Similarly to de la Madrid in Mexico, Perez offered a critique of the long-term Latin American development strategy. To a certain extent, it was a self-critique, since he had been president of Venezuela earlier.[40] The immediate consequences of the adjustment process were a social upheaval, a decline in GDP of 10.4 and a rise of inflation to 81 percent. Indications, however, are that these may considered transitional costs of a classical adjustment process. In 1990 inflation went down, while growth resumed. Obviously, oil price rise helped the recovery. In 1991, in spite of the decline of oil prices, GDP growth will remain high. Inflation, however, is again accelerating.

Peru

The democratic transition in Peru took place in 1980, when Bellaunde came back to the presidency, but the crucial political and economic event was the election of the APRA candidate, Alan García. After his inauguration in July 1985, the Garcia government decided to adopt a typical package of populist-nationalist measures. Inflation was controlled by overvaluing the local currency, the balance of payments by using multiple exchange rate system. At the same time, the government increased wages and public expenditures, worsening the budget deficit, while it limited the payment of interest on the foreign debt to 10 percent of export revenues. In the first two years, the economy grew, inflation declined, wages and consumption increased, as classically happens in the populist cycles (Diaz-Alejandro, 1981; Sachs, 1988). But, after this honeymoon, the devaluation of the inti became unavoidable, inflation returned, and by 1989 Peru faced economic chaos and hyperinflation. Table 11 is self explanatory about the national tragedy this country is facing: a sharply declining GDP per capita and hyperinflation.

Table 11. Peru: Macroeconomic variables in the 1980s.

	1980-84	1985-88	1989	1990
GDP Growth	0.5	2.5	-11.4	-4.9
GDP per capita	-1.9	0.3	-13.2	-6.8
Investment/GDP	22.4	17.9	16.1	17.7
Wages (1980 = 100)	95.0	91.6	41.5	39.4
Resource Transfer/GDP	1.9	2.5	3.2	-0.7
Debt/Exports	3.0	4.4	3.7	4.2
Budget Deficit/GDP[a]	6.0	6.4	6.2	3.0
Inflation	97.3	299.3	2,775.8	7,649.7

Sources: See Table 1.

Peru is the bad example Washington usually presents to contrast with its views. Yet this rhetoric ignores that the real alternative to the neo-liberalism is not nationalist populism but rather the approach that centers on the fiscal crisis. Up to 1989 Peru did not implement either the Washington reforms or those based on the pragmatic approach: Alan Garcia's government was a model of populism.

The election of a new president, Alberto Fujimori, in 1990, renewed hopes. The new president, as President Collor in Brazil, did not have a political party and a political tradition behind him. Yet in spite of his populist origin, he immediately adopted the Washington reforms. It is too early to draw conclusions from the plans and real achievements of the Fujimori government. By early 1991 the Peruvian economy showed some signs of recovery (prospects of 2.5 percent growth), whereas inflation came down to 400 percent yearly.

Argentina

The Argentinean crisis is most likely the most serious in Latin America. It is an extreme case of fiscal crisis. Argentina was a rich country, but she has been turning into a poor one every year. Since Peron assumed power in Argentina, decadence began. The military, in and out of government several times after the first Peron government, were not able to face the economic problems and modernize the economy. Throughout most of this period, Peron and the peronists represented the inward oriented industrial bourgeoisie and urban workers, whereas the military was allied with the meat and cereals export oriented oligarchy (the “burguesía pampeana”) and the great bourgeoisie (O'Donnell, 1977). Peronists were populist; the military, conservative and orthodox as to economic policy. At the end of the 1970s, under the ministry of Martinez de Hoz, the military tried to follow the neo-liberal approach, combining trade liberalization, fiscal discipline and a pre-announced exchange rate devaluation. The failure of these policies, plus the defeat in the Malvinas' war demoralized the military and opened the way for a democratic transition, with Raul Alfonsín being elected president in the end of 1983.

Table 12. Argentina: Macroeconomic variables in the 1980s before and after the democratic transition (1983)

	1980-84	1985-88	1989	1990
GDP Growth	-2.1	0.6	-4.4	-0.5
GDP per capita	-4.2	-0.8	-5.6	-1.8
Investment/GDP	17.5	12.0	8.7	7.5
Wages (1980 = 100)	92.5	108.9	83.3	78.7
Resource Transfer/GDP	1.0	4.1	6.4	6.7
Debt/Exports	3.9	5.7	5.4	5.0
Budget Deficit/GDP[a]	12.5	7.9	7.2	4.9
Inflation	191.2	292.6	4923.8	1344.4

Sources: See Table 1

The Alfonsín government was not populist. Its defeat in the 1987 parliamentary elections is a good indication of this fact. Government did not bow to the demands of diverse groups and classes that form the Argentinean society. The team of economists who conducted economic policy for five of the six years of the Alfonsín government was very competent. The importance of the fiscal crisis of state was probably not clear for them when they took office in 1984, but the day-to-day management of the economy led them to identify the origin of the crisis in the foreign debt and in the state’s fiscal situation.[41] Argentina was the first country in Latin America to combine conventional fiscal and monetary policies with a freeze: the Austral plan. The failure of this heterodox shock to stabilize the economy cannot be attributed to populism (as in the Brazilian 1986 Cruzado Plan), nor to its emergency and provisional character (as in the 1987 Bresser Plan and the Collor Plan I), nor to lack of skill (as in the 1989 Summer Plan and the Collor Plan II).

The Alfonsín government, however, was not able to control inertial, or chronic, inflation or "chronic dollarization," an economic phenomenon particular to Argentina.[42] It was unable to solve the debt crisis and to overcome the fiscal crisis of the Argentinean state. This failure is puzzling, since it was not caused either by incompetence or populism, since an enormous effort was put into reducing the budget deficit, agreements were reached with IMF about stabilization and with World Bank about structural reforms, while trade liberalization and privatization were initiated. The neo-liberal approach probably would answer that the Alfonsín government lacked sufficient determination and leadership. The fiscal crisis approach would add that this lack of strength was particularly clear in two areas: the inability to reduce the foreign debt and the inability to tax the proprietary classes. The Alfonsín government was not able to establish a consensus among the dominant classes about the gravity of the fiscal crisis, nor was it able to impose its leadership over theses classes. Years and years of economic deterioration weakened the sense of and the concern for the national interest in Argentina. The huge capital flight is an indication of this fact. The Alfonsín government, due to its political and personal limitations, and given the lack of foreign support (the national interest of the creditors represented in neo-liberal approach was in contradiction with the Argentinean national interest), was unable to change this situation.

The Alfonsín government ended with hyperinflation. The new president, Carlos Menem, elected by the populist peronist party, surprised the world and particularly Washington with the immediate and full compliance to the neo-liberal approach. An Economy Minister fully identified with the neo-liberal approach and the internationalized bourgeoisie was appointed. Liberalization and privatization were given absolute priority. A tax reform was initiated. For a few months, applause in the First World was widespread and warm. But, as the fiscal crisis had not effectively been attacked, nor inertial inflation and chronic dollarization adequately tackled, four months later, in December 1989, a second episode of hyperinflation erupted, and two months later, a third one. The neo-liberal approach suffered a serious setback. Reforms, based on liberalization and fiscal discipline, continued to be enforced, but the Argentinean economy did not present indications of recovery. In 1990, inflation hovered most of the time above 10 percent a month, whereas industrial production, that fell 4.9 percent in 1987 and 7.5 percent in 1989, was forecast to fall 7.0 percent in 1990.

