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The Latin American State

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The role of the state in Latin American economic development is undergoing fundamental reconsideration. Even while political scientists have been bringing the state back in, economists have been busy trying to take it out (Evans, Rueschmeyer and Skocpol, 1985). Reduced government intervention has seemingly been the winning side. Earlier presumptions about the clear benefits of public guidance no longer orient development strategy in most countries in the region. Instead, there is new vitality to the claims for the advantages of market liberalization and privatization of state enterprise. An apparent new consensus regarding a diminished role for the state in Latin America has emerged, reinforced by the rising liberal tendencies in industrialized countries and the precipitate rejection of central planning in the socialist bloc.

Causas de porqué América Latina es una región dónde el rol del Estado estaba cuestionado en los 90

This debate is central to development economics as a field, so much so that Deepak Lal (1985, p. 53) identifies its demise with this new recognition of the importance of "policy induced, and thus far from inevitable, distortions created by irrational dirigisme." But this reconsideration takes on a special significance in Latin America for two reasons. First, the model of state-led industrialization through import substitution is identified with the region. Raul Prebisch and the Economic Commission for Latin America (1950) were the most prominent advocates of this new, post-World War II development strategy, and it still is esteemed by many Latin Americans. Second, countries of the region have experienced a sharp break with past growth trends in the 1980s, experiencing a cumulative average decline in per capita income of some 10 percent during the decade. There is strong impetus for a new approach.

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Qué está detrás del consenso anti-estatista?

This essay focuses on the reasons underlying the new commitment to reduced state participation. In particular, I suggest that the impetus comes less from newfound ideological conviction in the virtues of the market than from ineffective macroeconomic policy in the 1980s. The principal problem confronted by the countries of the region is a fiscal shortfall, not massive inefficiency resulting from misallocation of resources. Latin America is not Eastern Europe, where reform translates into elimination of the monopoly of state ownership and the structure of central command. Latin American countries have adhered to market capitalism, but without experiencing its magical effects in recent years. It is the contest between the micro- and macroeconomic explanations that illuminates why surface agreement on a reduced state role conceals a continuing divergence of views within the region.

Visible and Invisible Hands

Economía del Desarrollo. Concepto

At least through the early 1970s, development economics largely defined itself as a subfield by its emphasis upon market imperfections and the potential for Pareto-improving government intervention. Attention was especially directed to how government could seek out dynamic externalities and exploit large divergences between private and social rates of return to investment. The belief was that private markets would lead to inferior solutions if left to themselves. After all, historical reliance on markets had not closed the development gap.

The World Bank (1988, p. 49) has labeled such a perspective as the "public interest" view. One can separate out several components. First, there is a problem of providing public goods and infrastructure, where market response leads to inadequate supply or natural monopoly. Second, there are other market failures owing to externalities, imperfect information, and so on. Third, there is a need for state policy to determine appropriate levels of capital accumulation, since future generations are not well represented in private preferences. Finally, and not least, the concentration of private power and wealth constitutes a reason for state correction in the name of social justice and equality. This adds up to an active and positive role for the state through direct production of goods and services, management of revenues and expenditures and regulation of private activity.

In the specific context of Latin America, the theory of industrialization through import substitution enshrined almost all these principles. A pillar of the approach was the belief that static market signals overestimated the returns to primary exports because of potential deterioration of the terms of trade. Prebisch's emphasis upon an inevitably negative trend rang true scant years after the decline in commodity prices during the Great Depression. On the domestic side of the market, private rates of return underestimated the advan-

enshrined: consagrado

tages of investment in industry, by neglecting the savings from avoiding costly imports, the benefits of technological and labor skill externalities and the consequences of coordinated production decisions. Individual consumption decisions, especially given the large disparities in income distribution, did not add up to an appropriate savings rate. The policy obligation of government was not only to offer the appropriate shadow prices through trade restrictions and credit and tax subsidies, but also to undertake complementary investment in infrastructure and strategic sectors and increase overall capital accumulation.

For some larger Latin American countries, principally Brazil and Mexico, import substitution policies were compatible with accelerated industrialization and high rates of aggregate growth. From 1953 to 1973, Brazil and Mexico increased their share of regional income from 43 to 54 percent, reflecting their relatively higher rates of growth. For other countries, the results were deficient. The share of regional income going to Argentina and Chile declined from 27 to 19 percent (ECLA, 1978).

