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The Crisis of the State Approach

The import substitution, state-led strategy that dominated Latin America from the 1930s to the 1970s was opposed rhetorically by conservatives and by Washington, but in practice businesspeople and governments supported it as long as it was successful. In Washington, the U.S. government and multilateral agencies, as well as businesses and commercial banks, mildly criticized the import substitution strategy, but in practice they financed it. The World Bank, until the end of the 1970s, was devoted to development economics and to an industrializing strategy very similar to national developmentalism. Yet this industrialization strategy had exhausted its potentialities in Latin America by the 1960s. Its life span was artificially extended in the 1970s by the availability of foreign capital. But real prices were increasingly dissociated from market-clearing prices by the distortions involved in the state intervention process. Subsidies to private enterprises and, less often, to consumption were maintained long after they had lost their original justification, aggravating the inefficient allocation of resources. The state paid the account. Public savings, which had been high in the 1970s, began to disappear. In the early 1980s a growing external public debt, which financed increasing public deficits, turned into a fiscal crisis of the state.[1]

This Latin American crisis was essentially the consequence of two decisions made in the early 1970s: on the Latin American side, the decision to persist in a growth strategy and in a mode of state intervention (import substitution) that no longer worked; and on the creditor countries' side, the decision to finance this strategy, thus ensuring its artificial survival. These two decisions increased Latin American indebtedness; and then, in each Latin American country they led the state to bankruptcy. A fiscal crisis ensued as the foreign debt increased and was nationalized, the increase in the interest burden plus renewed populist policies augmented the public deficit and reduced public savings, the public debt soared, and public credit evaporated. Initially, the foreign debt was not primarily public. In the 1970s state borrowing represented about 50 percent of the debt. In the early 1980s, however, it became nationalized as private firms paid their debts in local currency to their respective central banks, usually at an overvalued exchange

rate. This practice, in addition to shifting the foreign debt to the state, subsidized the private sector and induced deficit spending. Foreign savings were used by Latin American governments, particularly Brazil, to finance heavy import substitution projects and consumption (economic populism).

By the mid-1980s, when the transmutation of the foreign debt into state debt ended, around 90 percent of the debt had become the state's responsibility. The private sector remained capable of generating a foreign surplus, but only the state was supposed to pay the foreign debt. The nationalization of the foreign debt was a perverse form of financing public deficits and spurring the fiscal crisis. In the 1970s the public deficit was financed primarily by foreign borrowing; in the first half of the 1980s it was financed by private firms that paid their debts (usually in privileged conditions) in local currency to the state, which in turn had too little foreign currency to pay the banks. In the late 1980s countries either drastically reduced their public deficit by lowering wages and internal consumption, as was the case in Chile and Mexico, or their fiscal crisis deepened, as happened in most other Latin American countries.

Nearly all Latin American countries were committed to tight fiscal adjustment policies. But the fiscal deficit was so high, and the interest component related to the public debt so heavy, that countries were unable to adequately adjust their economies. In addition, the possibility of transmuting the old foreign debt into government debt offered an easy way to finance current deficits. Thus, foreign borrowing, which in the 1970s had backed the state-led import substitution strategy and fiscal indiscipline, continued to indirectly and negatively affect public finances in the first half of the 1980s as the nationalization of the debt fostered fiscal indiscipline and laid the foundation for a deep fiscal crisis.

James O'Connor (1973) introduced the concept of the fiscal crisis of the state, explaining it as the state's increasing difficulty in coping with the growing demands of several sectors of the economy and corresponding social groups. The concept I am using here is based on his ideas. The expression *fiscal crisis of the state* is redundant because all fiscal crisis is related to the state; but, in 1987, when I clearly comprehended this crisis, I decided to use the term to explain the Latin American crisis because it clarifies the central role of the state in that crisis. We could also refer to a "financial crisis of the state" because all fiscal crises have as their outcome the state's increased difficulty in financing itself.[2]

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

and insufficient, if not negative, public savings are, to use an economist's jargon, a flow characteristic of the fiscal crisis, whereas the size of the public debt—be it internal or external—is a stock property. Actually, the lack of public credit is the fundamental feature of a fiscal crisis of the state. A country may have a high public deficit and a high public debt, but the state does not need to lose credit or the government its credibility. This is the present case in the United States and Italy, where in spite of the deficit and the public debt there is no fiscal crisis, or the one that prevails is much milder than those existing in Latin America. The state's loss of credit—its inability to finance itself except through seigniorage (money creation)—is the quintessential characteristic of fiscal crises. When this loss of credit becomes absolute, or in other words when the fiscal crisis becomes acute and out of control, the state loses its capacity to guarantee its money, and hyperinflation is the likely outcome.

