

ECONOMIC REFORMS AND CYCLES OF STATE INTERVENTION

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Abstract. The neo-liberal wave that began in the early 1980s is just a manifestation of the cyclical pattern which characterizes state intervention, and the growth of the state organization. That one, when measured by the tax burden in relation to GDP, increased since the 1930s' great depression and the crisis of classical, laissez faire liberalism. Yet, as the welfare state and the developmental state grew sometimes too much, and often with distortions, it came to a crisis in the late 1970s. Radical liberal ideas were back, while more moderate market oriented reforms began to be implemented. The limits of such reforms, however, will soon become apparent, and state intervention or regulation, that have been decreasing, will again rise, confirming the cycles of the state.

An inner contradiction befouls the recent processes of transition to democracy in Latin America and Eastern Europe and the present hope for the consolidation of new democracies. The transitions to democracy took place in the middle of a deep and double crisis: a fiscal crisis related to the debt burden and a crisis of the developmentalist strategy of growth. This double crisis corresponds to a cyclical crisis of the state and is in the origin of the economic crisis these two regions face. Besides its political role of assuring law and order, the state has fundamental economic roles that are not being properly performed. As it becomes hostage to a fiscal impasse - the loss of public credit - at the same time that its previously successful strategies of growth promotion became distorted and lost effectiveness, the state fell into a deep crisis. This crisis helped to produce the transition to democracy, but subsequently undermined the new democratic governments, as they proved themselves unable to effectively recover the solvency of the state and define a new development strategy. Thus the crisis of the state was both a cause of the democratization process, as it revealed the failure of the old authoritarian or semi-authoritarian regimes to maintain the high rates of growth that characterized Latin America and Eastern Europe after World War II, but it is also in the present the reason behind the failure of economic development to be resumed and the new democracies to consolidate.

Simultaneously, in the developed world, the golden age of capitalism - the high rates of growth that prevailed in the 1950s and 1960s - came to an end with the suspension of the convertibility of the dollar in 1971 and with the first oil shock in 1973. These were just the symptoms of the downturn of a long wave. The rates of growth of the developed economies in the next 20 years were half of the previous ones. In the First World this slow-down did not turn into a deep crisis, as it did in Latin America and Eastern Europe, because the distortions in the growth of the state were kept under control, as long as governments acted more quickly in adjusting their economies. But its basic cause was the same - the crisis of the state: the fiscal crisis and the crisis of the mode of intervention.

On the assumption that the economic crisis in Latin America and Eastern Europe, as well as the slow-down in the developed countries since the 1970s are the outcome of a crisis of the state,¹ this paper argues that this crisis is related to an excessive and distorted growth of the state during its expansive phase. This growth weakened the state, not permitting that it performs the economic roles it is supposed to perform in modern and complex capitalist societies. But the paper also argues that the growth of the state is a cyclical process. The market-oriented reforms being today adopted everywhere have as objective to reform the state, reducing the state apparatus, privatizing, liberalizing trade and deregulating. These reforms are just a necessary phase of the cycle. The final outcome will not be the minimum state, as the neo-liberals suppose or desire, but a recovered state, ready to intervene and grow again. If the basic cause of the economic problems is the crisis of the state, its reform only make sense if the effect is a stronger although smaller state, not a weaker one.

The first response to the economic slow-down in the developed countries and the crisis in Latin America and Eastern Europe was a conservative wave - the neoliberal ideology - that took hold of the First World already in the late 1970s. This wave was particularly successful in the countries that suffered more

1 - I discussed previously the crisis of the state in Bresser-Pereira, 1992.

the crisis - United States and Britain. Britain, that lost the world hegemony in the First World War, United States, that lost its economic - but not military and ideological - hegemony in the 1970s and 1980s. It is not by chance that the neo-liberal wave was particularly strong in these two countries. The crisis was attributed to the excessive growth of the state. The benefits or miracles of the market were resuscitated; its failures, that had led to the 1930 depression, forgotten. The market would now solve all problems, cure all ills. The state should be reformed, and reform now meant reduction of the state apparatus, war to "big government". Privatization, trade liberalization, deregulation, often badly needed given the previous excessive growth of the state, became now the new priority of governments. But in a less consistent way tax reduction and the dismantling of the welfare state were put in the agenda. As a matter of fact, if there was a fiscal crisis, tax should increase not reduce. Yet, the Lafer curve, "showing" that as tax rates increased tax revenues decreased, served as a rationalization. On the other hand, the welfare state, that had proved an efficient or relatively cheap way of increasing standards of living without hurting the profit rate, started to be viewed as the cause of inefficiency and a way of inhibiting hard work and individual initiative.

In adopting this strategy, the new conservatives responded correctly to the excessive and distorted growth of the state, but failed to understand that the real objective should be rather a strong and lean state, than the minimum state. The well functioning of the capitalist system depends not only of a free market, but also of a strong although reduced state apparatus and to an increasingly fair distribution of income. The state is necessary to guarantee property rights and contracts, to stabilize the economy, foster savings and investment, to push technological progress, to promote income distribution and welfare, and, in institutionalizing and protecting the markets, to assure the existence of a strong civil society and of democracy.

The first reaction of the left, or the progressives, or the "liberals" was to resist to the conservative wave denying the need to reduce the state apparatus. They did not want to concede that the state had grown too much and should now be reformed and reduced. That privatization, trade liberalization and deregulation were indeed necessary. They adopted this attitude not only because they were sticking to old ideas, not perceiving that a new synthesis was necessary - a modern social democratic approach - but also because quite coherently they could not accept the dismantling of the welfare state, nor the idea of the minimum state. This paper, however, will suggest another reason: because they failed to understand the cyclical character of state growth or of state intervention.

Bureaucratic organizations have a long term tendency to grow. Thus the state, as the largest and most important bureaucratic organization, will tend to grow in the long run. Yet, this tendency should be not exaggerated, nor made linear. The state tends to grow absolutely, as societies become richer and more complex, but it does not necessarily tend to grow relatively. The share of public expenditures or the share of the state controlled production of goods and services in the GDP may increase, but moderately and, as proposed in this paper, in a cyclical and shifting way.

The Basic Hypothesis

My basic contention is that state intervention expands and contracts cyclically, and that, in each new cycle the mode of state intervention changes.² For a while, state intervention increases, the state assumes an increasing role in the coordination of the economic system, in the micro-allocation of resources, in the macro- definition of the level of savings and investments (or of the equilibrium between aggregate demand and supply), and in the micro-macro determination of income distribution among social classes and among sectors of the economy. It increases because it is being successful, because the state is performing a role that the market is unable or inefficient in performing. It is increasing because it responds in a fairly effective way to the demands of society.