Desequilibrios derivados de la estrategia sustitutiva de importaciones

But even where a strategy of import substitution worked, it was at the expense of growing disequilibrium in three critical dimensions. First, policy-induced exchange rate overvaluation discriminated against exports, especially non-traditional ones, making the balance of payments and access to essential imports more precarious. Second, an increase in government expenditures was not matched by increased tax revenues, thus giving rise to larger deficits financed primarily by accelerating inflation. Third, the emphasis upon industrialization frequently occurred at the expense of inadequate agricultural development that left significant pockets of rural poverty and hampered development of an ample internal market.

Los límites de la ISI se hicieron esperar. Hasta entonces, los efectos habían sido alentadores

An import substitution strategy was deliberately unbalanced, and hence not permanently viable even where initially favorable. Successful implementation required timely adaptations to stimulate exports, enhance revenues and sustain increases in agricultural productivity. Few countries were so adroit. The first post-1945 development crisis in the region occurred in the early 1960s, as evidenced by an aggravating balance of payments problem and rising inflationary pressures afflicting many countries.

The external constraint and fiscal deficits motivated new efforts to increase inflows of public resources. Through the creation of the Inter-American Development Bank and establishment of the Alliance for Progress, assistance was provided to finance structural reforms. These were still much oriented to the domestic economy and in the spirit of public intervention. Indeed, planning was enshrined as a national requirement, and because of its political origins, the Alliance emphasized land reform and greater income equality.

Only by the mid-1960s, under continuing strains and sometimes under military aegis, did there begin to be wider acceptance of the importance of market signals and the opportunities for greater expansion of exports. Import substitution thus was not a monolithic or unchanging doctrine. By the time that a professional literature critical of the import substitution style of Latin Ameri-

hampered: obstaculizado
adroit: hábil
aegis: tutela

can state intervention began to appear in the late 1960s and 1970s,[1] reality (and local criticism) had already made itself felt.

For Latin America as a whole, economic growth accelerated from 5.2 percent per year in the decade 1953–63 to 6.4 percent in 1963–73; the proportional increase in per capita performance was a much more dramatic 50 percent. The more successful countries were able to sustain a large public presence while also giving greater scope to market signals and the opportunities afforded by continuing expansion of international markets. Export performance, and access to imports, emerged as the most significant determinants of country growth rates during this period (Cardoso and Fishlow, 1989, p. 14).

Los inevitables problemas para América Latina aparecen con el II shock del petroleo

Even the oil shock could be withstood, but at the expense of increased external indebtedness and deterioration of domestic policy in the more difficult external environment. Regional growth slowed after 1973, but was still higher than the results in other areas. The true precariousness of the Latin American situation only became apparent when the second oil shock coincided with an abrupt rise in real interest rates and OECD recession. Countries had chosen their new style of adjustment via debt rather than blindly following the original import substitution and interventionist model, and the choice was a bad one. Asymmetric integration into the world economy through financial flows instead of exports took a heavy toll. When voluntary capital inflows virtually ceased after 1982, the only immediate possibility was drastic reduction in imports and income. The rest of the decade has been characterized by large resource transfers, accompanied in most countries by high real interest rates, large deficits financed by internal debt, accelerating inflation and economic stagnation (Fishlow, 1986, 1988).

contraste con el caso asiático y el acceso al financiamiento condicionado a reformas pro-mercado

This Great Depression of the 1980s, made more pointed by Asian success, has directed attention to structural deficiency. External agencies, on which almost all countries came to rely, conditioned their money on a greater commitment to liberalization. Plans to assist with the debt burden, whether proposed by Baker or Brady, required evidence of emphasis on the private sector. At the same time, more open politics and a regular electoral calendar in most Latin American countries have assured mounting domestic debate and pressure to redefine the role of the state.

enmiendas conceptuales

The outcome has been new emphasis upon the virtues of the invisible hand. That commitment has been given greater force by two theoretical amendments to the standard Pareto efficiency argument. First, the rent-seeking literature has emphasized the additional distortion created by "directly unproductive profit-seeking" activity in response to opportunities afforded by government intervention (Bhagwati, 1982; Krueger, 1974). Second, there has been a special emphasis upon outward orientation as the key source of successful economic development. A corollary proposition is also frequently implicitly or