In early 1991 a new stabilization plan--the Cavallo Plan-- attempted to control inflation. Since the economy was chronically and almost fully dollarized, the simple idea was to fix the exchange rate to the dollar by law, and to reach an agreement with business enterprises about prices. A full freeze was not necessary because in a dollarized economy, an exchange rate anchor is enough. This plan was wrongly called a “dollarization plan”. Actually what is being attempted is a kind of gold standard: a dollar standard. The Argentinean government committed itself to exchange australes for dollars at a fixed exchange rate. In this way government also tries to commit itself to absolute fiscal discipline. In favor of the plan plays not only the dollar standard, but also two other facts: the internal debt reduction and consolidation that was achieved through several unilateral measures and the society was prepared to accept higher transitional costs. Prospects, however, are not positive for the Cavallo Plan. The exchange rate was probably set at an overvalued level and fiscal problems are not solved. Inflation is presently very low, but it takes place mostly in non-tradables, aggravating every month the overvaluation problem. Only an enormous surge of confidence, national and international, would save the Cavallo Plan.

Brazil

Brazil was one of the wonders of the world in the 1970s. In the 1980s it was a stagnant country, with an episode of hyperinflation in early 1990. As Brazil is the strongest and most highly industrialized economy in Latin America, the debt crisis was initially interpreted as a short-term problem, one that a fiscal adjustment combined with additional finance would solve. This view coincided with the initial diagnosis in Washington: the so-called “muddling through approach to the debt crisis”. Playing down the debt crisis was widespread. The Brazilian authoritarian government and the Brazilian elites shared this view with the creditors.

A huge adjustment effort was undertaken in 1981 (before the Mexican 1982 moratoria) and another one in 1983. Current account was balanced, but inflation averaged 200 percent yearly in 1984 and 1985. Democratic transition took place in early 1985. Wrong information published by the Central Bank at the end of 1984 and beginning of 1985, led the new democratic government to believe falsely that the budget deficit had been transformed into a surplus.[43] Moreover, the large trade surplus in 1984 and some growth recovery in 1984 and 1985 led most economists to conclude that the crisis was over and the country was ready to grow again. Inflation, which remained high, would be only inertial or autonomous.

Table 13: Brazil: Macroeconomic variables in the 1980s before and after the democratic transition (1984).

	1980-84	1985-88	1989	1990
GDP Growth	1.3	4.7	3.3	-4.0
GDP per capita	-0.9	2.5	1.2	-5.9
Investment/GDP	19.3	17.5	16.7	16.0
Wages (1980 = 100)	106.0	112.5	116.0	106.0
Resource Transfer/GDP	0.7	4.4	4.9	2.8
Debt/Exports	3.7	4.0	3.1	3.5
Budget Deficit/GDP[a]	5.4	4.6	6.9	-1.2
Inflation	131.5	313.3	2337.6	1585.2

([a]) minus (-) indicates surplus

Sources: Banco Central do Brasil: *Brazil: Economic Program*, various issues. ECLA (Economic Commission for Latin America): *Panorama Económico de America Latina 1990* and *1991*.

The Cruzado Plan was the result of these optimist views. Its failure may be explained by its poor, populist administration. The democratic social pact, led by the PMDB (Partido do Movimento Democrático Brasileiro), that led Tancredo Neves to win the Presidency and José Sarney to assume it, was eventually a classical populist pact: an encompassing compromise among social classes based on the belief that democracy and the "right" expansionist economic policies would solve all Brazilian problems.

But populism, which dominated the two first years of the Sarney Government (1985-1986), is only part of the story.[44] The basic reason why the Cruzado Plan failed was the lack of a correct assessment of the fiscal crisis of the Brazilian state. The idea of a fiscal crisis did not exist in Brazil at that time. Economists-- except the populist ones--recognized fiscal deficit as a major problem, but believed that its elimination would be a relatively easy job, provided that government was not populist.

In the aftermath of the Cruzado Plan, during the first semester of 1987, inflation lost its relatively stable and dominantly inertial character. A hyperinflationary process was beginning. The Bresser Plan was an emergency attempt to stop it. But it was clear to the new economic team that the Brazilian crisis was much more serious than previously thought: that it was not enough to stop inertial inflation and to eliminate the budget deficit since the economic crisis was basically a fiscal crisis of the state, which had its origin in the foreign indebtedness and the increase of internal debt. The Macroeconomic Control Plan was the first consistent official diagnosis of these facts (Finance Ministry of Brazil, July 1987). This diagnosis distinguished a stock component--foreign and domestic public debt that had to be reduced--from a flow problem--the need to recover the savings capacity of the state. The authors, however, did not find political support for their diagnosis and strategy. They left government in December 1987, when inflation was already 14 percent a month and showed a moderate but consistent tendency to grow.

For one year, inflation continued its ascending course. The government tried unsuccessfully to control it through conventional fiscal and monetary policies. In 1988 a conventional agreement with foreign banks was concluded. The agreement was so bad for Brazil that the discount of the Brazilian debt in the secondary market went up in its aftermath. Brazil was now experimenting a hyperinflationary regime. A new freeze, the Summer Plan (January 1989), combined with extremely high interest rates,[45] only aggravated the situation. Instead of helping to control inflation, the high interest rate perversely indicated to economic agents that the state--the great debtor-- was bankrupt and eventually would not honor its bonds. Consequently, inflation accelerated explosively after the Summer Plan. Artificially holding down public prices and overvaluing the exchange rate did not help, as these were perceived as additional indications of the weakness and disorientation of the departing government. This process culminated in March 1990, when monthly inflation reached 84 percent.

The Sarney government, which left office that month, lacked determination and courage to face the Brazilian fiscal crisis. Basically, it was a populist government. In the first two years, a fully populist one; in the last three, a hesitating populist. And the society was not yet ready for a consensus on how to solve the fiscal crisis. Yet, since 1987 some progress in this direction was achieved: public deficit came to be viewed as a major evil. The need for a substantial reduction of the public debt--domestic and foreign--is now accepted as much more natural

The new government that took office on March 15, 1990, profited from this increasing consensus to initiate the next day a new radical stabilization plan: the Collor Plan. The new freeze and the blockage of 70 percent of all financial assets were bold measures, heartening the impression that the new President had the determination and courage that his predecessor lacked. His firm position in relation to the foreign debt provided the same positive signal. His decisions to liberalize trade and to speed up the privatization process were in the right direction. The fiscal adjustment undertaken was very firm: the Treasury had cash surpluses throughout the year and the public deficit was transformed into a surplus of 1.2 percent in operational, real terms. Capital levy, which took several forms, reduced internal debt substantially. The foreign debt remained without solution.

The problem, however, is that determination and courage are not sufficient: what is also required are vision and political ability. Vision was needed to make a correct assessment of the crisis and political ability to obtain political support for them. Neither was present in the first year of the Collor presidency. By May, it became clear that the plan failed. Still, up to September or October local and international confidence remained high. Only in December, when inflation reached almost 20 percent, did the government acknowledge failure. In January, a new freeze was adopted, without an adequate preparation and without any political negotiation. From its onset, it became clear that this plan would also fail to control inflation. The time of the incumbent Minister of the Economy was counted. Her aggressiveness in fighting the public deficit and in reducing the public debt,[46] coupled with the failure to control inflation, made the internal and foreign elites demand her fall. In May 1991, a new economic team took office. The heroic and often mistaken times of Collor and Zélia were over (Bresser-Pereira, 1991). President Collor ceased confronting society and began negotiating and compromising. He adopted a more relaxed, softer policy style. Yet, by mid-1991 Brazil was far from stabilization and resumption of growth.

Frontal Attack versus Confidence Building

Given the experiences just presented, it is possible now to examine the two approaches to the Latin American crisis according to two criteria: (1) the trade off between the decision of unilateral or quasi-unilaterally reducing the debt and the strategy of direct confidence building, and (2) the trade off between the political support for adjustment and reforms and the transitional costs involved (having in mind that they are not given but also a variable).

