

Washington Consensus or fiscal crisis of the state approach?

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University of Chicago, Department of Political Science, East-South Systems Transformations Project, Working Paper 6, January 1992. Available at <https://www.bresserpereira.org.br/824-washington-consensus-of-fiscal-crisis.pdf>.

This is the first version of the paper “**Economic reforms and economic growth: efficiency and politics in Latin America**” (1993). Capítulo do livro com Adam Przeworski e José María Maravall (1993) *Economic Reforms in New Democracies*. Slightly modified version of the Magna Class at the XVIII ANPEC’S Congress (National Association of Graduate Courses in Economics), Brasília, December 4, 1990.

Latin America faced in the 1980s the worst economic crisis of its history – a crisis defined by stagnation and high rates of inflation. In the middle of this crisis, several countries turned to democracy and ever since then they have been striving to reform their economies. In the early 1990s, some countries began to overcome the crisis, but it is premature to say whether a new wave of growth is underway. In 1991 growth of the region was negative; for 1992, a modest GDP increment, inferior to population growth, is forecast by the multilateral agencies.

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

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

I am particularly indebted to Adam Przeworski and José Maria Maravall, that discussed this paper with me in depth.

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

Table 1: Macroeconomic variables in the 1980s

	1980	1985	1989	1990
GDP Growth (ind.)	100.0	102.3	111.6	111.5
GDP per capita (ind.)	100.0	92.3	92.6	90.6
Investment/GDP	23.2	16.2	16.0	15.6
Res. Transf./GD	-5.9	2.7	3.2	2.5
Debt/Exports	2.2	3.5	3.0	2.9

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

In this chapter I review the Latin American economic crisis as seen from the perspective of the two approaches. In the first two sections, the neoliberal approach to Latin American crisis - the "Washington consensus" - and the fiscal crisis approach are defined; in the third and fourth sections, I analyze the Latin America fiscal crisis and its origins; the fifth section distinguishes "market orientation" from "market coordination," the sixth section outlines the appropriate reforms.

In the conclusion, besides a summing up, I show that although the neoliberal and the fiscal crisis approaches coincide in several respects, the focus on the fiscal crisis of the state leads to a number of distinctive analysis and recommendations.¹ While the neoliberal approach attributes the economic crisis in Latin America to the existence of a state too big and too strong, the pragmatic approach acknowledges that the state grew too much but explains the crisis rather by the weakness of a state hampered by the fiscal crisis than by its excessive strength. The neoliberal approach, adopted by the policy-making capital of the world, paradoxically limits economic policy to a negative role: that of reducing the state apparatus. Moreover, it ignores an essential characteristic of Latin American inflation since the 1970s: its inertial character. As a consequence, stabilization programs that follow the orthodox approach, when they are not simply ineffective, tend to generate high costs and, once stabilization is achieved, growth

takes long to be resumed. This ineffectiveness is aggravated by the dependence of multilateral agencies upon the developed world and particularly the United States, whose interests not always coincide with those of Latin American countries; a dependence that became particularly clear in the soft approach to the debt crisis. In contrast, the pragmatic approach emphasizes the need (given by the gravity of the fiscal crisis) to reduce or cancel public debt and it stresses the importance of recovering public savings. As a pragmatic approach, it emphasizes policy making, discarding the pessimistic neoliberal view that state intervention is always promoted in the personal benefit of policy makers. It asserts the need for a broad and flexible development policy once stabilization is achieved: a strategy in which state coordination has a subsidiary but significant role and the national interest criterion replaces nationalism.²

The Washington Approach

The Washington approach to the Latin America crisis crystallized in the last ten years. John Williamson (1990) has recently published a paper in which he defined what he called "the Washington consensus" and, while the expression "consensus" may be too strong,³ it is quite clear that some kind of concordance on the Latin American crisis does exist in Washington and more broadly in the OECD countries.

The origins of this perspective are reasonably clear. Its roots rest in the collapse of the Keynesian consensus (Hicks, 1974; Bleaney, 1985) and in the crisis of development economics (Hirschman, 1979). It is marked by the rise of a new right - neoliberalism - which is represented in the domain of economics by the Austrian school (Hayek, Von Mises), the monetarists (Friedman), the new-classics (Lucas, Sargent), the free-traders (Krueger, Balassa) and by the public choice school (Buchanan, Olson, Tullock, Niskanen). These views, tempered by some degree of pragmatism, are espoused by multilateral agencies in Washington, the Fed, the U.S. Treasury, the finance ministries of G-7, and the chairmen of the most 20 important commercial banks.⁴ They form the "Washington consensus": the neoliberal approach that, having Washington as geographical origin, has a powerful influence over governments and elites in Latin America.