[1] Among the critical literature, Little, Scitovsky, and Scott (1970) was first. But note that back in 1964, ECLA's *Economic Bulletin for Latin America* carried two articles critical of excessive protectionism and recognizing the end of the import substitution model.

withstood: resistido
heavy toll: alto precio
amendments to: enmiendas a

Criticas a las críticas: 1) son menos "fundamentales" de lo que parecen

explicitly added: liberalized domestic markets as well as freer imports are necessary to guarantee the competitiveness required for export growth.[2]

Despite their prominence, neither of these new criticisms of state intervention is decisive. They do not rule out the existence of externalities and imperfections that justified policy activism in the first place. The focus on rent-seeking correctly highlights the importance of how intervention is implemented, but in many cases only costs of response are reckoned, to the exclusion of positive benefits from public action. Even those costs are often assumed without regard to institutional mechanisms like auctions and performance-related allocation of subsidies that can do much to reduce the deadweight burden. The rent-seeking model posits a static competitive Eden as the counterfactual alternative rather than the reality of powerful private interests and inadequate price signals.

Incluso la discusión teórica fue perdiendo la fe en los mercados

If anything, modern economic theory has reinforced a more skeptical view of laissez-faire. Incomplete markets, imperfect information, strategic interactions, principal-agent problems, transactions costs, and bounded rationality take up a large part of the microeconomic literature. Stiglitz (1988) sees this new theory as the unifying element in tackling development issues. Economies of scale, external economies, and path dependence are now at the heart of the new growth economics (Arthur, 1988; Shleifer, 1989).

2) la orientación out-ward tampoco es la panacea

The appeal of outward orientation is its empirical basis. The calculations of effective protection and the oft-replicated statistical linkage between export performance and economic growth lend support to the critique of dirigiste policy. Two cautionary notes are in order about these findings. The data do not speak with a single voice with regard to the virtues of outward orientation; and the contribution of liberalization to successful export growth remains a contentious one.

High effective protection levels frequently exaggerate actual productive inefficiency; tariff reforms are not followed by massive failures and significant reallocation of resources. Multiple cross-section studies demonstrating a favorable impact of exports on aggregate performance are not fully satisfying in three ways (Fishlow, 1989). First, causality remains an issue. Improved productivity yields greater international competitiveness as well as the other way around. A majority of countries fail a Sims-Granger causality criterion. Second, the source of improved performance may be excessively attributed to exports by the production function framework utilized; there is strong evidence that access to imports is equally or more important. That means that exports partially count for their earnings of foreign exchange, not their allocative benefits. Third, the favorable impact of export growth will be mediated by its form; export-led industrialization is different from specialization in exports that are resource-based.

[2] For a summary of the arguments concerning outward orientation, and more extensive references, see Krueger (1985) and Balassa (1989).

rule out: descartar
reckoned: calculado
skeptical: escéptica
oft-: a menudo

contentious: contencioso/controvertido

This is not an argument against fully exploiting international market opportunities. Latin American countries have no doubt exaggerated the benefits of a focus on the internal market. But that does not make an export emphasis the appropriate universal alternative. Export growth of 10 to 15 percent a year may not be feasible. Rather than such an ambitious export-led process of development, the objective for many countries should be an export-adequate strategy where diversifying exports regularly keep up with product growth and earn needed foreign exchange. Unlike the econometric inferences of an elasticity of output growth to export growth of .3, computable general equilibrium models show a much smaller effect of an order of .1 (Chenery, Robinson and Syrquin, 1986, pp. 321–22). Less is at stake.

¿es suficiente "get prices right"?

But a still more critical question is the relationship between market signals and successful export penetration. Overvalued exchange rates are prejudicial. But simply getting them right, without other complementary policies that encourage investment and technological change, may not be enough. The response to the exchange rate depends not only on entrepreneurial capacity but the flexibility of the productive structure. The objective is not to get prices right in isolation, but to follow consistent policies long enough for productive transformation to occur. Liberalization of the financial system and trade may be the consequence of successful industrialization rather than the cause of competitive efficiency.

In sum, no one has yet shown that the failure of government intervention *necessarily* outweighs market failure. On the contrary, effective state action is widely regarded as an underlying feature of successful outward-oriented Asian economic performance. Westphal's paper in this symposium argues, as do many others, that Korea and Taiwan did not succeed in exports because of simple liberalization, but rather as a result of a conscious and state-directed development strategy. In Latin America as well, before this last dismal decade, the steady record of Brazilian and Mexican economic growth was associated with technocratic policy design and implementation.