Most characteristics of the fiscal crisis are self-explanatory. Yet I believe it is important to stress the issue of insufficiency of public savings. The fundamental flow characteristic of a fiscal crisis is not the budget deficit but rather negative public savings. Particularly in a developing country this factor has a strategic role. Negative public savings tend to be a direct cause of low investment rates and the stagnation of per capita incomes.

Public savings, S_G, are equal to current revenue, T, less current expenditure, C_G, where interest is included.[5]

$$S_G = T - C_G$$

Public savings represent a different concept from public deficit, D_G, which is equal to current state revenue less all expenditures including investments, I_G, and corresponds to the increase in the public debt:

$$D_G = T - C_G - I_G$$

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

$$I_G = S_G + D_G$$

These distinctions are important. They are part of the standard national accounts system but with a shortcoming: state-owned enterprises are excluded from the calculation of public savings. Yet few economists include public savings among their tools.[6] Under the fiscal and monetary adjustment approach adopted by the IMF, the stabilization literature refers almost exclusively to the public deficit. I believe, however, that in analyzing the economy of any country, public savings are at least as important as the concept of public deficit.

Public savings become particularly important if we adopt a broad concept of public investment. According to this concept, public investments cover not only investments proper, which include investments in projects in which the private sector has shown no interest (usually infrastructure), social investments (education and health), and investments in security (police and prisons). Public investments also include free public expenditures—"free" because they are not committed to public officers' salaries or to current state services, which improve the country's competitiveness; these investments include subsidies or incentives to private investment (agricultural and industrial policy) and expenditures on technological development to be provided for the private sector.

When public savings are near zero, the state has only one alternative: to finance investment through the public deficit. However, if the objective is to reduce the public deficit—an intrinsic part of any program to resolve a fiscal crisis—a likely outcome is a cut in public investments and the consequent reduction of GDP growth. Thus, with zero public savings, if the state invests, its indebtedness will increase and its creditworthiness will further diminish; if the public deficit is eliminated, investment will be cut. If public savings are negative, the state will have a deficit even if public investments are zero. The deficit will finance current expenditures, the bulk of which is typically interest on loans. In any event, the state will be paralyzed, unable to formulate and implement policies that promote growth. And this paralysis, more than anything else, reveals the relation between fiscal crises and economic stagnation.

When the Latin American crisis broke out, the creditor countries' interpretation of its causes and remedies underwent two phases. At first, between 1982 and 1984, the crisis was minimized and was viewed as only a liquidity crisis. Beginning around 1985, however, the crisis started to be taken more seriously. In addition to fiscal and balance-of-payments adjustments, "structural," market-oriented reforms were viewed as essential.[7] The Washington consensus was at last emerging, pushed by a conservative, neoliberal wave extant in the First World since the mid-1970s.

In the Washington consensus, the crisis was admitted to but in a limited way. Its causes were defined: fiscal indiscipline (or economic populism), resulting in public deficit; and excessive state intervention—particularly through state-owned enterprises, trade restrictions, and several types of subsidies to investment and consumption. The remedies were listed: fiscal adjustment aimed at eliminating the public deficit; structural or market-oriented reforms (particularly trade liberalization and privatization) aimed at deregulating and reducing the state apparatus; and limited debt reduction, according to the 1989 Brady Plan.

The debt crisis was not viewed as the single most important cause of the overall crisis. The internal causes received much more attention. When the

Brady Plan was formulated in February 1989, analysis demonstrated that it was correct overall but that the debt reduction it implied was insufficient. The burden of adjustment and reforms would fall almost exclusively on the shoulders of the debtor countries. Yet soon after Mexico signed the first debt agreement according to the plan, capital flows increased, and Mexico's economy steadily improved. A spurious correlation between the Brady Plan and these capital flows was immediately established. "Hot" money was going to the region, not because Latin America had solved its problems and was growing again but because it was attracting high interest rates, a perverse result of the lack of confidence provoked by the debt crisis. Yet Washington and the banks convinced themselves that the debt crisis had been solved. The motivation for an effective solution vanished.[8] Since 1990 the standard phrase in Washington—which is essential to the neoliberal approach—has been that "the debt crisis was grossly overestimated."