As state intervention increases, however, be it in terms of its share in GDP, or in terms of the degree of regulation the economy is submitted to, intervention starts to become dysfunctional. The two basic symptoms indicating that the expansion of the state went too far are excess regulation, which hinders rather than stimulates economic activity, huge public deficits that crowd out private investments, and negative

2 - The hypothesis that the growth of the state follows a cyclical pattern was originally presented to the symposium "Democratizing the Economy", Wilson Center and University of São Paulo, 1988, and published in Portuguese (*Revista de Economia Política*, 9(3) July 1989).

public savings that reduce total savings. This is the moment when the cycle reverts or is supposed to revert, when state control contracts and market control expands. It is the time for some de-regulation and denationalization.

The hypothesis of the cyclical nature of state intervention conflicts both with the static theories, which assume a given level of state intervention as ideal, and with the historical theories that claim a long-term tendency toward the statization of the economy. For the neoliberals, the ideal level of state intervention is very low, for the statist, very high, and for the pragmatists, intermediary. Although this author is closer to the pragmatists, all these three positions are unacceptable as long as they assume a given relation between market and state control as ideal or optimum. Instead the hypothesis is that this ideal relation will necessarily vary historically and according to a cyclical pattern of state intervention.

Thus, rather than falling into an endless discussion about a doubtful optimum, we can propose that there is a cyclical and ever-changing pattern of state intervention. If we are minimally successful in demonstrating this hypothesis, the ideological content of the debate on the economic intervention of the state will thereby be reduced.

There are economic and political limits to the growth of the state. The relations between the state and the civil society, or between the state and the market are not arbitrary. The market and the state are the two mechanisms that respond for the coordination of an economic economy. Although they are not parallel institutions, although the state is previous to the market and responsible for its institutionalization and regulation, it is possible to think that they also have complementary roles in the coordination of the economy. These roles have to be performed in a balanced way. A state that grows too much in relation to the market, may cause economic and political problems that, sooner or later, will limit its expansion. This paper proposes that, in the same way as, in the strictly economic realm, there are the business cycles and the Kondratieff cycles and, in the private/public interest alternative, there is the Hirschman cycle, in the economic-political realm there are "the cycles of state intervention". In each new cycle the pattern of intervention changes.

The present historical process of a relative reduction of the economic role of the state, initiated in the mid-1970s must be viewed as a phase of the cyclical pattern of state intervention. The slow-down of the capitalist economies, that since then takes place, is in part consequence of the distortions and inefficiencies provoked by the previous growth of the state. As these distortions were perceived by society, they gave rise to the conservative or neo-liberal wave. State failures are made responsible of all problems and market failures were overlooked or forgotten. Yet, there is no reason to identify market-oriented reforms with neo-liberalism, nor should we identify market orientation with market coordination. Japan and the Asian "tigers" are market-oriented economies, i.e., strongly competitive economies within the country and abroad, but they are not particularly market-coordinated economies, i.e., resource allocation is not the exclusive role of the market, but also a role performed by the state.³ Economic reforms that liberalize trade, privatize and deregulate may just be sensible economic policy, provided that they do not aim the minimal state, do not disregard market failures, do not ignore the potentialities of collective action. If the pattern of state intervention is cyclical, it tends to change. In each cycle or historical moment, the form it will assume will be different. After liberalization and privatization, the state will perform new roles, institutionalizing markets, investing in the infrastructure and in education, stimulating science and technology, protecting the environment, promoting welfare.

Although Polanyi (1944) was probably correct when he said that a self-regulating market system was an exceptional moment in the history of mankind, the opposite idea of a successful state-controlled economy may live for a very short period. Actually, mixed situations, combining market and state coordination, are the long term and general rule. As modern economies become more and more complex, the need of market and state coordination of the economy turns bigger and bigger. In order to perform its role smoothly and efficiently the market must be institutionalized and complemented by the state. In other words, the market and the state must be strong and effective. But, whereas market coordination is supposed to be self-regulating, state coordination is not. In theory, the market automatically regulates the economy, whereas the coordination performed by the state is dependent on design. In practice, given market failures and the intrinsic limitation of state coordination, new coordinating challenges are presented all the time, both to the market and to the state. State intervention is unavoidable but embodies, sooner or later, failures. Old forms

3 - On the subject, see Bresser-Pereira (1989 and 1992).

of state intervention must be eliminated and new ones, introduced. The state must be constantly reformed in order to be kept strong, effective. Often this process is lagging, only taking place after an economic and fiscal crisis breaks-up. As a result, what we see is a cyclical and ever changing pattern of expansion and contraction of state intervention.

Thomas Hobbes, the 17th century founder of the contractualist theory of the state - which a century later would serve as basis for liberalism and democracy - had very clear to himself that only a strong state would be able to guarantee civil society against anarchy and the law of the jungle prevailing in the state of nature. In his time the absolute monarchies were building a strong state - the mercantile state - which eventually grew too much and in a distorted way. Industrial capitalism and the democracies and that emerged in England, United States and France in late eighteenth century were the outcome of a liberal reaction against the absolute monarchies. They represent a phase of reduction of the state apparatus. Yet, liberal democracy was also the unexpected outcome of the original Hobbesian contractualist theory of the state, that, assuming the need of a strong state to assure internal peace, denied the traditional and religious legitimacy of the monarch, and affirmed the need of a social contract to found and guarantee an effective state⁴.

Types and Intensity of State Intervention

State intervention assumes many forms. It is possible to distinguish four of them: (1) macroeconomic regulation, (2) normative microeconomic regulation, (3) administrative or case by case microeconomic intervention, and (4) nationalizations or direct investment in state-owned enterprises. The intensity of these interventions will vary according to the moment and the situation.

It is possible to define the theoretical limit for each type of intervention. The limit of macro regulation is centralized planning; normative micro regulation may limit itself to some health and safety regulations for the production and distribution or to extend itself to practically all types of economic activities. Administrative micro regulation - specific, case by case state intervention, whose application depends on the decision of a given public official or of a government committee - may also be very extensive or very limited. In the first case, it will happen at the expenses of normative micro regulation, that is based on relatively stable rules or regulations instead of being achieved in a case by case basis. Finally, the limit of nationalizations and direct investment by the state is the abolition of the private ownership of the means of production.

State intervention will also vary according to the type of relation that the state establishes with business. This can be restraining, supportive, or neutral. Taxation and the regulation of health, safety and the environment are typically restraining. Subsidies and tax exemptions are the classical examples of supportive state intervention. Macroeconomic policy can eventually be neutral, although we know very well that distributive neutrality in state intervention is almost impossible.

The intensity of state intervention is very difficult to measure. The simplest way is to measure the share of state expenditures in the GDP, but this does not take the state owned enterprises into account. An entirely different and very relevant form of measuring state intervention is by the degree of regulation, but there is no established quantitative technique for measuring the intensity of state regulation. This paper uses a loose combination of both criteria.

The Optimum Degree of State Intervention

The classical economists who founded our science understood the impossibility of a radical separation between the market and the state very well. That is why they called our science political economy rather than economics.⁵ Political economy is the science that studies the wealth of nations, that examines

4 - On the founding role of Hobbes in relation to the jusnaturalist or contractualist theory of the state see Bobbio (1979).