Among the eight selected countries, only in Chile has the full range of reforms been implemented, even there to a lesser extent that it is usually supposed. Colombia did not need fiscal adjustment since it did not acquire a large debt. Among the remaining countries--all of them victims of fiscal crises--we have two cases: countries that adjusted in fiscal terms, stabilized, and have been implementing liberalizing economic reforms for some time, but did not resume sustained growth

(Mexico, Bolivia and perhaps Venezuela) and countries that are more recently trying to implement the reforms but did not yet stabilize (Brazil, Argentina and Peru).

We already saw why the countries that stabilized did not resume growth: the fiscal crisis was not effectively eliminated and no new strategy of growth replaced import substitution. Moreover, stabilization programs and reforms were only partially able to recover confidence in the economy.

A central objective of reforms is to recuperate economic agents' confidence (1) in the national currency, that, since the gold standard was abandoned, depends on the state credit; and (2) in the country's economy, that is coordinated and regulated not only by the market but also by the state. Confidence in money means stabilization, confidence in the country's economy, new investments, resumption of growth. Both depend on the confidence in the state. How can this confidence be recovered?

Two alternative strategies may lead to re-establishing confidence. One is to directly attack the causes of the crisis, reducing unilaterally or quasi-unilaterally public debt and increasing taxes, and consequently facing the resistance originating from the powerful sectors of society that would pay the bill. It is to act on the fundamentals. The other strategy is to win the support of creditors and local capitalists, while compromising on debt reduction and tax increase. In the first case, the fiscal crisis will be eliminated while costs of adjustment will be distributed among all groups: creditors who will have their credits reduced, technobureaucrats who will have their salaries and the number of posts at their disposition diminished, capitalists who will pay higher taxes and will have their credits to the state partially canceled, workers whose wages will temporarily fall. In the second case, the fiscal crisis will be reduced but not eliminated, since those best equipped to foot the bill--the foreign creditors and the local capitalists--will be spared the burden.

Mexico clearly adopted the second alternative. Brazil and Argentina, in relation to the internal public debt, when facing hyperinflation, had no other alternative but the first. Yet, the reduction of public debt was incomplete. There was not, in either case, a complete cancellation of debt, as happened in other programs of monetary reform,[47] and taxes were not increased as much as necessary. In other words, forgetting Machiavelli's advice, “evil” was not fully done. The fiscal crisis was not fully eliminated, not allowing for an effective recovery of confidence. On the contrary, as the state broke the law, confidence was reduced.

This dilemma--either to act aggressively in relation to the fiscal crisis yet risking the reaction of the powerful sectors or to act much less aggressively while trying to be gentle and reliable to the capitalist class--is a classical one. Keynes, for instance, perceived it clearly. In *A Tract on Monetary Reform*, he started from the assumption that a central task of governments is to preserve the confidence in money. Yet in the Preface to the French edition, he observed that in France, where the situation was not so bad, this task was possible without resorting to extreme measures, whereas in Russia, Austria and Germany, “the problem of balancing the budget was, during the earlier phases, a virtual impossibility. The initial impulse to collapse was, therefore, also a continuing impulse” (1923: xix-xx). Clearly having in mind this perverse situation, Keynes emphasized that

> “when the piled-up debt demands more than a tolerable proportion, relief has usually been sought in one or other of two out of three possible methods. The first is repudiation.... The second method is currency depreciation.... The remaining, the scientific, expedient, the capital levy”. But, he added, “there is a respectable and influential body of opinion which, repudiating with vehemence the adoption of either expedient, fulminate alike against devaluations and levies, on the ground that they infringe the untouchable sacredness of contract... Yet such persons, by overlooking the fundamental distinction between the right of the individual to repudiate contract and the right of the state to control vested interest, are the worst enemies of what they seek to preserve” (1923: 54-56).

The problem is to know before the collapse--not afterwards- - if there is an alternative to breaking contracts. If there is not, or if this alternative is highly unjust, some type of shock treatment will have to be considered by the state. Yet, if contracts are to be broken, it is better to do it in a straightforward way, once and for all, and, if possible, preceded by some negotiation. In this way the act is not unilateral but quasi-unilateral: preceded and followed by negotiations.

Mexico was able to adjust in fiscal terms starting in 1985, and in 1987, when inflation was below 200 percent a year, the Mexican government was able to control it through a heterodox shock coupled with a social agreement. In this way, Mexico was able to limit violations of contracts. No monetary reform, no capital levy, no quasi-unilateral reduction were undertaken. The only “violence” was a price freeze. As a trade off, Mexico had no other alternative but to impose high costs on its people.

Perhaps this strategy was possible because Mexico never faced hyperinflation and because it counted with an authoritarian political regime. Just the reverse was the case of Brazil and Argentina: countries which after the democratic transition were unable to adjust, faced hyperinflation, neared or reached collapse, and eventually had no other alternative but to reduce the internal debt unilaterally. Yet this reduction was conducted in such an incomplete and awkward way that stabilization was not achieved and confidence has not recovered.

The Politics of Economic Reforms in Latin America

Populism

The Washington consensus and the pragmatic approach agree that it is essential to adjust and to implement market oriented reforms. Why isn't adjustment achieved? Why aren't these reforms completed? What are the obstacles the Latin American policy makers confront? In particular, what are the political obstacles? Are they only internal or also external? Is politics only a matter of populism, or should a broader understanding of political obstacles be sought?[48] Are Latin American countries doomed to undertake fiscal adjustment and economic reforms only when the crisis reaches the bottom of the well, when hyperinflation and economic chaos prevails, or will they be able to start reforming before this point?

According to the Washington consensus, the central political obstacle is internal: economic populism. Populist politicians, who control Latin American parliaments and often the executive branch, constitute the main reason why neither the public deficit is eliminated nor inflation controlled. Yet while economic populism is a part of the problem, it is not the essential part. Economic populism is just another name for fiscal indiscipline. It is the willingness to satisfy excessive and inconsistent demands of all sectors of society while ignoring savings, fiscal, and foreign exchange constraints, and, when unbalances arise, to postpone adjustment. The question is why economic populism is so frequent in Latin America.

To answer this question it is necessary to distinguish populism in general, "the populist pact" and economic populism. Populism as a political practice is a strategy adopted by politicians to establish a direct relation with the people, using a discourse that emphasizes the national interest, economic growth and income distribution. As a political practice, populism is reinforced by the existence throughout Latin America of presidentialist regimes and direct presidential elections. Industrialization in Latin America, from the 1930s to the 1960s, was usually undertaken under the leadership of populist politicians. They formed "populist pacts": broad coalitions of industrialists, urban workers, military and civilian technobureaucrats and sectors of the old agrarian oligarchy, that promoted growth and promised income distribution through state intervention and import substitution. These coalitions ended in the 1960s, replaced by new authoritarian technobureaucratic-capitalist coalitions, that excluded workers, giving rise to what O'Donnell (1973) called "bureaucratic-authoritarian regimes".[49] Yet, in most Latin American countries the developmentalist and "populist" economic policies based on state intervention were maintained by the new military regimes. Foreign debt and foreign direct investment were the new sources of financing for this second wave of import substitution. When this source was also closed in early 1980s, states in Latin America were bankrupt and the crisis erupted.

Thus, there is a clear distinction between populism in general, the "populist pact" that prevailed between the 1930s and the 1960s, and economic populism. Actually, in these countries, economic populism and orthodox policies tend to follow a cyclical pattern.[50] At some time a populist regime adopts policies that hold down inflation while increasing aggregate demand and growth. The basic tool is exchange rate overvaluation. Bolstering nominal and real wages and raising government expenditures complete the populist strategy. For some time the results are wonderful, as inflation seems under control and the economy healthy. When balance of payments difficulties emerge, import controls are strengthened. When a demand inflation starts, price controls are enhanced. But these ad hoc remedies do not have a lasting effect. Soon, as exports go down and imports up, the country faces a full-fledged balance of payments crisis. Foreign reserves are exhausted, and since the government is forced to devalue the local currency, inflation rises again. When the economic crisis breaks out, a political crisis usually follows. In the past this was the moment for a military coup, with the support of the capitalist class. Populism is over for the time. By this stage, the crisis is so serious that it is not enough for the new government to devaluate. It adopts a full "orthodox" package of economic policies: price liberalization, trade liberalization, expenditure cuts, tax increases. Some of these reforms are necessary, others ill-suited to the economic and social realities of the country. The transitional costs are high and the results not always bright. Sometimes, as in Argentina in 1979 and Chile in 1980-81, they may be disastrous. Anyway, as long as economic policies are purely orthodox, growth tends to be modest, economic inequalities increase, and popular unrest rises. In other words, a new populist cycle is under way.