Fanelli, Frenkel, and Rozenwurcel (1990:1), in their critique of the Washington consensus, observed that the Latin American crisis

> did not originate in the weaknesses of the import substitution strategy but rather in the dynamics of the adjustment to the external shock that took place in the beginning of the 1980s. In fact, the principal constraints to growth today originate in the long-lasting features of the external and fiscal imbalances induced by the debt crisis that has still not reversed after ten years of adjustment.

The three Argentine economists underestimated the exhaustion of the import substitution strategy, but their definition of the origins and nature of the crisis is an excellent example of the crisis of the state approach.[9]

Additionally, the political origins of this crisis did not primarily stem from economic populism, as is usually thought in Washington.[10] Populist economic policies undoubtedly played a role, but populism has always existed in Latin America, and before the 1980s did not throw up an obstacle to reasonable price stability and growth. The new historical event that led Latin American economies to their first ever fiscal crisis was a nonpopulist decision made in the 1970s, mostly by the military regimes, to underwrite an enormous foreign debt and, subsequently, to turn it into a state responsibility. Populism is blamed by the neoliberal approach for something that was not primarily its fault (Bresser Pereira and Dall'Acqua 1991; Cardoso and Helwege 1990). It was not by chance that the only country in Latin America that experienced satisfactory rates of growth in the 1980s was Colombia, which had not previously run up a large foreign debt.

The inability to finance the state through taxes, particularly income taxes, is an essential trait of the Latin American countries now enduring a fiscal crisis. Wealthy people do not pay their fair share of taxes in Latin America. The tax burden tends to be systematically low, not only when compared with developed countries but also in contrast to Asian countries at

about the same level of development (Kagami 1990). Tax systems tend systematically to be regressive in Latin America because they are based primarily on indirect taxes.

The state in Latin America was originally financed through export taxes. Later, when rents from primary products exports had been reduced, state investments were financed by indirect taxes, by specific taxes matching expenditures in a given sector,[11] by the reinvestment of profits of monopolist state-owned enterprises,[12] and by security funds—which, by definition, tend to present a surplus in the first years after they are created. In the 1970s, when for several reasons these sources of state revenue had been exhausted or were insufficient, foreign debt proved an easy alternative to finance the state. With the suspension of this source of financing, inflationary tax increased as a means of financing the state.[13] The typical way of financing the state—through taxes, particularly income taxes—was never typical in Latin America. As Przeworski (1990:20–21) observed, "The crucial question is whether the particular state is capable, politically and administratively, of collecting tax revenue from those who can afford it: in several Latin American countries, Argentina notably, the state is so bankrupt that the only way it can survive day-to-day is by borrowing money from those who could be tax-payers." This feature could be attributed to populism, but I would rather identify it with the authoritarian, limited democratic character of the Latin American capitalist state, which entails subjecting the state to the rich.

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

The Washington consensus was defined by Williamson (1990) and immediately became identified with neoliberal ideas. In fact, it is a milder form of neoliberalism because the Washington bureaucrats who formulated it lacked the dogmatism that characterizes neoliberal or neoconservative ideas. Neoliberals, for instance, aim at the minimum state, whereas Washington—even in its more conservative phase in the late 1980s, when the consensus was formulated—always attributed a positive role to the state in social expenditures (education and health) and infrastructure investments. Williamson himself is not a neoliberal but a classical liberal.[14] Since the

Democratic Party won the presidential elections in 1992, the neoliberal wave has clearly receded in Washington.