Even if there has been implementation failure in Latin America, that is an argument for correcting it, not for pursuing a second-best policy of laissez-faire in the presence of externalities that can be exploited to accelerate economic development. Paradoxically, the very array of powerful private interests celebrated by the rent-seeking and related literature requires a strong state to manage successful reform. In the absence of state capacity, concentrated market and political power and other imperfections may make laissez-faire an *n*th-best choice.

From Satisfactory Performance to Stagflation: The Deficit as Cause

The argument in favor of an altered state role in Latin America has to come from the side of macroeconomic failure, not a debilitating sectoral

keep up with: seguir con
dismal: triste
steady record: registro estable

misallocation. Despite a greater public presence in many countries in the 1970s, evidence suggests that there had already been more, not less, attention to market signals and international competitiveness. Despite the eloquence of Hernando de Soto (1989) in chronicling a stifling Peruvian mercantilism, the earlier tide of structuralism has been in retreat. In most of the region, rent-seeking was arguably less prevalent in the 1970s than it had been in the 1950s and 1960s, and export performance improved during the decade. Even in the dismal 1980s, according to the Inter-American Development Bank (1989, p. 4), "[E]xport activity has grown much more rapidly than the rest of the economy. ... [It] increased by 32.3 percent between 1980 and 1987, while the rest of the economy did so by only 7.4 percent."

Rather, the real villain of the piece is fiscal inadequacy.[3] This has made it more difficult for Latin American countries to adjust effectively to the less favorable external economic environment of the 1980s. The rise in world interest rates and an initially high external debt reflected itself in increased public expenditures. For the region, external debt service rose from about 3 percent of GNP in 1977–78 to as much as 8 percent in 1984, before falling to around 6 percent in the late 1980s (World Bank, 1984, 1989). Because much of the debt was public or publicly guaranteed, it helped to elevate interest costs to significant fractions of public expenditures: for large debtors the amounts were a fifth and more. Those countries that successfully managed the export surpluses required to effect the payment thus faced an internal transfer problem: how was the indebted public sector to acquire the foreign exchange?

The stylized answer is through increased domestic finance of an increased deficit. Despite some reduction in non-interest governmental expenditure, principally for investment, no full compensation occurred. Hence countries faced larger deficits and at the same time less access to foreign finance; that is what made it such a crisis. In aggregate, Latin American government deficits (after some correction for the inflation component of interest payments) rose from 4 percent of national product in 1980 to levels of 7 to 8 percent in the period 1981–87 (ECLA, 1989). Longer-term comparable data are available for Brazil, where government deficits (excluding the central bank component) rose from approximate balance in the early 1970s to 5 percent and more in the early 1980s.

The options for financing this deficit were either increases in real internal debt or a tax on financial intermediation: the inflation tax on base money plus indirect effects through reserve requirements and credit controls. For many countries, in the absence of a developed capital market, the only resort was accelerated inflation; for others, principally Brazil and Mexico, increased domestic debt figured prominently. Neither was a viable solution. As private agents protected themselves against the inflation tax, higher rates of inflation

[3]For recent treatment of, and extensive other references to the fiscal problem, see Reisen and von Trotsenburg (1988) and Easterly (1989). There is a considerable difficulty in assembling the comparable comprehensive data on the consolidated public sector needed for analysis.

chronicling: crónica
stifling: asfixiante
tide: marea/oleada

were required, possibly extending well beyond the point of maximum revenue collection. As internal debt put pressure on domestic interest rates, not only was private investment crowded out, but interest payments themselves grew at faster rates than revenues. In the end, the financeable deficit compatible with stable inflation tended to decrease even while the actual deficit increased. Tax collections were eroded by accelerating inflation, directly through the Tanzi-Olivera effect[4] and indirectly by the increased incentives for evasion to compensate for reductions in wealth. Indexing assured that past inflation rates reproduced themselves.

Under these conditions, the deterioration in economic performance in Latin America is no great puzzle. Investment declined on the supply side, and demand was stifled to try to dampen inflation. Uncertainty was fed by the considerable variability in real magnitudes as inflation levels climbed. Public policy floundered between efforts to stabilize through fixing exchange rates and public sector prices, and price liberalization to reduce subsidies and public enterprise deficits.