Economic populism is a consequence of democratic politics in countries where the electoral body is formed of an enormous mass of people poorly educated and economically deprived. Sachs (1988), noting that in Asia economic populism is much less frequent, attributed the problem to the high degree of income concentration prevailing in Latin America. As a matter of fact, some degree of populism is part of the democratic experience in Latin America. It is a problem of political underdevelopment with deep economic and cultural roots. The alternative to populism is ideally modern democracy, but in practical terms it has often been authoritarian regimes. Probably a more realistic approach is to live up with some degree of political populism while strongly criticizing economic populism. After all, both phenomena are not necessarily correlated. In Brazil, the Vargas regime (1930-45 and 1951-54) was politically populist, but economically it was not. A classical episode of economic populism took place in Brazil under a military, non-populist government (1979-80). As Faucher remarks, “populism is not associated with any specific economic policy or program... populism uses economic levers to satisfy political ends... populist governments do not always adopt 'popular' economic policies” (1991: 1-2). Menem in Argentina, Collor in Brazil, Fujimori in Peru were elected after classical populist political campaigns, and once in government adopted orthodox economic anti-populist policies.

Democracy and Reforms

If populism is a viewed as a perverted manifestation of democracy in underdeveloped societies, the temptation is to ascribe economic reforms and economic efficiency to authoritarian regimes. These regimes would be “a necessary step” not only between underdevelopment and development, but also between traditional oligarchic political regimes and modern democracy.

During long years when authoritarian regimes were backed by Washington as a barrier to communism, they were also seen as pursuing sound economic policies. The alternative was presented as one between “modern” authoritarian regimes able to stabilize or populist regimes unable to do that. This view was expressed in Thomas Skidmore's 1977 paper on stabilization efforts in the 1950s and 1960s in Argentina, Brazil, and Mexico. According to Skidmore, “governments in competitive political systems find it extremely difficult to reduce inflation, once it has exceeded 10 percent... all the cases of successful stabilization have been carried out by authoritarian (or one-party) governments” (1977: 181).

Hence, it would seem that under authoritarian regimes and in two-party systems like Colombia, where it is difficult to distinguish democratic from authoritarian rule, the adoption of more lengthy and persistent adjustment efforts is more feasible than in democratic regimes (Haggard and Kaufman, 1990). Yet the same authors plus Webb, having found support for the hypothesis that “authoritarian regimes may be more likely to stabilize when inflation and social conflict are high,” add that their “findings provide no evidence for the general proposition that authoritarian governments have lower inflation than democracies or are more likely to stabilize”. (Haggard, Kaufman and Webb, 1990: 4, 23 and 27) One reason is that populist-developmentalist practices were pursued by many Latin American authoritarian regimes.

The perception of economic superiority of authoritarianism has been challenged in the 1980s, when, on the one hand, the United States changed its policy towards the authoritarian regimes in Latin American, and, on the other hand, these regimes became the object of a severe criticism on the part of Latin American elites. Since authoritarian regimes failed to implement market oriented reforms in the 1960s and 1970s and finally drove their economies to an enormous crisis in the 1980s,[51] the new assumption, shared for different reasons by U.S. and Latin American elites, was that the new democracies would be able to stabilize and implement reforms. This assumption is confirmed in several new studies. Karen Remmer studied IMF standby programs in Latin America between 1954 and 1984 and came to the conclusion that authoritarianism is not a condition for economic stabilization. She added: “authoritarian regimes may inspire greater outside investor confidence or otherwise surpass their democratic counterparts in economic management, but they are no more likely to initiate stabilization programs or to survive their political reverberations” (1986: 20). In another paper, where Remmer reported on a study of twenty-one competitive elections in Latin America between 1982 and 1990, after signaling “the paradox” that transitions to democracy took place in the middle of severe economic crisis, she concluded that the new democracies are more stable than usually thought: “the so-called `new' democracies do not stand out as a distinctive group that can be characterized as unusually vulnerable to economic reversals... Latin American experience of the 1980s suggests that economic crisis should be described less as a threat to democracy than a challenge posing opportunities as well as risks” (1991: 28-29).

Remmer is probably too optimistic about democracy when she adds that “the assumption that political leaders in new democracies will be peculiarly predisposed to succumb to the temptations of economic populism thus seems inappropriate.” (1991: 30) Badly needed economic reforms were delayed in the new Latin American democracies, particularly in Argentina, Brazil and Peru. When populist leaders in Argentina, Bolivia, Venezuela, Peru and Brazil adopted non-populist policies it was because the crisis in these countries was so deep that even the short-term costs of sticking to populist policies became higher than the costs of adjustment. When there is no other alternative but to undertake reforms, they are undertaken independently of the authoritarian or democratic character of the regime. And, indeed, a democratic regime is not, necessarily, less powerful than a authoritarian one to introduce them.

The political power of a government is derived in large measure from the support it receives from civil society at large and from the country's elites. In democratic regimes, this support tends to surge at special moments, particularly after elections. At such moments, the newly elected governments have enough popular support to impose transitional costs on the population. If the economic crisis is particularly acute, the political power of the new government is increased. In Brazil, the inauguration of the Collor government (March, 1991), and in Argentina, the inauguration of the Menem government (August, 1989) coincided with hyperinflationary bouts. In both cases the respective governments were very powerful at those moments and adopted strong reforms initiatives. Yet, they failed. Authoritarian regimes may have a more stable power but only as long as they receive the support from elites. When they lose this endorsement, however, they are especially weak.

Efficiency of Reforms

The frequent failure of fiscal adjustment and reform efforts pose the question whether these efforts are effective and efficient? This is both an economic and political problem. Political scientists, when analyzing constraints to economic policies, usually accept as given that economists (or World Bank, or IMF) know which policies are to be adopted. Starting from this assumption, they ask if governments will win the political support or will mobilize the required political inputs to implement the reforms.[52] This question, discussed above, is undoubtedly relevant: indeed, both democratic and authoritarian regimes usually fail to introduce reforms because they are not able so assemble the political inputs required to implement them. Yet, particularly with regard to stabilization programs, it is common that they fail--or that they engender excessive transitional costs--not for lack of political power but because they are poorly designed.

Stabilization in Chile in the 1970s is a typical case of stabilization that was successful, but inefficient, given the exorbitant transitional costs.[53] In turn, the Collor Plan I (March to December 1990) is a paradigmatic example of an ineffective policy.