This milder form assumed by the Washington consensus, in comparison with neoliberal ideas, combined with the changes that have taken place since the consensus was formed in the late 1980s, has led some to ask whether there really is a difference between it and the crisis of the state approach. There is. First, we are not considering the intentions of *A* or *B* but the statements, as they were made by the leading figures in Washington. Second, we are not taking into consideration the changes that have occurred. These changes did occur, and reveal that soon after the consensus was formed it began to disintegrate, but this does not alter the basic neoliberal roots of the original consensus.[15]

The Washington consensus views itself as the only alternative to the import substitution strategy and to the national-developmentalist interpretation of Latin America. This is not the case. New facts demand new approaches. The national-developmentalist approach can be considered the generic designation of two interpretations of Latin America: the national-bourgeois and the new dependency interpretations. The national-bourgeois (or center-periphery) approach, which Prebisch (1949) formulated in Santiago, Chile, as executive director of the United Nations' ECLA (now ECLAC), was the first paradigmatic moment of self-interpretation of Latin American development. Celso Furtado (1950) was the Brazilian pioneer of this vision of Latin American development. The new dependency theory, first comprehensively analyzed by Cardoso and Faletto (1969), was a second paradigmatic moment of interpretation of Latin America. It prevailed in the 1970s, following the economic crisis of the 1960s. These two approaches were closely connected. They lost their capacity to explain Latin American development as the crisis expanded in the 1980s.[16] The neoliberal critique emerged and prospered in the void left by the failure of the two previous interpretations. But as is the case with all ideological interpretations, it, too, was soon revealed as dogmatic and unrealistic.[17] A new synthesis is on the way as the 1980s crisis is being overcome. It may constitute the third paradigmatic moment of interpretation of Latin American development once it is in fact under way. I call it the crisis of the state or the social-democratic approach.

The crisis of the state approach, whose immediate origins are found in the new dependency theory, takes us a step forward in the direction of more market-oriented and market-state–coordinated reforms. It acknowledges that there is a populist, fiscal indiscipline problem and that the public deficit is also a major problem, but it adds that the problem is more serious than merely one of fiscal indiscipline. In fact, most Latin American countries face a fiscal crisis.

The fiscal crisis approach defines the fiscal crisis as the consequence not only of the public deficit but also of excessive public debt, negative public savings, and—following on the lack of state credit (its incapacity to finance itself except through seigniorage)—the government's lack of credibility and immobilization. It acknowledges that the state has become too big, that state-owned enterprises tend to be inefficient, that regulation has been distorted (protecting the special interests of bureaucrats and industries), and that national developmentalism became distorted by populism. Thus it supports market-oriented reforms, particularly outward-oriented, export-led industrialization. But it does not confuse market-oriented with market-coordinated reforms. The economy must be strongly market-oriented—that is, it must be as competitive as possible, both inwardly and outwardly. Economic coordination, nevertheless, must be mixed. This approach assigns to the market the basic role of resource allocation, but the state, after being reformed and fiscally adjusted, must assume new and important coordinating functions not only in the social realm but also in the fields of technology and international trade, as well as maintaining primary responsibility for infrastructure investments.

The crux of the fiscal crisis approach is the idea that the crisis is the outgrowth of a state that is too weak. The state did not become too big and too strong, but too big and too weak—unable to carry out its specific functions and to complement the market as it should. The state is weakened and immobilized by the fiscal crisis that was the outcome of the disordered and distorted growth of the state apparatus. The objective of structural reforms should not be to reach the minimum state but rather to strengthen the state and to define a new strategy of development consistent with new and limited forms of state intervention. Given the cyclical and ever-changing character of state intervention (Bresser Pereira 1993d), the new sectors in which the state will have to invest, in addition to the social sector and infrastructure, are high technology and the environment.

The assumption that it is enough to stabilize and to reduce state intervention to achieve growth is false. Although liberalizing reforms do foster market coordination and improve resource allocation, creating a more efficient economic system is insufficient for growth. If growth is to resume, it is necessary to combat the fiscal crisis, recover the public savings capacity, and define a new strategy of development. The national-developmentalist approach has stressed the role of the state but, supposedly following a Keynesian view, has accepted and even advocated chronic public deficits. This populist view is contradictory in itself. Its sponsors have weakened the very state they intended to make stronger. In public savings lies the difference between current state revenue and expenditures. A state can only be strong and capable of playing a strategic role in the development process if it is able to finance its investments and its social and economic policies with public savings, rather than incurring increasing debts.