5 - Political economy is the original name of economics. It was abandoned when the neoclassical economists decided "to purge economics from politics and ideology". The tradition, however, was maintained by Marxists, Keynesians and structuralists. More recently, it has appeared in the universities of the advanced countries, generally outside the departments of economics, in a field called political

production and distribution in a market which obeys the law of value but is regulated and warranted by the state. There is no production, much less distribution, without power: private power and political power are permanently present in the market. As Altvater reminds us, the existence of capital depends on the existence of the state (1972).

It is significant, however, that a basic criterion that is commonly used to distinguish conservative economists from progressive ones is the role they attribute to state intervention in the economic coordination of the capitalist system. The former are in principle against, and the latter in favour of some degree of state intervention. Conservatives are against state intervention primarily because they fear socialism.⁶ Radicals traditionally favour it because they believe the nationalization of large corporations is the road to socialism. For a long time, socialist or social-democratic parties supported nationalizations believing it would be a way to socialism. In Britain, with the Labour Party after World War II, and more recently in France with the Socialist Party, a nationalization process took place. More recently, however, it is becoming increasingly clear that nationalizations are not an essential part of a socialist agenda. The left generally favours limited state intervention, but sometimes may well favour privatization and deregulation, because it accepts that the creation of state-owned enterprises and regulation may have gone too far. It does not accept the neoliberal thesis of the minimal state, but has abandoned altogether the old idea that nationalization is the road to socialism, realizing that one thing is statism, another, socialism.⁷

Although neoliberal and statist rhetoric may be decidedly ideological, this does not mean that the solution is simply to opt for an intermediate alternative. Alec Nove also does not believe in this kind of solution to the problem. He observes that "the vision of perfect competition and perfect markets, as well as 'full communism', are... inherently unrealistic" (1978: 237). Yet this does not mean that solution is to be "in the middle", between pure capitalism and pure statism. Such an intermediate alternative is obvious - actually contemporary capitalist social formations can be labeled "bureaucratic capitalism", to stress the important role the bureaucratic class plays in it not only at state level but also within the big corporations and the public institutions - but it does not give any real indication of the ideal level of state intervention. In another text Nove underlines:

It would be nice to imagine the waste inherent in a competitive market and the waste caused by centralized 'Stalinist' planning could both be eliminated. No one has yet found such optimum (1977: 157).

According to the cyclical approach to state intervention here proposed, there is no such thing as an intermediary optimum between market and state control of the economy. In every stage of the growth of a country, and at every moment of the cyclical development of the state, there is a spectrum of efficient combinations of market and state coordination of the economy. Yet, there is a persistent tendency for the excessive growth of the state. Soviet Union and Eastern Europe are the limit examples of this trend. But we know that these countries experienced high rates of economic development in their first stage of industrialization, a state which, in the case of the Soviet Union, lasted for a long time.

On the other hand, it is important not to confuse the statist social formations with contemporary capitalism where the welfare state was established, generally, but not necessarily, under the sponsorship of social-democratic governments. State intervention in the welfare state has been mostly successful because moderate. According to research conducted with extreme methodological rigour by Kurt Rothschild (1986), between 1960 and 1984 the rate of economic growth in the advanced European economies tended to be higher and the rate of unemployment lower in the periods that the countries were governed by left-wing (social-democratic) parties or coalitions of parties that favoured a higher degree of state intervention. Although statistically demonstrated, this superiority has not been stable over time: in some periods it was clear, in others not so clear. Actually, although reasoning or historical experience support a middle-of-the-road strategy, they cannot tell us "how much" state intervention should be used.

economy, or, contradictorily, political economics. See, for instance, Alt and Chrystal (1983), a mix of survey and textbook on the subject.

6 - Note that not all conservatives are for laissez-faire even in theory. Many "old" conservatives, following Edmund Burke, favour state intervention to preserve tradition and family. In practice, they will support state intervention wherever it promotes accumulation and stabilizes the economy.

7 - I wrote extensively on the subject in the 1970s. See particularly Bresser-Pereira (1981).

The Growth of the State

Although an historical tendency toward increasing state intervention can be traced this tendency is limited and not linear. The tendency was implicit in Marx and explicitly developed by Adolph Wagner (1893), according to whom, as per capita income increases nations will spend a larger part of their national product through government. Wagner presented several reasons for that increase (see Wildavsky, 1985): the growing complexity of legal relationships introduced by the increased specialization and division of labour, an increase in social friction due to an increasing density of urban areas, insufficiency of private savings for investments requiring large sums of capital, increasing demand (income-elasticity in excess of one) for investments in the production of certain goods whose benefits can not be strictly appropriated to the private investor ('public goods' in modern terminology), and the need to regulate private monopolies.

Marxist economists explain state growth as a counter-tendency to the law of the falling rate of profit. The state nationalizes the low profit industries in order to assure a satisfactory average rate of profit for the private sector. Keynesians emphasize the need for state regulation to complement the market's regulating function and the insufficiency of demand problem. Social democrats underline the welfare, income-distributing function of the state.

Conservative public choice theory explains the growth of the state in terms of the demands of special interest groups. Mueller and Murrell underlined that the assumption behind Wagner's law is that the income elasticity of the demand for public goods exceeds the income elasticity of its demand for private goods. This leads to state growth because "the formation of bargains between parties and interest groups lead to an increase in government size" (1985: 31). Mueller (1987) enumerates five basic explanations for state growth: the demand of public goods, distribution of income, inducement of interest groups, interests of the state bureaucracy, and fiscal illusion about the true size of the state.

All these reasons or explanations seem compelling. The statistical evidence supporting Wagner's thesis is overwhelming. Borchering, for instance, found that in the United States government expenditures (federal, state and local) increased from 7.7 to 21.4 per cent of GNP from 1902 to 1933, decreased to 20.4 per cent of GNP up to 1940; and then increased steadily, reaching 35 per cent of GNP in 1978 (1985: 361). In Germany, total public expenditure as a proportion of GDP increased steadily from 15.7 to 42.5 per cent of GDP from 1913 to 1969 (see Mandel, 1972: 488). In the OECD countries, general government expenditures as a percentage of GDP increased from 26.3 per cent (unweighted average) in 1960 to 47.0 percent in 1982 (Saunders and Klan, 1985).

But neither the theoretical arguments nor the empirical evidence can be taken as definitive. Wagner wrote his work in Germany at the end of last century, in a moment in which the state had assumed a decisive role in promoting the German late industrialization. After its industrial take off, however, German state intervention followed a pattern similar to other late comers in the process of industrialization: it diminished in the productive and financial areas while increasing in the regulatory and welfare realm.