La inflación, consecuencia del déficit fiscal: pasó a ser la preocupación #1.
A pesar de los diversos intentos, solo fueron exitosos aquellos que atacaron el déficit fiscal

By 1985, inflation necessarily became a principal preoccupation in several countries as it exceeded all previous bounds. The array of special circumstances elicited a heterodox response, the first of a series whose most recent manifestation was Brazil's March 1990 program. These plans, in their varying form in different countries, have much to say about the critical fiscal problem and the role of the Latin American state.

The Argentine Plan Austral and the Brazilian Plano Cruzado were the first, launched in 1985 and 1986, respectively. They started from a theory of inertial inflation. Both ended indexing arrangements that institutionalized adjustment to past inflation; wages were set to nominal levels corresponding to their real average over a previous period. Both promised more rigorous monetary and fiscal policy. Both anchored prices to a newly devalued and more realistic exchange rate. Both introduced new monetary units and froze prices and wages to create instantaneous disinflation. Both were launched in an overt political fashion by civilian presidents and gained initial widespread support.

After initial successes, both soon unravelled, as price and wage controls eroded and repressed inflation became overt. Despite a series of new partial programs in the same spirit, inflation soared. In Argentina it was necessary to advance the inauguration of a new president in 1989 as speculation defeated all attempts to stabilize; and in Brazil, inflation exceeded 70 percent a month in early 1990 in the last months of the lame-duck government.

By contrast, the Bolivian stabilization plan put in place in 1985 and the Mexican effort initiated in 1987 have thus far been more successful and enduring. The former, under conditions of hyperinflation and dollarization,

[4]The consequence of inflation in eroding real tax collections through sheer delay in receipt was given prominence, and empirical justification, in Tanzi (1977). The independent and earlier discovery by Julio Olivera, an Argentine economist, is usually given recognition by those steeped in the Latin American tradition.

to dampen: amortiguar
floundering: tambalénadose
elicited: provocado
overt: abierto
both soon unravelled: ambos pronto se desenredaron
soared: se disparó

sheer delay: gran retraso

relied on massive devaluation and a subsequently fixed exchange rate to anchor price stability. The latter was structured around a negotiated incomes policy to restrain inflation to lower levels of price and wage increase with the exchange rate again serving as anchor. In both, import liberalization was also pursued to provide an external check on domestic prices.

What especially characterizes both of these successful stabilization programs are much greater underlying fiscal discipline and restraint on demand than in Argentina or Brazil. In Bolivia, there were significant dismissals in state enterprises (in COMIBOL, the state mining company, from 30,000 to 7000) and a reduction in public sector real wages. Revenues from increased taxes on petroleum rose sharply in the short term, while more wide-ranging reform has proceeded more slowly. In Mexico, in 1987 the primary surplus (exclusive of interest payments) was already close to 5 percent of gross product; in both 1988 and 1989 the surplus continued to increase (CIEMEX-WEFA, 1990).

Evaluación de los experimentos monetaristas en AL

Rational expectations theory has been a misleading guide in its implication that inflation can be stopped at modest costs, something all too appealing to Latin American ears. There has been too much attention to changing expectations and establishing the credibility of fixed exchange rates and monetary restraint and too little to the need to remedy the underlying fiscal imbalance. The future orientation of the theory works best when there is a memory of earlier stability to which to return. In Latin America, the gold standard was itself less the rule than the exception; postwar inflation at high rates erased any residual memory.

Previous experiments with international monetarism in Chile and Argentina at the end of the 1970s foundered out of misplaced faith in an exchange rate anchor and the automaticity of adaptive international flows. The later heterodoxy in Argentina and Brazil, although more drastic as inflation has mounted to four digits, retained—at least until the latest effort in Brazil—a deep fear of recession as the counterpart of stabilization. What the Bolivian and Mexican experiences suggest is that the check to inflation is far from costless. Instantaneous conversion to belief in future price stability was less important than a soft economy that discouraged wage and price increases. External reserves and even explicit coordination can help, but in the end credibility has been earned the hard way.

The lesson is clear. It requires an effective state, not reliance on the market alone, to establish expenditure priorities and impose restraint. Inflation is symptomatic of a lack of command. Magic formulas don't work. They obscure the underlying lack of consensus within Latin American countries and ineffective mobilization of elite opinion that made it impossible to raise taxes early in the debt crisis or adequately to cope with a deteriorating fiscal balance in the 1950s and 1960s. External finance, and proliferation of the public sector, concealed the real weakness of the state during the 1970s.