The crisis of the state or social-democratic approach assigns the blame for Latin America's economic difficulties to the debt problem as much as to economic populism. A consequence of both was a fiscal crisis of the state, which expressed itself in high rates of inflation. As prices and wages tend to be informally indexed, this high inflation often has a chronic or an inertial character. This was particularly true in Brazil. In this approach, stabilization programs, in addition to adopting orthodox fiscal and monetary policies, should include income policies and reduce the outstanding public debt. Once stabilization has been achieved, market-oriented reforms should ensue, but the state that emerges from these reforms—although smaller and reorganized—should have not only a political and a welfare role but an economic role as well, particularly in the area of targeted industrial policy oriented toward export promotion.[18]

Although the fiscal crisis or social-democratic approach has as its antecedent the national-developmentalist and dependency approaches that dominated the 1970s, it differs from them somewhat. The major difference between it and the national-developmentalist approach lies in the fact that the latter interpretation took the causes of underdevelopment to be structural and directly related to imperialism, whereas the social-democratic approach assumes that the causes are to some extent strategic and have major domestic origins. To proponents of the crisis of the state approach, underdevelopment is not ordained by fate and cannot be explained mainly by imperialistic exploitation; it can be overcome when correct domestic strategies are adopted, particularly when a fiscally sound state aligns itself with the private sector and together they define a development strategy. Also, proponents of the social-democratic approach criticize the populism that often distorted national developmentalism. As with the previous approaches, the crisis of the state interpretation denies the thesis of the minimum state. It is also concerned with the importance of international variables, which were manifested in the 1980s through the debt crisis and the protectionist policies of the developed countries. It is critical of the standard diagnoses and recipes, which ignore the specificities of Latin American countries.

Since the onset of the debt crisis, the adjustment programs sponsored by Washington have called for balancing budgets through current expenditure and investment reductions. The alternative—eliminating the budget deficit through an increase in taxes and a reduction of the public debt—has received less attention.[19] In practical terms, balance-of-payment and price adjustments are considered to be so important that the quality of fiscal adjustment is not taken into account. A fiscal adjustment that hurts investments is considered to be as good as one that cuts current expenditures. Expenditure cuts are treated as superior to tax increases, ignoring the fact that expenditure cuts will usually be regressive whereas tax increases can be a tool of income distribution.[20] Debt reduction is systematically left as a last resort. And the

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

In contrast, the fiscal crisis approach starts from the hypothesis that growth does not automatically resume following stabilization, either because stabilization is achieved at the cost of public investment or because reform does not tackle the public savings issue. This approach asserts that growth will be resumed only if stabilization and market-oriented reforms are combined with the recovery of the public savings capacity and with policies that define a new strategic role for the state. For the fiscal crisis means not only that the state has no credit and is unable to finance its activities but also that it has lost the capacity to invest in and propel long-range policies oriented toward industrial, agricultural, and technological development. Once the fiscal crisis has been overcome, public savings will have to be restored to finance a growth program.[21]

The neoliberal approach assumes that private savings and investments will substitute for public investment. True, historically this has been the trend of investments in manufacturing and infrastructure. The state played a decisive role in both Germany and Japan at the end of the nineteenth century, directly investing in the productive sector. Since the beginning of the twentieth century, this role has continually been reduced and transformed. In both countries, however, the state continues to play a fundamental role in the social field and in promoting economic development through industrial and trade policy. The privatization that started in the 1980s is a second historical wave of substituting private for state ownership. It is being induced not only by ideological but also, if not mainly, by fiscal reasons. It is a form of overcoming the fiscal crisis of the state. Through selling state-owned enterprises the state reduces—or should reduce—its debt to the private sector.

As has happened in the developed countries, the state in the developing ones will continue to play a fundamental role in the social field and in development promotion. According to the crisis of the state or social-democratic interpretation, the state in Latin America will have to perform a supplementary but nevertheless strategic role in coordinating the economy and promoting economic growth, as Japan did and East and Southeast Asia are now doing. These regions, where development has been extraordinary, are made up of fiscally balanced states that use public savings to promote development.

The social-democratic approach supports trade liberalization but not as a magic formula. As Colin Bradford, Jr. (1991:88) observed, the recent literature on development strategies presents two alternatives to achieving international competitiveness: (1) "structural reform of the national economy for domestic competitiveness which results in dynamic growth and an increased supply of exports"; and (2) "trade policy reform for international competitiveness which allows the economy to respond to external demand."