An Historical View

This cyclical pattern of expansion and contraction of state intervention may be seen in a historical perspective. In each cycle new modes of state intervention are introduced. The state expands and contracts, but in doing so it also continuously changes the forms of its intervention.

From a broad historical perspective, taking Britain, France and United States (the first industrial countries) as references, in the first stage of capitalism - the mercantilist period - the state intervened to support the process of primitive accumulation. The strategy was successful, but the distortions provoked by excessive regulations and by the royal monopolies eventually became dominant and gave rise, in a first moment, to the criticism of the classical economists and, in a second, during and after the Industrial Revolution, to a sharp reduction in state intervention. Competitive capitalism reigned during the nineteenth century, but around 1870 the growth of the big corporations and of the big unions were the signs that a new phase - that of monopoly capitalism, where state intervention was again required - would soon start. For several decades the capitalist system, which is essentially based on the market, resisted to state intervention, but since the beginning of the twentieth century state intervention began to increase again.

Yet, it was only after the great depression of the thirties and the revolutionary criticism of Keynes to neoclassical liberalism that a more clear-cut and deliberate process of state intervention evolved. This was the great moment of the welfare state and of Keynesian macroeconomics. It was also the great moment of

development economics and indicative economic planning in the developing countries. The prosperity of the 1950s and 1960s, a true Golden Age of economic performance, to use the expression coined by Glyn, Hughes, Lipietz and Singh (1988), was accompanied by increasing state intervention - and also by mounting social demands from the workers. In Europe, transfer payments and households subsidies rose from around 8 per cent of GDP in 1955-57 to around 16 per cent by mid the 1970s (Glyn et al., 1988: 23).

Since the 1970s, however, the world economy faced a new long term slow-down. This crisis was defined by the generalized fall-off of growth rates and by stagflation. Its main cause, however, was no longer insufficient aggregate demand, as in the 1930s, but rather the crisis of the state. After so many years of expansion, financed not only by taxes and profits of the state owned enterprises but also by an increased public debt, the threat of a fiscal crisis was now a reality. The state had turned big, but also weak. The collapse of the Keynesian consensus and the rise of neoliberal - monetarist, rational expectation, public choice - theories were the outcome. There was no other alternative but to reform the state. Privatization, trade liberalization and de-regulation - i.e., market-oriented reforms - became imperative. State intervention halted and began slowly to reverse. In the 1930s, when the price mechanism and orthodox economic policies proved ineffective to avoid the depression, the left felt victorious and the right, defeated. Now the reverse was taking place: the right believes itself to be victorious and the left, defeated. But in fact, market-oriented reforms, pointing to the reduction of the state apparatus, were just a manifestation of the cyclical character of state intervention. Moreover, it soon became manifest that the new cyclical contraction of the state was much less accentuated than the previous explanation.⁸

Economic Long Cycles and Political Cycles

This cyclical process of expansion and contraction of the state can probably be viewed in another dimension, using the long Kondratieff cycles or the long-waves approach.⁹ The hypothesis is that in the expansion phases of the long cycles, state intervention would increase, while in the contraction ones, it would be reduced. This was precisely what happened in the last long cycle: from 1940/45 to 1970, state intervention increased, and since then - or, rather, with a delay of around a decade - it has slowly been being reduced.

Starting with this hypothesis, clearly supported by evidence from the present long wave, one can search for further confirmation in the previous long cycle. If the same pattern was observed, state intervention should have increased between approximately 1895 and 1920, and then decreased or relatively decelerated until 1940. Wallis' data on the percentage of non-military expenditure in GNP in the United States show that, with a certain lag, this was precisely what happened.¹⁰ This percentage increased steadily up to 1932, then declined up to 1943 and finally resumed growth up to 1968, the last year examined. In France, the correlation between the Kondratieff cycles and public expenditures is again quite clear, but the same lag cannot be found. According to data of Delorme and André (1983: 723), the percentage of total state expenditures in the GDP increased from the beginning of the century until 1922 then declined until 1934, increased sharply up to 1969; and the next year begins a moderate decline up to 1974, the last year examined.

When Gordon (1978) examined the Kondratieff cycles he identified them with "stages of accumulation", that would be characterized by

8 - In Britain, where the process of de-regulation and denationalization received full support from the conservative government of Margaret Thatcher, the reduction of state intervention was eventually much smaller than initially intended.

9 - The evidence in favour of the Kondratieff cycles is very strong. The recent literature on the subject is extensive. See Ernest Mandel (1980), Frisch and Gahlen, eds. (1984), Tibor Vasko, ed. (1985), Di Matteo, Goodwin and Vercelli, eds. (1986), Solomos Solomou (1987), A. Kleinknecht (1987), Joshua Goldstein (1988), David Gordon (1989). I examined the subject in *Lucro, Acumulação e Crise* (1986: ch.12).

10 - Joseph J. Wallis' data are based on the survey undertaken by the U.S. Department of Commerce, *Historical Statistics on Government Finance and Employment* (Washington, D.C., 1969).

"a full set of integrated institutions... necessary for individual capitalist accumulation to continue.... The institutional integrity of a stage of accumulation will begin to dissolve after a period of prosperity" (1978: 27-28).

If we accept that among these institutions the dominating one is the state, it is not difficult to establish the relation between the long cycles and changes in the pattern and intensity of state intervention.

Hirschman's Political Cycle

Thus, the hypothesized existence of cycles of state intervention may be directly related to the long cycles analysis. Another relation that can be made it to the political and historical and political cycles proposed respectively by Albert Hirschman and by the two Schlesingers, Senior and Junior.

Hirschman, in an extraordinary book, *Shifting Involvements* (1982), proposes that societies oscillate "between periods of intense preoccupation with public issues and of almost total concentration on individual improvement and private welfare goals" (1982: 3). He defines public action as the action in the public interest, striving for public happiness. In the past this was the only legitimate type of behaviour. The alternative to public action was the withdrawal for purposes of reflection, was the *vita contemplativa*. With capitalism and liberalism pursuing the private interest became also legitimate, giving rise to generation cycles of preoccupation with the public and the private.

Cyclical theories are supposed to have an endogenous mechanism for the cycle. In the case of state intervention, the endogenous mechanism is accumulation of distortions deriving from state intervention and from market regulation. In Hirschman's political cycle, the endogenous mechanism is disappointment, frustration. After a period of pursuing the private interest, of increasing individual consumption people will become disappointed and look for the public interest. But, after some time of intense participation in public affairs, disappointment will also eventually manifest. Given this fact, Hirschman says that it is a mistake to think in terms of fixed goals. "Men think they want one thing, and then, upon getting it, find out to their dismay that they don't want it nearly as much as they thought" (1982: 21). Specifically, Hirschman criticizes Mancur Olson's neoliberal critique of collective action (1965). Collective action is only unlikely when individuals are disappointed with public action. History proved endlessly that collective action may be very strong in some occasions. Curiously this was particularly true in the 1960s, when Olson first presented his theory. After the disappointment faced by the generation of the 1960s, the shift to private action in the 1970s and 1980s could be predicted in terms of a cyclical theory, never in terms of Olson's absolute an a-historical hypothesis about the impossibility of collective action.