According to this approach, the causes for the Latin American economic crisis are basically two: (1) excessive state intervention, expressed in protectionism, over-regulation, and an oversized public sector and (2) economic populism, depicted as fiscal laxity, the unwillingness to eliminate the budget deficit.⁵ Following this assessment, economic reforms should in the short run combat economic populism and control the budget deficit, while in the medium run they should embrace a "market-oriented" strategy of growth, i.e., reduce state intervention, liberalize trade and promote exports.

In Williamson's (1990: 8-17) version, "the Washington consensus" comprises ten measures: (1) fiscal discipline should be imposed to eliminate the fiscal deficit, (2) priorities in state expenditures should be changed to eliminate

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

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

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

The Fiscal-Crisis or Pragmatic Approach

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

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

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

Since the onset of the debt crisis, the adjustment programs sponsored by Washington called for balancing budgets through both current expenditure and investment reductions. The alternative of eliminating the budget deficit through an increase in taxes and a reduction of the public debt received less attention.⁸ In practical terms, balance of payment and price adjustments are regarded as so important that the quality of fiscal adjustment is not taken into account. Fiscal adjustment that hurts investments is considered as good as the one that cuts current expenditures. Expenditure cuts are treated as superior to tax increases, ignoring that expenditure cuts will usually be regressive while tax increases can be a tool of income distribution.⁹ Debt reduction is systematically left aside as a last resource. And the idea that the recovery of public savings is an essential part of reforms is usually disregarded.

In contrast, the fiscal-crisis approach starts from the hypothesis that growth does not automatically resume after stabilization, either because stabilization is achieved at the cost of public investment or because reforms does not tackle the public savings question. This approach asserts that growth will only be resumed if stabilization and market-oriented reforms are complemented with the recovery of the public savings capacity and with policies that define a new strategic role for the state. For the fiscal crisis means not only that the state has no credit, being unable to finance its activities, but also that it had lost the capacity to invest and push forward long-run policies oriented to industrial, agricultural, and technological development. Once the fiscal crisis is overcome, public savings will have to be restored in order to finance a growth strategy.¹⁰

Table 2: Latin America: Per capita GDP growth and inflation in the 1980s. *See*

	GDP per capita			Inflation		
	1985-89	1989	1990	1985-89	1989	1990
Argentina	-2.1	-5.6	-1.8	468.6	4923.8	1344.4
Brazil	2.2	1.2	-5.9	489.4	2337.6	1585.2
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	2775.8	7649.7
Venezuela	-1.1	-10.1	3.2	32.5	81.0	36.5

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

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

The pragmatic approach supports trade liberalization, but not as a magic formula. As Collin Bradford Jr. (1991: 88) observes, the recent literature on development strategies presents two alternatives to achieving international competitiveness: (1) "structural reform of the national economy for domestic competitiveness which results in dynamic growth and increased exports" or (2) "trade reform for international competitiveness which allows the economy to respond to external demand". The last alternative is characteristic of the Washington approach. Its representatives enumerate several "pre-requisites for a successful outward-oriented strategy" (Krueger, 1985) but it is quite clear that the essential pre-requisite in their view is to liberalize trade and open the economy. The first alternative is preferable in the light of the pragmatic approach.¹¹ While trade liberalization alone may be an appropriate strategy for small countries like Singapore, Hong Kong, or Uruguay, for the large countries of Latin America, trade liberalization should be just one ingredient in a development strategy encompassing public savings, investments in education and in technology as well as export promotion. The import substitution strategy is over, having exhausted long time ago its potential. This strategy does not assure international competitiveness. But it makes little sense to believe that it is enough for the state to stabilize, to liberalize trade and to promote public education for growth to automatically resume. In the words of Bradford Jr.:

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 knowledge generation process both domestically through education, training, literacy, R&D support, and the like as well as the crucial absorption of technologies from abroad through open economic policies (1991: 93; parentheses mine).