The second alternative is characteristic of Washington's approach. Its representatives enumerate several prerequisites for a successful outward-oriented strategy (Krueger 1985), but it is fairly clear that the essential prerequisite in their view is to liberalize trade and open the economy. The first alternative is preferable in the social-democratic approach. Whereas trade liberalization alone may be an appropriate strategy for small countries like Singapore, Hong Kong, or Uruguay, for the large countries of Latin America trade liberalization should be only one ingredient in a development strategy that encompasses public savings, investments in education and technology, and export promotion.

The import substitution strategy exhausted its potential a long time ago. This strategy does not assure international competitiveness. But it makes little sense to believe it is enough for the state to stabilize, liberalize trade, and promote public education for growth to resume automatically. In Bradford's words (1991:93):

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

The social-democratic approach should be viewed not as a rejection of but as an alternative to the Washington consensus, with which it shares many views. Both are opposed to the national-populist posture still alive in Latin America, although with progressively less credibility and support.[22] The social-democratic approach accepts the need for reducing the size of the state, which grew exorbitantly over the past fifty years, and agrees that this expansion has generated serious distortions because the state has tended to be captured by the special interests of rent seekers. It emphasizes, however, that the crisis of the Latin American state is a result of the fiscal crisis, which weakened the state, and the fact that the form of state intervention—the import substitution strategy of industrialization—is exhausted. This approach does not accept the neoliberal axiom that says "since state failures are worse than market failures, the solution is to reduce state intervention to a minimum." In fact, state failures are dependent upon the state's own cyclical growth movement. When the state is dominated by the interests of special groups and falls victim to fiscal crisis, its failures will be overwhelming. At that point market-oriented reforms will be nothing more than required reforms of the state. Once the state has achieved that reform, which is similar to a business enterprise's restructuring, public policies will recov-

er efficiency and effectiveness, and the state will be able once again to play a complementary but strategic role in coordinating the economy.

Hence, market-oriented reforms are not the monopoly of neoconservatism. A social-democratic approach will support them provided they are not radical or dogmatic, aiming at an unrealistic minimal state. This approach stresses, however, that the neoliberal assessment of the causes of the crisis is incomplete and partially mistaken—for instance, when it confuses a deep fiscal crisis with a voluntaristic conception of fiscal "indiscipline," when it underplays the role of the debt crisis, and when it ignores the fact that there are conflicting as well as mutual interests between both Latin America and the First World and Latin America and other developing countries.

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

The concept of the fiscal crisis of the state should be clearly distinguished from mere fiscal laxity or budget deficits. The fiscal crisis is a structural phenomenon rather than a short-run, circumstantial one. Persistent public deficits certainly engender a fiscal crisis, but once the deficits have been eliminated, the country confronts a more serious problem: potential public savings are being used to pay interest on domestic and foreign debts instead of being used to promote growth.

A two-entries matrix (Figure 2.1) helps to summarize the differences among the social-democratic or crisis of the state approach, the neoliberal or orthodox approach, and the populist version of the national-developmentalist approach. On one axis we have fiscal discipline (low or high), on the other market-state coordination (mixed or market). The first cell (fiscal indiscipline–mixed coordination) corresponds to the populist national-developmentalist approach. The second cell (high fiscal discipline–mixed coordination) corresponds to the social-democratic approach; it is typical of the European social democracy. It could also be called the East Asian approach because fiscal discipline and state intervention have been the cornerstones of Japanese, Korean, and Taiwanese economic policy. The difference between the social-democratic and the East Asian approaches is that the first accentuates the income distribution role of the state and the second does not.[23] The third cell (high fiscal discipline–exclusive market coordination) corresponds to the neoliberal approach or orthodox economic views. Finally, the fourth cell (low fiscal discipline–exclusive market coordination) corresponds to populist neoconservatism, whose best example was

Figure 2.1 Four Approaches to Crisis

Market-State Coordination	Fiscal Discipline: Low	Fiscal Discipline: High
Mixed	Populist	Social-Democratic
Market	Reaganomics	Neoliberal

Reaganomics—the economic policies that characterized the Reagan administration in the United States (1981–1989). There is no example of this kind of approach in Latin America.