Its failure cannot be attributed to lack of political power or insufficient political will. It failed because it was poorly designed: because in its second phase, from May to December, the Brazilian government adopted a strictly monetarist strategy, ignoring that the inertial component of inflation was very high.[54] The first phase of the Collor Plan I, between March 16 and May 15, was a heterodox, shock phase. It consisted of a monetary reform, that included a capital levy, a blockage of 70 percent of all financial assets in the economy, and a freeze. It acknowledged the inertial or autonomous character of inflation. After May, however, when it became clear that inertial inflation was back, a second, strictly monetarist phase began. Ignoring the informal indexation of the economy and the endogeneity of money supply in these circumstances, an infeasible monetary target was defined (9 percent increase for the monetary basis in the second semester of 1990), and everything was subordinated to the attainment of this target. In August an IMF mission visited Brazil and wrote a letter of intention fully supporting the stabilization program that the Brazilian government signed. This agreement was not approved by IMF's board only because Brazil was in arrears and the commercial banks were pressing for a previous negotiation. For seven months, from May to November, mainstream, orthodox economists were projecting a fall of inflation “next month,” given the abandonment of any kind of formal indexation, the consequent reduction of real wages, the severity of fiscal policy, the rigor of monetary policy, the high interest rates, and the consequent recession. When inflation reached almost 20 percent in December, while the Central Bank lost control of the monetary basis, the prediction of the neo-structuralist theory of inertial or autonomous inflation was confirmed. Yet, monetarist economists resorted to their classical explanation when their sponsored programs failed, arguing that fiscal and monetary policy were not severe enough. They were. The Collor Plan I failed not for weak fiscal or monetary policy, but because, ignoring the inertial character of inflation and the hyperinflationary regime prevailing in Brazil since the failure of the Cruzado Plan, it did not use incomes policy and a nominal anchor (the exchange rate)-- the two essential tools to control this type of inflation.

In general, stabilization plans that follow the Washington approach tend to fail if inflation is high and chronic, with a strong inertial component, and thus autonomous in relation to demand. This type of inflation, situated between the “moderate” inflation existing everywhere and hyperinflation, has been variously called “autonomous,” “inertial,” “high,” or “chronic.”[55] When inflation is chronically over 5 percent a month, a series of informal and formal indexation systems are bound to appear as a result of economic agents' struggle to protect their relative share in income. As economic agents indexate their prices to some index of past inflation, raising them in a phased way, it becomes difficult to curb inflation. Relative prices are being permanently balanced and unbalanced, given the lack of coordination of prices increases. Informal indexation makes inflation rigid, autonomous of demand, inertial.

To control this kind of inflation, conventional fiscal and monetary policy are not enough. Since the ultimate cause of inflation is the fiscal crisis of the state, a fiscal shock will be necessary. And given the inertial component, an incomes policy, some kind of a freeze, is required. This fact, that became clear to Latin American structuralist and probably also to Israeli economists in the early 1980s, is being increasingly acknowledged. In the introduction to a recent book on the Lessons of Recent Economic Stabilizations and its Aftermath, Michael Bruno sums up the findings of the group of economist on this intermediate species of inflation that became so common in recent times:

> Given inflationary inertia, the orthodox cure is necessary but not sufficient. The correction of fundamentals does not by itself remove inflationary inertia, as the most recent Mexican example has shown. Supplementary direct intervention in the nominal process, such as a temporary freeze of wages, prices, and the exchange rate, can substantially reduce the initial cost of disinflation. (1991: 2).[56]

This type of inflation is typical of Latin America, particularly of Brazil and Argentina. The Washington consensus, given its monetarist foundations, has an enormous difficulty in understanding it. IMF theoretical analysis and the ensuing stabilization programs ignore autonomous or inertial inflation. The consequence is inefficient if not ineffective stabilization policies.

Transitional Cost and Consensus

Since adjustment and reforms involve transitional costs, the more general reason why they are postponed is the absence of a minimum political consensus on what must be done. Questioning begins with the meaning of adjustment and reform. The broad objectives--stabilization, growth, distribution--are generally accepted, but from that it does not follow that fiscal adjustment, balance of payment adjustment and trade liberalization should be adopted. It is true that, as populist policies are increasingly discredited, fiscal discipline and market orientation are increasingly included in the consensus. But the consensus usually stops here. Even economists have very different views on how to stabilize and reform. Is it already time for reform? How to share the transitional costs among social classes? Which groups or sectors of society should pay the bill? Should the sacrifices be endured only internally or shared with foreign creditors?

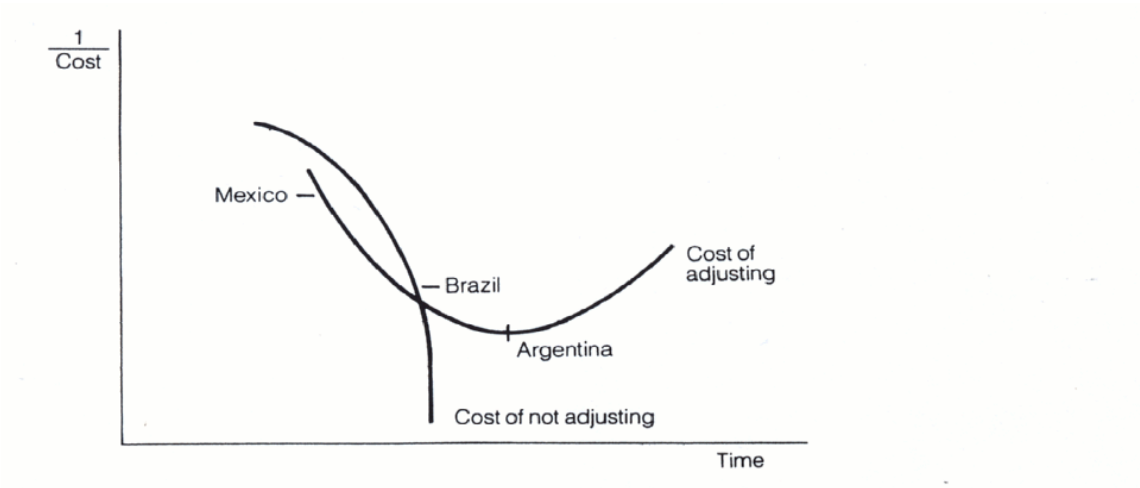

Figure 1 The costs of reforming and of muddling through

These questions have no simple answers. Politicians are permanently under pressures of the constituencies they represent. The rational economic behavior consistent with a relatively high preference for future consumption would be to correct any distortion, particularly any acceleration of inflation, as soon as it happens. But this posture represents some form of anticipation of the transitional costs. In Latin America, entrenched populist beliefs make economic agents accept sacrifices only when the crisis turns unbearable. But even then nothing guarantees that the consensus will be achieved. Usually economic agents will try to pass the required sacrifices on to others.

The decision to adjust as soon as distortions appear implies a trade-off between the short-term costs, which are in some way "anticipated," and the medium-term benefits from reform. Transitional costs are anticipated in the sense that, at this early moment, the costs of reforming are higher than the costs of muddling through, of non-reforming. The concept of "transitional cost" is based on this anticipation. Yet, if reform is not undertaken and the crisis continues to aggravate, sooner or later the costs of muddling through become equal and eventually higher than the costs of adjusting and reforming. At this moment it is no longer appropriate to speak of "transitional costs" as an opportunity cost, since not to reform costs more than to reform.

This phenomenon may be more easily seen with help of Figure 1. On the vertical axis we have the inverse of costs: both of reforms and of muddling through

(1/costs).[57] The curve of the cost of muddling through declines at an increasing rate. When it becomes vertical or perfectly inelastic in relation to time, this means that the economy arrived to economic disorder or chaos, usually made visible by hyperinflation. The curve of costs of reforms has a **U** shape. It declines for a while at a declining rate and then inflects and moves upward as the benefits of adjustment increase.

The vertical distance between both curves, where the cost of adjustment is on the left of the cost of immobility, represents the net transitional cost, the anticipated cost of initiating reforms. The net transitional costs are the difference between the costs of adjusting and of muddling through.

While the cost of muddling through is given and retrospective, the cost of adjustment is prospective, that is, it will materialize only if adjustment is implemented. In the graph, this cost depends on the time when the decision is made. For Mexico, for instance, the adjustment curve would be upward and the left. Thus there is a curve of adjustment for each country, depending on the moment it decides to reform. But, if it is so, which cost of adjustment curve appears in Figure 1? The curve plotted is "the limit" curve of adjustment- -the limit because it is the curve whose bottom point corresponds horizontally to the moment the curve of immobility becomes vertical, i.e., to the point where the costs of not having adjusted may increase infinitely. The limit curve corresponds to the last moment reform may be undertaken before economic chaos. It is also the curve that envelops all the possible adjustment curves that could be plotted depending on the specific moment when each country decides to adjust.