Arthur Schlesinger, Jr., following the tradition of his father, that developed a cyclical analysis of American history according to a conservatism *versus* liberalism approach¹¹, and adopting Hirschman's theory, proposes that the political cycles are defined by a "continuing shift in national involvement between public purpose and private interest" (1986: 27). He observes that "it is the generational experience that serves as the mainspring of the political cycle... each new generation, when it attains power, tends to repudiate the work of the generation it has displaced" (1986: 29-30). On the other hand, he does not see correlation between the political cycle and the business cycle: the depression of the 1930s ushered the New Deal; in contrast, the Progressive Era, 1901-1919, began in a time of general prosperity. It can be added that the recent conservative wave began with the economic crisis of the 1970s; it will probably end in the early 1990s.

The cycles of state intervention discussed here involve some linking of Kondratieff's long economic waves and Hirschman's political cycles. Cycles of state intervention are both an economic and a political phenomenon. They share characteristics of both types of cycles. The changes in emphasis from market coordination to state coordination and vice-versa are means to confront an economic crisis. If failures of market coordination underlie the crisis, increased state intervention is necessary; if the economic crisis may be related to excess state intervention, reduction of the state apparatus will be unavoidable. On the other hand, the political cycle may also be related to the dynamics of the economic crisis. If the economic downturn is tied to the failures of the market, a progressive political phase may prevail, as was the New Deal. In contrast, if the crisis may be attributed to excess or distorted state intervention, a conservative criticism and a conservative wave may occur, as it has been the case in the last 20 years. We should,

11 - See Arthur Schlesinger, Sr. (1949).

however, resist suggestions of any mechanical relationship between economic crisis and the political cycle. The collective disappointment stressed by Hirschman may have strictly political origins, such as, for instance, the excesses of authoritarian rule or the disorder of revolutions.

The Logic of the Cycle

The reason why state intervention shows a cyclical pattern is more or less obvious once the idea is established. The market is clearly unable to guarantee capitalist accumulation by itself, nor does it possess an endogenous mechanism to promote a socially acceptable distribution of income. Given these two facts, state intervention is necessary for both accumulation and distribution. As a matter of fact, the coordination of a capitalist system is the outcome of two mechanisms, not one: the market and the state. State intervention will always take place, in spite of the permanent criticism from the right (and also from the left).

State intervention will increase in intensity during the expansion phase of the cycle. Starting from a low level of state intervention and from a high level of market coordination of economic activity, state intervention will try to correct the distortions caused by the market. In the initial stage of the cycle regulatory policies will be successful in coordinating the economy, correcting market failures. Usually they will (a) stimulate national production through an increase of state expenditures and modernization of given industries through several types of subsidies and tax exemptions; (b) distribute income through taxation and welfare expenditures; (c) limit abuses through many forms of regulation. On the other hand, the state will make direct investments by creating state-owned enterprises, particularly if the country is in the initial stage of industrialization.

After the initial successes, however, which may persist for several years - state intervention will begin to give rise to distortions. The growth of state expenditures, resulting from increasing pressure from businessmen, consumers and bureaucrats, will tend to cause serious fiscal imbalances. As excess regulation implies higher costs, it will increasingly pose obstacles to the international competitiveness of the business enterprises. Criticism of these distortions will mount as the rate of inflation increases or as balance-of-payment problems arise. State-owned enterprises, which in the initial phase had a major role in promoting forced savings and executing strategic investments, will tend to show increasingly inefficient management and poor economic results. The state, which initiated the cycle as a strong agent and which seemed to become stronger and stronger, actually weakened, harmed by fiscal problems and by inefficient forms of intervention. If state reforms are not promptly undertaken, fiscal problems will change into a fiscal crisis, and distortions in state intervention may eventually lead to the effective paralysis of the state. It becomes any longer possible to postpone fiscal adjustment, deregulation and privatization.

The logic behind the cycles of state intervention is quite simple. It is similar to the logic of all cyclical processes. The expansion phase may be considered as a sound growth process, and also as in tumescence or inflammatory process. Everything increases - investments, profits, wages, consumption, state expenditures, regulations - but this growth is not necessarily balanced. If it were, if growth followed always the equilibrium path, we would not have cycles; just a golden path of growth. As a rule growth is an unbalanced process. The successful experiences of the expansion phase tend to be overdone. If the increase of state expenditures and of state regulation are successful, economic agents do not know when to stop. They will increase state intervention until it becomes dysfunctional, with the negative consequences of intervention outweighing the positive ones. This lack of functionality of state intervention will become particularly obvious if the increase of state expenditures ends in a fiscal crisis. After a period of continuous failures under increasing criticism, it will be time to reduce state intervention, opening space for more market coordination of the economy.

However this is not the end of the story. After a while, the process of de-regulation and privatization will come to an end and a new process of state intervention will begin. It will be different from the previous expansion, as the state will assume new roles demanded by capitalists and, increasingly, by the technobureaucratic salaried middle class and by the workers. As Rangel, whose dialectical vision of the intervention process is quite clear, says:

At a given moment in the cycle the debate between privatists and statistes, that never ceases completely, tends to assume acute forms, preparing a new distribution of the activities that form the economic system... Always, after the battle, the privatists seem to be the winners because the state had

to renounce to certain activities. However, in a second moment - more a question of concept than of chronology - the social and economic system will force the state to assume new responsibilities. (1984: 153-154)

The new wave of state intervention will respond to the instabilities inherent to the market system together with the increasing demands of society for better standards of living, for more security and predictability, for continuous technological development, for an enhanced protection of the environment. This new intervention will be different from the previous one because some of the problems that had to be faced in the previous expansion of state intervention have now been solved, because new problems or new challenges have emerged, and because of old mistakes should not be repeated.

Intervention as an Industrialization Strategy

The cyclical character of state intervention can also be viewed from the standpoint of the process of economic development. State intervention will vary historically according to the stage of economic growth, but not linearly as Rostow (1960) believed. After the classical contribution of Gerschenkron (1962), it became established that the later the industrialization takes place in relation to the first industrial countries, the larger the tendency for the state to initially play a major economic role. Taking this theory to its limit, the Soviet Union may be considered not as an unsuccessful socialist experience, but rather as a case of successful (in the first phase) statist industrialization strategy (see Bahro, 1978). Germany and Japan, at the end of last century, and Brazil and Korea, this century, would be intermediate situations where an alliance between the bourgeoisie and the state technobureaucracy backed the initial industrialization process.