With this general framework in mind, let us examine the eight largest countries in Latin America (see Table 2.1). Two—Chile and Columbia—have had strong development for some time. Colombia never experienced a real fiscal crisis or high rates of inflation. Chile was able to solve its fiscal crisis and to stabilize in the 1970s, adopting orthodox, costly, and inefficient—but eventually effective—economic policies. Colombia did not undertake modernizing or liberalizing economic reforms. Chile did, although it did not privatize its copper mines. Both countries show large public savings. One country—Mexico—adopted a strict fiscal adjustment program in 1985; implemented bold economic reforms in 1987; and liberalized and privatized its economy, and stabilized its inflation in December 1987, when prices and wages were frozen and the government mediated a social agreement—the Pacto de Solidariedad Social—between businesses and workers. Mexico did not actually solve its debt crisis because the negotiation of its foreign debt according to the Brady Plan produced a limited reduction of the debt (around 15 percent). The internal fiscal effort, however, was enormous. The heterodox shock in December 1987 was well prepared, well negotiated, and well implemented. And the structural reforms were radical. This internal effort, the perspective that Mexico would be a part of NAFTA, and an increasing flow of foreign investments have created positive expectations regarding Mexico. Since 1991 Mexico has started to grow again but at modest rates that are not compatible with the high levels of foreign investments. A sign that its fiscal crisis has not been completely overcome is the heavy burden of the payments of interest on the public debt.

The other five countries are still dealing with fiscal crises. Bolivia's inflation was stabilized in 1985; the economy remained stagnant for some time but has recently begun to grow again. Venezuela and Peru adopted rad-

Table 2.1 Latin American Per Capita GDP Growth and Inflation in the 1980s (selected countries)

	GDP Per Capita (%)			Inflation (%)		
	1985–1989	1989	1990	1985–1989	1989	1990
Argentina	–2.1	–5.6	–1.8	468.6	4,923.8	1,344.4
Brazil	2.2	1.2	–5.9	489.4	2,337.6	1,585.2
Bolivia	–1.8	–0.1	–0.2	192.8	16.6	18.0
Chile	4.4	8.0	0.3	19.8	21.4	27.3
Colombia	2.7	1.5	2.1	24.5	26.1	32.4
Mexico	–1.3	0.9	1.7	73.8	19.7	29.9
Peru	–2.6	–13.2	–6.8	443.2	2,775.8	7,649.7
Venezuela	–1.1	–10.1	3.2	32.5	81.0	36.5

Source: Economic Commission for Latin America, *Panorama Económico de América Latina*, 1990 and 1991.

ical economic reforms in 1991 but were caught in serious political crises the next year. In 1992 the democratic regime in Peru broke down, and the newly elected president assumed dictatorial powers. In Venezuela, President Andrés Perez and his orthodox economic reforms are under serious attack from all sectors of society. In Argentina, which—like Bolivia, Peru, and Brazil—experienced hyperinflation, the Cavallo Plan induced an exchange rate shock (the adoption of the exchange rate as a nominal anchor) in April 1991, which combined with strong fiscal adjustment and economic reforms to allow the economy to stabilize and resume growth. The overvaluation of the peso, however, threatens the program.

It is useful to mention that the governments of the Latin American countries—mainly Chile and Colombia, which have enjoyed positive economic outcomes—are far from following all of the neoliberal recipes. Chile's copper mines are still state-owned, and its public savings are around 10 percent of GDP. Colombia has executed few liberalizing reforms. Mexico was stabilized as a consequence of a heterodox shock and still firmly controls the prices of monopolistic sectors. In all of these countries the state, which is slowly being restored, plays a central role.

Brazil has long been trying to implement fiscal adjustment and economic reforms. Early in 1990 a frontal attack on inflation—the Collor Plan I—was undertaken but failed. In 1992, an orthodox and gradualist economic program monitored by the IMF pushed real interest rates to around 4 percent a month and led the economy into a deep recession without reducing inflation. The program only succeeded in keeping the inflation rate stable at a little above 20 percent a month. At the end of the year the president, who had been charged with corruption, was impeached. Until March 1994 the

new president, Itamar Franco, showed no capacity to face the chronic or inertial inflation, which is currently over 30 percent a month.[24]

The two approaches to the Latin American crisis—the neoliberal strategy and the social-democratic one—are compatible with two alternative strategies of stabilization and reform: a frontal attack on the fiscal crisis and inflation; or a gradual confidence-building strategy. Both strategies involve fiscal discipline, balance-of-payments equilibrium, and market-oriented economic reforms—particularly trade liberalization and privatization. Both are concerned with eliminating subsidies and administrative controls, correcting prices, stimulating internal and foreign competition, assuring efficient resource allocation, and reducing the size of the state.