From this figure it possible to derive a rational "bottom of the well" concept. In practical terms, there is no bottom of the well for a crisis. It can go on for ever. But we can define the bottom either as the point where both curves cross. At this intersection, the curve of non-adjustment became vertical and net transitional costs are zero. After the first point, it is irrational, even to short-term thinkers, to postpone reforms. Reform is imperative. And probably it will be as chaotic as the crisis it tries to cure.

We can locate the moment Mexico and Argentina introduced reforms in this Figure. Mexico did it at an early stage. Thus, the transitional costs were high. In compensation, the cost of adjustment curve turned up soon. This curve is not plotted in the Figure, but can easily be imagined. In contrast, Argentina postponed reforms as much as possible. It initiated reforms several times, since the assumption of the Alfonsin government, but it was not able to go through. Only after several episodes of hyperinflation, after the two curves had crossed, reforms were indeed implemented: initially, in 1990, in a chaotic form and subsequently, in 1991, with the

Cavallo Plan, in a more orderly way. Brazil is between these two countries. At the end of 1990, it is probably at the point the two curves cross. Yet, given the experience of Argentina, there is no assurance that reforms will finally be firm and successful. The consensus required to follow through is still to be achieved.

Rational collective economic behavior implies that reforms are undertaken as soon as distortions arise. It requires that consensus on what is to be done be reached as early as possible. Democratic politics is, essentially, a process of negotiation and persuasion that drives society to this consensus. Yet, it is a time-consuming process. And it may be very costly, if the required measures are postponed for long. While one waits for the consensus, the crisis may linger for years.

Leadership matters. A statesman endowed with the Machiavellian virtù, with vision and courage, may be able to anticipate the consensus. Support will emerge a posteriori, given the success that reforms eventually achieve.[58] The courageous ways in which Mario Soares in Portugal or de la Madrid in Mexico faced the crises in their respective countries exemplify such leadership. Yet statesmen are a fruit of chance. In their absence, a country may wait until hyperinflation and chaos before political and economic elites are persuaded that there is no alternative but to adopt a program of reforms.

Conclusion

Two basic alternatives are left in Latin America to overcome the fiscal crisis. The first is to attack it directly, reducing internal and foreign public debt and increasing taxes. The second is to spare the dominant sectors of the economy from sacrifices, while adjusting in fiscal terms and implementing reforms. The first alternative is risky. If the attack is not strong enough and well designed, chances are great that the ensuing situation will be worse than before. The second alternative is politically easier, since little is demanded from the most powerful groups, on whom stabilization and the resumption of growth depend. The flow fiscal measures, the reforms and an agreement with banks according the Brady Plan will work towards confidence building. Yet, as it will probably be unfeasible to place all the required sacrifices on workers and the middle class, as the cases of Venezuela and Peru underline, the fiscal crisis will not be completely solved. For some time the threat of collapse of the whole system will be present.

Mexico is following quite consistently this second alternative. Up to this moment the results are mixed. The Mexican economy remained stagnant until recently and while there is now some per capita growth, it remains modest. Mexico is far from having solved all its problems. Yet it is possible that the fiscal crisis will be eventually overcome due to the new investments and the repatriation of capital. The debt agreement according to the Brady plan implied an unsatisfactory debt reduction, but contributed positively to the confidence building process. Mexico is following this strategy on the razors edge. International reserves are stable. Current account deficit is being compensated by large capital inflows. Oil price increases represented a big help in 1990. If oil price remains high and if foreign direct investments and capital inflow are maintained, the negative trade and current accounts may be neutralized. And in the medium run, productivity increases may bring back the exchange rate to balance.

Argentina, Venezuela, and Peru try to follow the Mexican example, for the moment, without a clear success. In 1991 the three countries were presented by Washington as successful examples. The deep political crisis in Venezuela, following an abortive military coup in February 1992 and President Fujimori's coup in Peru in April this year showed that the internal costs of economic reforms were very high and democracy, feeble and unstable. Brazil, as long as it confronted foreign creditors and local capitalists, with the Collor Plan I, seemed to have chosen the first alternative of distributing the sacrifices required to overcome the fiscal crisis among all the sectors of society. Yet, the failure of the orthodox stabilization program, that followed in May the heterodox shock of March 1990, left the Brazilian economy in a difficult situation. Washington, having supported this stabilization program, now blames only Brasilia for its failure. In May 1991 a new finance minister, identified with Washington, took office. One year later, however, inflation remained over 20 percent a month and the economy stagnated.

Latin America is still immersed in economic crisis. Colombia, committed to fiscal discipline, was the only country to avoid the fiscal crisis. Two authoritarian governments, Chile and more recently Mexico, overcame or are overcoming it. But the transitional costs were very high. The Bolivian economy remains stabilized, but did not resume growth. Venezuela engaged in a severe fiscal adjustment in 1989 and is so rich that it is resuming growth in spite of the limited debt reduction derived from the Brady Plan agreement on the foreign debt. Peru's and Argentina's crisis went so far and so deep, the hyperinflation episodes and the fall in income were so distressing, that at the present the costs of not facing the crisis are higher than the costs of adjusting, including the costs of canceling a part of the internal public debt.

The Brazilian economy, much more powerful, in 1991 had not yet reached the point where crisis becomes unbearable to society. Most sectors of society still believed either that the transitional costs of fiscal adjustment were bigger than the costs of immobility, or that there exists some magic formula to avoid the transitional costs, or that theses costs should and could be transferred to others sectors of the economy.

The neo-liberal approach to the Latin American crisis involves international pressure. This pressure entails formal conditionalities on the part of the multilateral agencies and informal ones on the part of governments of the advanced industrial countries and the international business community. I criticized this approach in several instances: because it does not acknowledge enough the gravity of the fiscal crisis, it compromises excessively with internal and foreign creditors, it does not provide for a reasonable burden sharing, it is based on a misguided assessment of the nature of inflation, its stabilization programs are too costly, and, most importantly, because even if succeeds in stabilizing, it does not offer effective strategies to recover public savings and promote the resumption of growth.

Yet, the Washington consensus, if it is coupled with internal pressure coming from the well-informed and modern sectors of society, if it is identified with the national interest and if it is determined to cope with the fiscal crisis, to implement market oriented reforms and to define a new strategy of growth, may be effective. As it discards populism and nationalism, the internal pressure, while rejecting naive internationalism and foreign subordination, may be helped by the external influence, provided that local governments conserve a critical assessment of the neo-liberal assumptions behind the Washington consensus and that governments, multilateral agencies and civil society in advanced countries, particularly in the United States, are less doctrinaire and more pragmatic.

Politics is the art of compromise. Compromise that has to be achieved not only internally, but also in the international relations of Latin America. Neo-liberalism is a rhetoric rather than an effective practice in the advanced countries. It is usually a doctrinaire rhetoric. But it is a rhetoric that has to be taken into consideration, particularly when it argues for badly needed fiscal discipline and market oriented reforms.

The fundamental challenge faced by Latin America is its fiscal crisis. Stabilization as well as the resumption of growth depend on overcoming the insolvency of the state and on recovering public savings. Washington, while pressing for the elimination of the public deficit, gives much less attention to the recovery of public savings. Its structural reforms have an essentially negative character. Yet reforms must lead to a new development strategy, where the market would play the major role but a reorganized and reduced state has an orienting task.

Latin America is a dependent region. The national interest of each of its countries has much in common with the national interest of advanced countries, particularly the United States. But there are also conflicts of interests and of views. Compromise will have to be achieved on a variety of issues: compromise that acknowledges differences but does not overestimate them.