Direct state investment during the first phase of late industrialization is necessary because only the state has the ability to extract the required forced savings from society. However, once this phase of primitive accumulation is over, forced savings cease to be the essential element of the growth strategy. The classical problem of an efficient allocation of resources becomes fully relevant, because economic development can no longer be based on a continuous increase in the rate of capital accumulation, or on the protection of the internal market from foreign competition. Growth now depends on the efficient allocation of resources, on the productivity of labour and capital. International competitiveness cannot anymore be eluded or avoided. Capital accumulation remains essential to growth, but now it depends on innovation, on the permanent introduction of technical progress, on the efficient allocation of resources, rather than on forced savings and protection.

At this point, the limitations of economic planning or state intervention as compared to market coordination become evident. Business enterprises coordinated by the market and moderately regulated by the state tend to and must be more flexible, more creative and more efficient. In contrast, state-owned enterprises not only do not have as much incentive to innovate, but they are also often the victims of contradictory political demands. As a result, the process of state intervention will tend to be reduced after the initial phase of late industrialization. This was exactly what happened at the beginning of this century in Germany and Japan, and is presently taking place in countries like Argentina, Brazil, Korea and Mexico. In ex-Soviet Union and in Eastern Europe, where the statist mode of state intervention was taken to the limit, the state just collapsed. In China, however, this still did not happen. At least for the moment reform is being successful. The economic system remains dominantly statist, but it is firmly changing to mixed or bureaucratic capitalism.

Economic Reforms in a Strong State

Now it must be clear that the cyclical pattern of state intervention - the succession of expansion and reduction, of strength and crisis of the state - is a consequence of a basic need. The state in contemporary bureaucratic capitalism is supposed to be strong. It must be politically and financially strong, with legitimacy to impose and collect taxes that assure the realization of public savings and enable a reasonable degree of freedom in deciding on public expenditures; it must have credit and be able to guarantee the national currency. This strong state is supposed to perform a strategic role, together with the market, in the coordination of the economy.

To be and remain strong, however, it must be continuously reformed. Yet, it is very difficult to reform as a routine. All cyclical processes derive from the fact that in the expansion phase, when everything seems to work well, it is very difficult to avoid excesses and distortions.

As the state grows it appears to become stronger, but actually it tends to become weaker, more distorted, and eventually it falls victim to a fiscal crisis. At this moment, it will come under attack from all sides. In order to curb the state apparatus and to restore the solvency of the state, civil society has no other alternative than to attack and criticize the state - or the bureaucrats and clients that profit from it. This attack, however, must be constructive. It should not aim at the destruction of the state, but at its recovery. Because it must be clear that, if the economic crisis that comes with the crisis of the state is the outcome of the fact that the state is not properly performing its economic tasks, the real challenge is how to reform the state in order to enable it to effectively perform its role.

The question, then, is how is it possible to reform the state within an ideological context where market-oriented reforms are identified with the withdrawal of the state from any economic role, where economic liberalization is assumed to aim at a minimum state, and within a practical context where privatizations are frequently so wild, stabilizations so costly and reforms so inefficient. Since privatization has been wild in Argentina, the social cost of adjustment very high in Venezuela and Chile, and stabilization very incompetent in Brazil, and since reforms often proved inefficient and destructive of the existing productive system in Eastern Europe, one can ask: can these attempts at reform reconcile the requirements of effective implementation with those of the consolidation of democracy?

This was a basic question under review at the Forlí Conference which provides the basis for this collection of papers.¹² The consensual and general answer to it was that liberalization of the economy and the consolidation of democracy are only possible where the state and the civil society are strong. The strength of the state depends on its legitimacy, on the government representativeness within the state, and on the support that both the state and the government derive from civil society. The strength of civil society depends on the existence of a well-structured market system and on the balance of powers and the cohesiveness of the multiple groups and associations forming it. A weak state, financially bankrupted and politically deprived of support from civil society, as it is common both in Latin America and Eastern Europe, is unable to create or regulate markets and is ill-suited to guarantee market-oriented reforms, just as much as a weak civil society is inconsistent with representative democracy.

Thus, after excessive and distorted growth the state needs to be reformed. Economic reforms are essentially reforms of the state. For many years, economists have debated how to stabilize, how to achieve fiscal discipline and the solvency of the state, and how to promote market-oriented reforms and social reforms that spur economic growth and push income distribution. In Washington, something like a consensus was achieved in late 1980s - the "Washington consensus". It corresponds to a conservative, neo-liberal paradigm. Although it was John Williamson who coined this expression, the actual neo-liberal consensus should be distinguished from Williamson's (1992) own careful definition of the consensus he is identified with (he adopts a neo-classical rather than a neo-liberal approach).

Besides, it is clear that this "consensus" is far from being consensual in Washington or anywhere. In the Forlí Conference it surely was not. Today it is generally agreed that the state has grown too much, that fiscal discipline, trade liberalization and privatization are necessary. But the consensus ends here. Paul Streeten, in his paper, showed that "for the proper work of markets, strong and in many cases expanded, state intervention (of the right kind, in the right areas) is necessary. Is it possible to favour a strong state with a limited agenda" (1992: 1). Williamson underlined the need of deideologizing the role of the state in modern economies. He properly observed:

"the fundamental political divide (on economic issues) is not between capitalism and socialism, or between free markets and state intervention, but between those concerned to promote an equitable income distribution ('the left') and those concerned to defend established privileges ('the right')"

12 - The Forlí Conference "Economic Liberalization and Democratic Consolidation" was sponsored by the Social Sciences Research Council, the European Centre for the Study of Democratization, the Inter-American Dialogue and the University of Bologna-Forlí, Forlí, April 2-4, 1992. I presented to this conference a previous version of this paper, and later I decided to explicitly complement it with some of the ideas that were then discussed.

(1992: 5).

In the industrialized countries the cycle of the state took a milder form. It was defined by a general slow-down of the world economy, whose inner cause was the fiscal crisis of the state. The immediate response to the fiscal crisis was fiscal adjustment. As a consequence, the crisis - except in the U.S. and in Italy - was overcome or circumvented. The growth rates declined to half of what they were during the post-war 25 years but remained positive. Latin American and the Eastern European countries did not follow such a benign path. For about 10 years after the collapse of the Bretton Woods system they were able to postpone adjustment, supported by abundant foreign finance. The result was an enormous foreign debt, a much worse fiscal crisis, and the entrenchment of inflation, (which accelerated into near hyperinflation in several cases) creating an urgent need for deep market-oriented reforms.

Yet, if the inner nature of the crisis is the same - the crisis of the state - and if the experience of the industrialized countries is to be taken into account, - rather than to adopt the neoliberal rhetoric it is necessary to underline that in the developed countries the state was not destroyed or weakened, but reformed and strengthened. Thus, the same should be done in Latin America and Eastern Europe. In East and South-East Asia the crisis itself was avoided because the state remained strong whereas the economy turned highly competitive, market-oriented.