Privatization may now be emerging as another panacea. It promises to satisfy the need for larger domestic finance, reduced public expenditure and

foundered out of misplaced faith in: hundido por la fe equivocada en greater productive efficiency all at the same time. Foreigners and internal interests alike find it easy to criticize overblown bureaucracies and overextension of state enterprises. But a closer look counsels caution.

First, the objectives may be inconsistent. Where the dominant motive is immediate finance, because of the salience of government deficits, it is the best-managed and most efficient enterprises that must go, reducing future net revenues. There is a tradeoff between present and future, not a pure gain. Fire sales of money-losing public enterprises are not likely to bring in much money. Recording the proceeds as revenue rather than as a means of financing the deficit gives too favorable an impression of the benefits.

Second, selling off the perpetual losers will only reduce future claims on public subsidies if macroeconomic policy is conducted better. Favored work rules, controls over prices and high levels of indebtedness help to explain poor bottom line results. Two of these factors do not operate at the enterprise level, and even wages and employment are not set entirely independently by private firms. Change in ownership alone does not make the crucial difference. Moreover, note that restructuring debt to make enterprises more attractive to new owners simply transfers the future interest payments to another part of the government accounts.

Third, promises of how privatization will increase efficiency may be overstated. Measuring productive efficiency in parastatal activities is not easy because cash flow results can distort. The very rapid growth of state enterprises during the 1970s—they multiplied by a factor of 2 and 3 times in several Latin American countries—was associated less with a comprehensive strategy of expansion in key sectors than financing balance of payments gaps. That is, Latin American governments used guaranteed loans for such enterprises as a means of increasing capital flows and access to foreign exchange. State enterprises remained with the specific financial liabilities, increased in real terms through devaluation and higher interest rates, although there was sometimes no counterpart in real investment. This problem is further compounded by the generalized tendency to place controls on public sector prices as a way to check accelerating inflation. New private owners may not be better managers. What may count more than ownership is greater exposure to competitive forces, possibly through import liberalization when the domestic market is small.

Fourth, it matters who buys and how. If credit is extended to finance purchases, the public deficit is reduced but not total demand. If private wealth is further concentrated by the acquisition of the new assets, pressures on public officials for special treatment will be enhanced rather than reduced. It is interesting that holders of the external debt have resisted conversion into equity of public enterprises; they prefer to use swaps for more attractive private assets.

In sum, the deep-seated deficit problem in Latin America and its attendant serious consequences permit no easy solution. The debt crisis of the 1980s has underlined the fragility of the state and its inability to respond to the less favorable external environment. Increasingly, the issue is not merely debt reduction but redesigning the Latin American state. In the last analysis, there is limited gain, both fiscally and in the balance of payments, that is available under the Brady plan to reduce the debt burden of Latin America.

Redesigning the Latin American Developmental State

There are two competing models of redesign. One starts by stripping away public functions and confidently assigning them to the private sector and the market. The other begins by confronting the central challenge of the public deficit and defining a new development strategy. Their partial congruence in some particulars creates not only a false impression of consensus, but leads to inconsistent policy. For where the first gives priority to a reduced state and slashed expenditures, the latter requires a stronger state and command over resources.

Although the multilateral institutions seem to favor immediate and wide-ranging liberalization, in conjunction with aggregate restraint, there is limited evidence to support such an approach, particularly where markets have been working. This shock therapy promises too much too quickly. One has to reduce inflation quickly when it has reached stratospheric levels, but that is only a first step. Initial success can help to restore confidence, but it can also promote a misplaced euphoria that conflicts with the institutional underpinning of fiscal responsibility that is at the heart of effective governance and economic development.

Countries in the region have become committed to change, but most are groping toward the second of these models. They are doing so both because liberalism is still not widely seen as an attractive doctrine, and because there is need to offer a developmental perspective to satisfy an increasingly frustrated populace. Pinochet's "Chilean miracle" is not an ideal that Latin Americans wish to emulate. Vargas Llosa's vision of a Peru radically transformed and democratized by deregulation is the exception that proves the rule, and has not been rewarded at the polls. Salinas's Mexico, even while moving to greater integration in the world economy and closer links to the United States, retains a strong and active public role. Underlying Mexican trade liberalization, moreover, is a powerful macroeconomic logic: imports have dampened inflationary pressures and there is need to attract capital inflows to avert a looming foreign exchange constraint.