Depending upon the seriousness of the fiscal crisis, a frontal attack strategy or a gradual confidence-building one is recommended. If the fiscal crisis has become hyperinflation and, in practical terms, the state is destroyed, the only alternative is a risky frontal attack on the fiscal crisis. If the economic situation has not deteriorated so greatly, a gradual confidence-building strategy is feasible.

By frontal attack I mean canceling internal public debt through monetary reform and reducing foreign public debt unilaterally or quasi-unilaterally to levels consistent with balance-of-payments and fiscal constraints. All countries that face hyperinflation must adopt some combination of these two measures. The problem is that this strategy is risky. If it fails, the ensuing situation will be even worse than the previous one. This is why a gradual confidence-building strategy is used when possible.

Bolivia, Peru, and Argentina—which had the worst fiscal crises among the Latin American countries, achieving hyperinflation—had no alternative except frontal attack. Brazil tried a frontal attack strategy in 1990, but it failed. The classical case of a confidence-building strategy was used in Mexico, although inflation there was also eliminated by a shock. However, in Mexico, as in Venezuela, the public debt was not canceled, and the fiscal adjustment was based on expenditure and wage reduction rather than on tax increases. A conventional Brady Plan was signed in August 1989, six months after the plan was announced by the U.S. secretary of the treasury. Public savings recovery, however, was very limited. Market-oriented structural reforms were undertaken fully—in other words, the costs of adjustment and of overcoming the fiscal crisis were imposed on the workers and the middle class. Local and foreign creditors were exempted from substantial debt reduction, and wealthy local people were exonerated from paying higher taxes. As a trade-off, confidence was restored among investors. Foreign investment and repatriation of capital started to take place.

The realistic alternative for Latin America lies somewhere in between a frontal attack and a confidence-building strategy. A pragmatic strategy recognizes: (1) the weight of the fiscal crisis; (2) the need for market-oriented

structural reforms and fiscal discipline; (3) the necessity of reducing internal and foreign public debt; (4) the hegemonic (and conservative) character of the United States in Latin America; and (5) the conflicting views of the Latin American elites, who are aware of the fiscal crisis but resist tackling it through fiscal discipline and debt reduction—including foreign debt reduction, given strong ties with the United States.

The national interests of the Latin American countries and of the United States have much in common. Clearly, the United States is more relevant to Latin America than Latin America is to the United States, but many opportunities are open to all of these countries if they are able to understand each other and manage their differences productively. Although U.S. economic hegemony was not limited to Latin America but extended all over the world, the possibilities for cooperation between the United States and Latin America were limited while that hegemony existed. At the moment, however, it seems this global hegemony has been ceded to Japan and Europe, and new possibilities for international alliances have emerged as a result (see Chapter 16). Conflicts between the United States or, more broadly, between the First World and Latin America may on some occasions have had a real or a factual basis. The debt crisis was one paradigmatic case; disputes over property rights may be another. But in most cases the national interests of the Latin American countries and the First World coincide. Yet in many cases ideological viewpoints and conflicting approaches to the problems and solutions to the Latin American crisis cloud these mutual interests.

The conflicting approaches I have analyzed here constitute a case in point. In practical terms, the crisis of the state approach to the origins of the crisis and the social-democratic or pragmatic approach to solving it are preferred by the Latin American countries. The First World, which in practice does not apply the neoliberal approach, uses it rhetorically as a standard recipe for Latin American problems. Yet as growth continues in Latin America in the 1990s, it will be the social-democratic approach—based on the European and the East Asian experience—rather than the Washington consensus that will prevail, if only because the neoliberal approach is an effective critique of the national-developmental and state-led strategies but not a practical or viable answer to Latin American problems.