There are strange contradictions in the neo-liberal views prevailing in Washington. For instance, they propose to fight high, inertial inflation in gradual and orthodox terms, using just conventional fiscal and monetary policy, and to privatize and liberalize abruptly, according to the "big-bang" strategy. Such course makes very little sense. The inverse - to frontally attack high inflation while imposing fiscal discipline, and to privatize and liberalize gradually while the market institutions are created by civil society and regulated by the state - is a more sensible alternative. Macroeconomic problems, such as stabilization and balance-of-payments adjustment, are to be dealt with in a different manner from microeconomic ones, as privatization and the efficient allocation of resources through trade liberalization. The state and the market are strengthened when fiscal discipline and price stabilization are rapidly achieved. There is no reason to delay stabilization. Yet, they are weakened when wild privatization and shock liberalization are attempted in a context where market institutions are poorly defined or non-existent.

International competitiveness and the elimination of protectionism is an essentially desirable reform and must be firmly secured, but trade liberalization should not be so radical and abrupt as to mean the destruction of local industry. Neither should it be implemented if the local exchange rate is overvalued, given an immoderate flow of international resources. This danger, which seemed remote in the 1980s is now present. While in the developed countries the interest rate is now very low, in the highly indebted countries, including Mexico, interest rates remain high, demonstrating that the debt crisis is still present. These high interest rates are perversely attracting international capitals and transmitting misleading signals of prosperity. Today hot money finance in the developing countries has many similarities to junk bond finance in the developed nations.

There is an implicit assumption in the neo-liberal consensus that the only alternative to it is populism and/or nationalism. The suggestion here, however, is that there is a more pragmatic or social-democratic alternative, one that has similar immediate objectives - the solvency of the state and the introduction of market-oriented reforms - but that preserves the role of the state, asserts its social and economic roles, and underlies its function as a principle of legality and sovereignty. The critique of the neoliberal approach and the draft of this alternative was the central concern of Bresser, Maravall and Przeworski (1992) on economic reforms in new democracies (1992). In the Forlì Conference the same theme was the object of privileged reflection and conceptualization: democratization and liberalization are precarious in the context of a weak state and a weaker civil society.

The Politics of Reforms

A second divide separates those who believe that authoritarian rule is necessary to promote economic reforms in the developing countries and those that believe that democracy is perfectly consistent with the reform of the state and the market. Gourevitch (1992) defined four possible theories relating markets and democracy: (a) markets require democracy; (b) markets require authoritarianism; (c) democracy requires markets; (d) democracy requires centralized planning and public ownership. Yet, even if the last theory is

discarded for obvious lack of support in reality, the consistence of the other theories with the recent experience of nations is also far from obvious.

The historical phase in which the creation of markets and the consolidation of capitalism required an authoritarian state is over for most countries in the world. This was the phase of primitive accumulation, when the basic stock of capital of a nation was formed, when saving roughly increased from 5 to 15% of GDP. In the history of capitalism this was the mercantilist phase, that in most of Europe took place in the eighteenth century, and in Latin America and Asia, a century later. The recent experiences of bureaucratic statism in Eastern Europe and bureaucratic-authoritarian developmentalism in Latin America represented an artificial lengthening of the process of primitive capital accumulation, a strategy to boost heavy industrialization that only for a limited time was able to successfully promote economic development. It was a strategy that postponed the downturn of the economic cycle and of the cycle of state intervention, but, as trade-off, caused a much worse crisis in the 1980s. In these regions, primitive accumulation was already completed, the levels of savings and investment, although reduced by the economic crisis, are high enough to demonstrate that there already exists a reasonable stock of capital. If the times of primitive accumulation are over, the same is also true in relation to the corresponding authoritarian rule.

Yet, democracy is not consolidated. In addition, it may be endangered by poorly designed economic reforms. For instance, how consistent with democracy is the "big bang" approach being urged upon and used in Eastern Europe? Moreover, as reforms according to the "big bang" approach cancel the state's economic coordinating role where there is no market to replace it, is it realistic to suppose that markets will be spontaneously created and the democracy consolidated, while the state is destroyed rather than reformed?

These questions suggest an answer. It is not enough that the state be reformed and reduced after it grew too much. It is necessary that it be efficiently reformed. The political scientists who, in the last years, concentrated their interest in stabilization programs and economic reforms, initially assumed that the economists knew how to design them. Thus, they did not take into account that economic reforms could be costly, inefficient and even ineffective. This can be so for many reasons: because reformers tend to be ideological, because they usually ignore the specificities existing in Latin America or in Eastern Europe; and because, armed with their text-book formulas, they are not equipped to cope with the abnormal times, the deep crisis of the state, that these countries are undergoing.

Economists, policy-makers, businessmen and political scientists in the First World are convinced that the only reason why stabilization programs and market-oriented economic reforms do not work is political. Populist politicians, radical union leaders, corporatist bureaucrats and shortsighted or covetous business owners in developing countries would impede the success of reforms. In believing so they ignore that after World War II those countries experienced high rates of growth counting on the same human assets; that in developed countries politicians, workers, middle class bureaucrats and business owners may have a stronger sense of citizenship or a more solid political culture but are not essentially different; that in Latin America the original cause of the present 12-year-old crisis was not populism but the unconsidered developmentalism of the military regimes that Washington authorities supported politically and that First World banks financed.

This view that blames politics for all evils is now changing among political scientists as they see that many reforms with strong initial political support failed. Moreover, they perceive this approach to be very dangerous to the consolidation of democracy, even though it obviously has some foundation. If the resistance of politicians is what blocks reforms, the "logical" solution is to close Congress and restore authoritarian regimes, as Fujimori, an elected president now turned dictator, has just done in Peru. On the other hand, if it is acknowledged that although there is political resistance, but there are also poorly designed economic reforms, it would be wise to give equal weight to both of the corrective tasks, that of surmounting political obstacles, but also that of defining efficient reforms that stabilize and permit the resumption of growth at acceptable or justifiable costs.

Populism has reemerged in Latin America, and nationalism is resurging in Eastern Europe, as a direct consequence of the democratization process. Since the economic crisis has not been resolved, but deepened, the first democratic governments after the transition experienced increasing erosion of support. Meanwhile, the debt crisis, transformed into a fiscal crisis as the foreign debt was transferred to the state, was not satisfactorily managed. The burden of fiscal adjustment fell almost exclusively on the debtor countries. Some countries, such as Mexico, were able to impose the sacrifices on their people while competently stabilizing the economy and introducing reforms. Others such as Chile, less competently

stabilized (the costs were extremely high), but were effective in the design and implementation of structural reforms. Most countries initially failed to stabilize and reform. As the crisis deepened, hyperinflation loomed. This was particularly the case of Bolivia, Peru, Argentina and Brazil in Latin America - countries whose experience Kaufman and Haggard (1992) analyse. Some years after the democratic transition, when new presidents are elected in the middle of severe hyperinflation, they adopt shock market-oriented reforms, liberalizing their economies - sometimes wildly.