Notes

[1] I do not use the words "government" and "state" as synonyms, as usually done in Anglo-Saxon countries. In this paper they are distinct concepts. "Government" is the body that runs the state (the Presidency and its ministers, the Congress, the Supreme Court). "State" is the bureaucratic organization, the apparatus, that has the exclusive power to legislate and tax population living in a given territory. Thus the state is a larger entity of which government is an essential part. Still larger is the concept of "nation-state", the sovereign country or nation, that also should not be confused with state.

[2] Washington, although dominated by neo-liberal ideas, remains very much worried by income and wealth concentration in Latin America. It does know that inequality is not just a major social problem, but also a crucial obstacle to effective modernization in the region.

[3] On the pragmatic aspect of the approach I am proposing, see my paper "A pragmatic approach to state intervention" (1990), where I analyze the pragmatic approach East and South-east Asian economists use to deal with their problems.

[4] The "Washington approach" is the dominant approach in Washington and more broadly in the industrialized countries, but not necessarily a consensual one. Richard Feinberg, commenting Williamson's paper, left clear that, although there is a movement towards "a centrist consensus" in Washington, there are many doubts: "An example, the role of the state. We agreed that there should be some trimming and streamlining. But do we want the final product to be a sleek high performance Jaguar or a minimalist Yugo"? (1990: 22).

[5] In relation to the management of the foreign debt crisis this group forms what Susan George called "the system" (1988). This system is commanded by the Treasury, and has as basic arms the Fund and the Bank. The other finance ministers of G-7, on one side, and the chairmen of the more important international banks (around 20), on the other, complete the "system". In the early phase of the debt crisis, the Federal Reserve Bank, then governed by Paul Volcker, represented the U.S. government. Since the Baker Plan (1985), the influence of the Fed began to diminish, practically disappearing after Volcker left its governorship in 1987.

[6] This omission of the foreign debt is not casual. Although Washington recognizes the existence of a debt crisis – or rather, a debt "problem," – the current position is that this problem has been grossly overestimated.

[7] It is not as easy as in the case of the Washington approach to define the sponsors of what I am calling, for lack of another established name, the "fiscal-crisis" or "pragmatic" approach: "fiscal crisis" to underline the basic cause of the Latin American crisis, "pragmatic" to disallow any kind of dogmatism. As direct predecessors of the present essay I should cite Sachs (1987), Dornbusch (1989) and Fanelli, Frenkel and Rozenwurcel (1990) and my essay "A pragmatic approach to state intervention" (Bresser-Pereira, 1990). Here, I will quote several economists not only in Latin America and Asia, but also in the U.S. and Europe, who share the basic tenets of this approach. Only among the economists quoted in this essay, besides the two other co-authors of this book, Adam Przeworski and Jose Maria Maravall, I would indicate as sharing the views of the fiscal crisis of pragmatic approach: Adolfo Canitrot, Albert Hirschman, Alice Amsden, Andre Lara Resende, Edmar Bacha, Collin Bradford Jr., Elhanan Helplman, Eliana Cardoso, Felipe Passos, Fernando Fajnzylber, Gene Grossman, Guillermo Rozenwurcel, Jeffrey Sachs, Jose Maria Fanelli, Joseph Ramos, Michael Bruno, Miguel Kiguel, Mitsuhiro Kagami, Nora Lustig, Paul Beckerman, Paul Krugman, Pedro Malan, Persio Arida, Richard Feinberg, Roberto Frenkel, Rogerio Werneck, Rudiger Dornbusch, Sebastian Edwards, Werner Baer and Yoshiaki Nakano.

[8] Barbara Stallings (1991:3) pointed out recently that "the older ideas about external influence have been too quickly abandoned. Ironically, just as international variables became specially important in the 1980s, they disappeared as a key factor from theories of development".

[9] This is not consensual in Washington. Recently, the World Bank has been stressing the importance of increasing taxes to balance the budget and also to finance anti-poverty programs that would make fiscal adjustment and structural reforms compatible with democracy. IMF is increasingly worried how to achieve stabilization with growth. See particularly Vito Tanzi's paper (1989) in the IMF book edited by Mario Blejer and Ke-young Chu, Fiscal Policy, Stabilization and Growth in Developing Countries (1989).

[10] This critique is originally due to Sachs (1987).

[11] There is, obviously, an alternative: to finance growth with foreign savings, particularly with foreign direct investment. This is in part the route presently being followed by Mexico. Foreign investment and capital repatriation permitted Mexico to overcome stagnation and start economic recovery.

[12] It is present, for instance, in Fajnzylber (1990).

[13] The populist and nationalist approach shuns off any type of adjustment, proposes that fiscal deficits and higher wages are functional in invigorating aggregate demand and growth, denies that state intervention was too high and that the protectionist import substitution strategy is exhausted. The number of proponents of these ideas in Latin America was drastically reduced in recent years. The correspondent practices, however, continue to be widespread.

[14] There is a redundancy in this expression, since a fiscal crisis is always a crisis of the state. "Financial crisis of the state" is an alternative expression with the same

meaning. Fiscal crisis of the state, however, serves to stress that the state is in a crisis.

[15] The state in Brazil is internally financed by the "overnight market". Everyday, economic agents transform their deposit accounts in the banks into loans to the state with one day maturity. In this way, financial assets are indexated and protected from inflation, whereas the state is financed with a bond that is quasi-money. The Collor Plan I (March, 1990) was an attempt to cope with this problem (Bresser-Pereira and Nakano, 1990).

[16] We could exclude from current revenue and expenditure the state owned enterprises. In such a case the simplest way to consider their savings (or dissavings) is to add to the identity the profits (savings) or deduct the losses (dissavings).

[17] I have no knowledge of any study of public savings in Latin American countries. As for Brazil, the information exists but, as everywhere, it excludes the state-owned enterprises. An economist who used the public savings concept in a pioneering way was Rogerio Werneck (1987) in his study of the economy of the Brazilian state.

[18] As notes in Table 3 inform, the criteria are not the same for all countries. For some countries state-owned enterprises are included, for others they are not.

[19] In Mexico, public deficit increased up to 1982, when it reached 8.3 percent of GDP, and then decreased due to a particularly strong fiscal adjustment. In 1989 the Mexican public deficit fell to 1.8 percent. In 1990, it reached zero. However, data about the operational public deficit (PSBR - public sector borrowing requirements in real terms) are not usually mentioned by the proponents of the Washington consensus, when they refer to Mexico. They normally use the concept of primary deficit (public deficit minus interests) that in 1980 was 3.1 percent of GDP, increased to 7.4 percent in 1982, but since 1983 was strongly reduced, changing into a primary surplus of 8.0 percent of GDP in 1988 and 7.8 percent in 1989. The primary surplus shows, undoubtedly, the great effort Mexico performed. But the permanence of a considerable public deficit, that only in 1990 reached zero,is an indication that the public debt problem, particularly the foreign public debt, was not solved, constraining the Mexican government to pay an enormous sum of interests.

[20] These ratios, together with the data in Table 3, particularly the public savings ratio, are excellent indicators of the fiscal crisis. An additional and important information would be the total public indebtedness (internal and external, including state-owned enterprises), but I have not been able to find these data for the eight countries. The interest burden of central government gives an indication

[21] On the fiscal character of the crisis, see also Jeffrey Sachs (1987), Bresser-Pereira (1987, 1988b), Fanelli and Frenkel (1989), and Reisen and Trotsenburg (1988).

[22] Economic populism has some classical contributions: Canitrot (1975), O'Donnell (1977) and Diaz-Alejandro (1981). These papers plus recents contributions by Sachs (1988), Dornbusch and Edwards (1989), Eliana Cardoso and Ann Helwege (1990), and myself, alone (1988c) and with Fernando Dall'Acqua(1989), were put together in a book, Populismo Economico (Sao Paulo: Editora Nobel, 1991).