The convergence toward a stronger state is independent of political origins and winning campaign slogans. The Argentine Peronist Menem professes Manchester liberalism, while the Brazilian conservative Collor embraces confiscation of wealth. Economic emergency compels strong measures, and increasing recognition that the state is too large and too weak. Not until, and unless,

stripping away: despojar
slashed: recortado
groping: ir a ciegas
at the polls: en las urnas
avert a looming foreign exchange constraint: evitar una inminente restricción de divisas

embrace: abraza

there is an increase in public revenues as well as reduced expenditures, will control of inflation long succeed. One can hope that this lesson is being learned and that external advice will reinforce internal predispositions.

Macroeconomic equilibrium, once achieved, will not by itself guarantee economic development. The length of the crisis has intensified uncertainty and rewarded private sector caution. Restarting and sustaining economic growth is where the public sector has a central and critical role. First, increased public investment is essential to larger private investment; deteriorating infrastructure and lack of adequate public services have reduced private returns. Increased spending also sends the important signal that the fiscal emergency is over. Second, there is need for larger social expenditures for the improvement of education and health as well as expanded programs targeted to the poor. Evidence suggests significant increases in inequality and poverty as a counterpart of the stagnation and accelerating inflation of the 1980s. Political stability requires more than rhetorical recognition of this fact. Third, the public sector must become a better regulator and subsidizer, even as it divests some of its productive activities and liberalizes trade. Natural monopolies in private hands will have to be overseen; financial activity cannot be left unattended; priority private investment will have to be encouraged. Industrial policy in developing countries starts from knowing what has gone before; it does not have to be, and especially for the smaller countries should not be, synonymous with an emphasis on the internal market.

In short, there is still a very constructive role for the state, based upon theory and practice. To perform that role effectively requires a new coalition of political support that is founded on both new and old realities: much reduced external finance and need for larger domestic saving, especially of the public sector itself; an expanded, but more competitive, international market in manufactured products, based upon diffusion of technology and imports of capital goods; limits to the domestic tax base; and unacceptably high income inequality throughout the region. Political transformation is very much a component of redesign of the state; democratization is only a beginning.

Populism, with its primary focus on inequality and its predisposition to a very activist and inward looking state, is not the principal constraint to such transformation in most of Latin America.[5] Raging inflation has weakened its appeal. Opposition to effective policies has not come from mass organization; the poor do not speak with a single, or very loud, voice. Labor unions are divided and less powerful than in the 1960s. Real wages have undergone significant decline in almost all countries.

[5]See Sachs (1989) and Dornbusch and Edwards (1990). Both papers come perilously close to identifying macroeconomic failure with populism tautologically. Nominal wage demands obviously reinforce inflation and impede stabilization. What is needed, however, is careful analysis of the special force of wage demands and their channels of pressure under populist regimes rather than others; and a careful look at whether wages were the decisive causal factor in provoking initial macroeconomic disequilibrium.

The blocking forces have been others. One has been the absence of an effective structure of political parties. Another has been a private sector interested more in guaranteed benefits than risk taking, and comfortable with a state presence that provided transfers and assured order without threat from below. Technocrats were able to satisfy those demands so long as they had abundant resources; as those diminished, so did the quality of their policies.

The technocrats have been blamed for the failure, while the private sector has emerged in some eyes as the future savior. The conversion to a narrow market-oriented view risks discarding a three-decade process of increasing sophistication of Latin American public administration. Bureaucrats do not only wear black hats. Some have contributed to imaginative policies and defended the national interest against powerful private rent seekers. The heart of the matter is not simply taking the state out, but bringing the private sector, and civil society, back in more positively.

The challenge to the countries of the region is formidable. There are no simple blueprints. The Asian developmental state cannot be copied. That brand of corporatism where authority was more centralized, resources readily available to the state and pressures from income inequality less salient proved much more functional than the Latin American style of catering to all. The prospects for economic development in the region during the decade ahead and beyond hinge upon the outcome of the process of redesign of the state that is now under way. The longer it takes to bring this process to successful fruition, the more the accumulated forces of economic erosion of the last decade make success difficult to achieve.

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