Kaufman and Haggard ask how is it that democratic governments could launch such comprehensive and orthodox program?. International pressures (the Washington consensus) may be a cause, but the real reason for these liberal shocks - a reason that contrasts, with the gradualist character of reforms in Chile and Mexico -, is the depth of the state crisis. When the finances of the state have collapsed, when it is immobilized by economic chaos, when "de facto privatization" is the radical and disorderly reduction of the fiscal capacity of the state rather than the result of a rational policy (as it happened in Peru)¹³, when "the state is dying" (as declared Bolivia's president Paz Estensoro in 1985), when the net costs of adjustment are smaller than muddling-through the crisis,¹⁴ when the economy is on the verge of, or has already fallen into, economic chaos, then there is no alternative for a new government but to adopt radical - and often irrational - liberalizing steps. The word "steps" applies here, rather than "reforms", because at this moment the state is unable to define and implement reform. The maximum it can do is to withdraw, to let the market to do its work. Market failures may be big, but in this emergence state failures are worse.

Yet, the exercise of extensive executive powers in the midst of economic crisis can have a longer term explanation. With this in mind, O'Donnell (1992) develops the concept of "delegative democracy" he has been formulating in the last two years (1991). He reminds us that representative democracy is based on a strong state, that should not be equated with the bureaucratic apparatus: "the state is also (besides a bureaucratic apparatus), and no less primarily, that aspect of social relations that establishes a certain order". It is "the effect of a legality". In representative democracy "the equality guaranteed to all members of the nation in terms of citizenship is crucial not only to the exercise of the political rights entailed by the workings of political democracy", but also the "effectiveness of the individual and associational guarantees", i.e., to the existence of a strong civil society. O'Donnell adds:

"One of the contemporary tragedies is that, in most newly democratized countries, privatizations and other forms of democratization are undertaking jointly - and unnecessarily - with a sharp weakening of the state. Nothing illustrates better the dominance of neo-conservative ideas than the almost indiscriminate evilness presently attributed to the state. The carriers of these ideas, in interplay with a deep socio-economic crisis, are not only reducing the size of the state: they are destroying the state" (1992: 6).

Laurence Whitehead contrasts the belief existing in consolidated democracies that both representative governments and price stability are ends-in-themselves, to Latin American general view that "will attach a higher priority to the reduction of gross inequalities or the breaking of supposed 'bottle-necks' to development, than to absolute price stability or the more polished refinements of 'formal' democracy" (1992: 19). And he adds: "both democratic consolidation and economic liberalization rest on a common foundation: the manufacture of stabilizing expectations. Fiscal crisis may abruptly lower expectations, and thus create a moment of opportunity for this to be done" (1992: 25). In fact, expectations are much lower today in Latin America and Eastern Europe. This is certainly helping the introduction of economic reforms, but if they are not economically efficient, politically realistic, and do not have expressly in mind to preserve rather than to destroy the state, these two regions are headed for many economic and political troubles.

13 - Richard Webb, in the "Prologue" to Sachs and Paredes' book on Peru writes: "The most striking result of Peru's fifteen-year economic crisis has been de facto privatization. The public sector has undergone massive compression. The state is withering away, and surprisingly the process has been independent of any political program... The shrinking preceded conservatism... The state is shrinking despite the politicians, the bureaucrats, and the broad preferences of the Peruvian polity." (1992: 1)

14 - For the concept of net transitional costs, see Bresser-Pereira (1992). Net transitional costs are transitional costs, the costs of adjusting and reforming, less the costs of muddling through the crisis. As the crisis deepens, net transitional costs tend to lower

There is no doubt that stabilization and market-oriented reforms are a priority in Latin America as well as in Eastern Europe. The question, however, is whether these objectives are to be achieved in inefficient, unnecessarily expensive ways: destroying, rather than strengthening, the state; fragmenting rather than assuring cohesiveness to civil society; excluding from the agenda the resumption of growth; and leaving free monopolistic "market" forces which only increase economic inequalities. As Whitehead warns, the possible positive effect of lowered expectations "will fade over time unless the resulting patterns of economic and political behaviour can be underpinned and reinforced by a new framework of more effective and credible liberal institutions" (1992: 25).

As Hawthorn stressed

"there may, as Constant suggested, be an affinity between free commerce and a representative democracy. But as Hume and Smith had insisted, remembering Hobbes, this can only be realized if there is a sovereign authority to guarantee secure and civil liberty... Indeed, Zaire, India and Venezuela show how liberalization can actually undermine the preconditions for democratization that liberal theory suggests as its natural corollary. The demand now is that economies open themselves to investment from outside, and that they retain control over their currencies and their non-economic policies only in so far as both are compatible with the free flow of money and goods. It is, in effect, the demand that governments surrender their economic sovereignty" (1992: 38-39).

He concludes, based on the quoted authors and on the American Federalists, that nothing can be achieved without a strong state, a sovereign state.

Conclusion

If this is so, if a strong a sovereign state is essential to the consolidation of democracy and the resumption of growth, the neo-liberal economic reforms may eventually be harmful both to market-oriented reforms and democracy, if they don't take into consideration the cyclical character of state intervention, if they don't understand that the present crisis of the state is a cyclical phenomenon, if they ignore that their objective is to reduce the state in order to strength it, not to make it weaker.

Democracy is not consolidated in Latin America and Eastern Europe, as Fujimori's coup in Peru dramatically confirmed in May 1992. Liberalization will help the consolidation of democracy only if it is not achieved by further destroying the state instead of reforming it. In Latin America and particularly in Eastern Europe the state grew clearly above the level it should. Thus, for some time the tendency will be to reduce state intervention. Yet, the experience of late industrialization in Germany and Japan show that there was a new wave of state intervention when these countries reached levels of economic growth comparable to those of the more developed countries. In this second cycle of state expansion, however, the emphasis was no longer concentrated on investment on state-owned enterprises, but in building up the welfare state and in regulating the markets.

The old patterns of state intervention have faced a crisis since the 1970s. This crisis, still in progress, will first mean a reduction of the economic role of the state, but will most likely make the state ready for a new historical phase of expansion. Given the ever-changing character of state intervention, in this new phase intervention will necessarily take on new forms, responding to new or newly-defined needs of society. In this phase, the emphasis of state intervention will most likely be the promotion of technological development and the protection of the environment. The first strategy was adopted in Japan some time ago. The European Economic Community is clearly working in this direction, and the United States will have no alternative but to follow its competitors. The state is now operating on the frontier of the national states, as a weapon to assure their international competitiveness. The protection of the environment, which in the 1970s was as banner of the green movement, has in the last 10 years become a dominant concern all over the world. State regulation is already playing a major role in this realm, and it will be more accentuated in the future.

In very broad terms, it can be said that, the first stage of state intervention was oriented towards primitive accumulation, towards forced savings that made industrialization possible; the second, towards building the welfare state: the third will probably support scientific development, technological progress and environmental protection.

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