[23] The average income tax in Latin America was, in 1988, only 23 percent of the total government revenues. And this figure is inflated due to the oil producers, like Ecuador and Mexico (Cheibub, 1991).

[24] The Washington approach tries insistently to use the Asian NICs (New Industrializing Countries) to support their views. As to the role of the state, this does not make sense. The definitive book on this subject was written by Alice Amsden (1989).

[25] Robert Heilbroner observes: "Capitalism is thus intimately entangled with planning as it is the market. Its entanglement is called not planning but economic policy, and I need hardly add that economic policy is very different from central planning. It is planning nonetheless - that is, a deliberate effort to bring about some outcome different from that would otherwise emerge from the market process." (1990: 98)

[26] Sachs (1987), criticizing the Washington approach, showed that the economic success of Japan, Korea and Taiwan cannot be attributed to trade liberalization, given the mixed character of these economies, where the state continues to play a decisive role.

[27] Stephen Krasner observes that "the demands associated with proposals for the New International Order, which assumed their greatest saliency in the mid-1970s, are the clearest manifestation of the Third World efforts to restructure market oriented international regimes" (1985: 7).

[28] I examined the statist social formations and the technobureaucratic mode of production in A Sociedade Estatal e a Tecnoburocracia (1981a).

[29] According to Przeworski, "capitalism is irrational in the sense that under this system we cannot use full productive potential without rewarding those who control the productive endowments". In turn, "socialism," which he defines "as synonymous with centralized command over resource allocation" is infeasible, while "in the real world people starve" (1989: 3, 16, 28).

[30] See especially the study by Michaely, Papageorgiou and Choksi (1991).

[31] For a survey of these studies see Grossman (1990). Among the papers surveyed are Grossman and Helpman (1986), Pack and Westphal (1986), Flam and Steiger (1989), Krugman (1987) and Helpman and Krugman (1989).

[32] Real interest for investor in the developed countries is around 4 percent. The spread is 2 percent. Thus, the real interest rate for loans will be around 6 percent, consistent with a reasonable rate of return of investments of around 12 percent. In Latin America the real interest rate that would attract capital will be around 10 percent. The spread required by the banks, around 5 percent. Thus, the real interest rate on loans--15 percent--will only be consistent with an average rate of return on investment of around 25 percent. Such a high rate of return would only be possible with additional concentration of income, in a region where this is a major economic and political problem.

[33] Brazil, Mexico, Argentina, Chile, Venezuela, Colombia, Peru and Bolivia.

[34] Mexico's per capita rate of growth in 1989 and 1990 were respectively 0.8 and 0.4 percent.

[35] It is important to note that a substantial part of the high rates of growth may be explained by the increase in copper prices in the international market since 1985. This increase that was fully captured by the Codelco, while in Peru, for instance, the same did not happen. I owe this observation to Roberto Frenkel.

[36] Primary budget surplus (or deficit) is equal to budget deficit minus interests on internal and foreign debt.

[37] David Goldman, for instance, wrote in Forbes magazine (July 9, 1990): "Mexico's stock market index has approximately doubled since July 1989... Under President Carlos Salinas de Gotari, Mexico is set to repeat the success story of South Korea but on a far grander scale."

[38] Debt reduction in net cash flow terms, considering the new loans that were necessary to offer as collateral to the banks, was around 10 percent, when a reasonable reduction would be 60 percent (see Lustig, 1990). According to Bacha, the reduction in net annual interest due was of 19 percent. But he used a Libor of 9.125 percent. "If the calculations were done with the much lower Libor rates observed in 1990-91, the interest savings would be correspondingly reduced" (Bacha, 1991: 9).

[39] Obviously the assessment of the Mexican debt agreement is subject to controversy. Van Wijnbergen, for instance, believes that "the package meets Mexico's financing needs as currently projected and is compatible with a gradual recovery of growth in Mexico over the next six years" (1991: 41). A different view is held by S. Islam (1990), according to whom the Brady Plan missed the opportunity to give the breath for growth. Mexico's positive performance would rather be explained by sounder policies and higher oil prices.

[40] President Pérez declared to a Brazilian journalist, that "there was a basic mistake in the Latin America development process... Governments developed a series of defensive strategies against abusive practices of the international capital, that we then called imperialism. This brought excess state intervention and an artificially protected economy" (1990).

[41] Mario Brodersohn, who was responsible for the negotiations of the foreign debt in the Alfonsín government, says: "There is today a broad political consensus in Argentina that the public sector faces a deep structural crisis" (1989: 1). This consensus did not exist in 1984, when Juan Sourrouille's economic team took office. The same happened in Brazil. Only in 1987, after the failure of the Cruzado Plan, it become clear that a fiscal crisis was at the origin Brazilian crisis.

[42] On this subject see Bresser-Pereira and Ferrer (1991). True dollarization took places in several countries for a short period, together with hyperinflation. In Argentina, however, there is a true or effective dollarization of the economy for several years, before, during and after hyperinflation. This fact poses additional difficulties to the stabilization of the economy.

[43] See Central Bank of Brazil, Brazilian Economic Program, vol.7, May 1985, p.25.

[44] An analysis of the populist character of first years of the Sarney government may be found, for instance, in Bresser-Pereira (1988c), Sachs (1988), Beckerman (1990).

[45] In the first month the real interest rate was 16 percent a month.

[46] Internally, Zélia Cardoso de Mello was successful in reducing the public debt. Around 50 per cent (30 billion dollars) was canceled. Externally, she was just beginning to negotiate when she left the Ministry.

[47] For instance, the monetary reform in West Germany in 1948.

[48] My first systematic attempt to answer this question is in Bresser-Pereira (1988c).

[49] I prefer to use the expression "technobureaucratic-capitalist authoritarian regime" to define this political coalition, emphasizing the that it was based in a basic agreement between the bureaucrats, particularly the military, and capitalists. O'Donnell's expression, however, was generally adopted, and is very useful to define a type of coalition that was dominant for about twenty years in Latin America, at the beginning with the support of Washington.

[50] On the subject see Canitrot (1975), O'Donnell (1977), Diaz-Alejandro (1979), Sachs (1988).

[51] Mexico and particularly Chile represent exceptions to this general rule.

[52] This attitude is present, for instance, in the book edited by Joan Nelson, Economic Crisis and Policy Choice (1990).

[53] See on this subject Diaz-Alejandro (1979), Foxley (1983), Ramos (1986) and Edwards and Edwards (1987), among others.

[54] See on the subject Bresser-Pereira and Nakano (1990) and, for the definition and analysis of the two phases, Bresser-Pereira (1991).

[55] The theory of inertial inflation was developed in the early 1980s. Passos (1972), that wrote a pioneering book on the subject, calls it "chronic inflation"; I called it initially "autonomous inflation" (Bresser-Pereira, 1981b); Frenkel uses the expression "high inflation"; but the dominant expression came to be "inertial inflation", a misleading expression because it is inconsistent with the acceleration that usually comes together with it. For a survey of the subject see Bresser-Pereira and Nakano (1987) and Baer (1987).

[56] A similar kind of analysis can be read in Kiguel and Liviatan (1988) and Beckerman (1990). It is Washington adopting the pragmatic approach.

[57] I got the idea of constructing a curve of costs of transition from Przeworski (1990b). I added the curve of "unadjustament", of non-implementing the required reforms. I used the inverse of the cost in order to indicate graphically a fall into the bottom of the well as costs go up.

[58] Fernandez and Rodrik (1991) specify some conditions when this may be true. Suppose that, if implemented, reforms generate a low prize for many people and a large loss for a few but that individuals do not know a priori whether they will gain or lose. Then the expected value of reforms is negative but once they are introduced the winners outnumber the losers.

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