The pragmatic approach should not be viewed as a rejection but as an alternative to the Washington consensus that shares many views. Both are opposed to the "national-populist" posture that still exists in Latin America, although with progressively less credibility and support.¹² The pragmatic approach accepts the need for reducing the size of the state, which grew exorbitantly in the last 50 years, and agrees that this expansion generated serious distortions since the state tended to be captured by the special interests of rent-seekers. It emphasizes, however, that the crisis of the Latin American state is due to the fiscal crisis, that weakened the state, and to the fact that the form of state intervention--import substitution strategy of industrialization--is exhausted. It does not accept the neoliberal axiom that says: "since state failures are worse than market failures, the solution is to reduce to a minimum state intervention." While state failures may be as bad as market failures, economic reforms and, more broadly, economic policies, represent an attempt to limit and overcome these failures. Sometimes reforms imply less state intervention, but at times more.

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

The neoliberal diagnosis of the origins of the Latin American crisis of the 1980s is historically inaccurate. This crisis cannot be attributed to solely to economic populism since populism always existed in Latin America. It cannot be ascribed to import substitution strategy, since for many years this strategy yielded excellent economic results. It cannot be attributed to the intrinsically erroneous character of state intervention, because during many years this intervention was successful. Latin American economic development between 1930 and 1980 would never have been so intense were it not for the active role of the state.

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

The concept of the fiscal crisis of the state should be clearly distinguished from mere fiscal laxity or budget deficit. The fiscal crisis is a structural phenomenon, rather than a short-run, circumstantial one. Persistent public deficits certainly engender a fiscal crisis, but once the deficits are eliminated, the country confronts a more serious problem. James O'Connor (1973) introduced the concept of fiscal crisis of the state,¹³ explaining this crisis by the increasing incapacity of the state to cope with the growing demands of several sectors of the economy and corresponding social groups.

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

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

Most characteristics of the fiscal crisis are self-explanatory. Yet I believe that it is important to stress the issue of insufficiency of public savings. Particularly in a developing country, this factor has a fundamental strategic role. Negative public savings tend to be a direct cause of low investment rates and the stagnation of per capita incomes. Public savings, SG, are equal to current revenue, T, less current expenditure, CG, where interests are included.¹⁴

$$SG = T - CG.$$

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

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

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

$$IG = SG + DG.$$

These distinctions are important. They are part of the standard national accounts system but with a shortcoming: state-owned enterprises are excluded from the calculation of public savings. Few economists include public savings

among their tools.¹⁵ Under of the fiscal and monetary adjustment approach adopted by the IMF, the stabilization literature refers almost exclusively to the public deficit. Yet to analyze the economy of any country, public savings are a concept at least as important as the concept of public deficit.

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

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

The Fiscal Crisis in Latin America

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

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

	Public Investment (% GDP) ⁽¹⁾		Public Savings (% GDP) ⁽¹⁾		Public Deficit (% GDP) ⁽²⁾	
	1980	1988	1980	1988	1980	1988
Argentina	8.9	7.9	2.3	-2.2	7.6	8.6
Brazil	2.4	3.0	1.1	-2.6	6.7	4.8

Bolivia	1.2	2.7	-6.7	-2.0	9.1	5.5
Chile	2.6	3.5	6.4	11.4	-5.4	0.5
Colombia	6.6	7.7	0.7	1.1	2.5	2.2
Mexico	9.6	4.4	1.5	-0.9	3.8	3.5
Peru	3.0	0.5	2.0	-3.6	3.9	7.6
Venezuela	1.3	3.2	7.3	-0.4	-4.0	8.6

(¹) Bolivia, Peru and Venezuela: only central government; Chile: central government, decentralized entities and municipalities; Brazil: state-owned enterprises not included. Argentina, Bolivia, Chile and Venezuela: public investment does not include capital transfers. (²) Bolivia: 80, only central government.

Source: Interamerican Development Bank: Economic and Social Progress in Latin America: 1990 Report. ECLA (Economic Commission for Latin America): Panorama Economico de America Latina 1990 and 1991. For the public deficit (PSBR) also Central Bank of Brazil and Bank of Mexico.

Governments in Latin America, which between the 1930s and the 1970s performed a major role in structuring the national interest and in promoting economic growth through the appropriation and utilization of forced public savings, were hurt by the fiscal crisis, and eventually immobilized. In Table 3 we selected eight Latin America countries. In spite of its deficiencies, Table 3 is quite clear on the fiscal crisis. In most countries public investment was kept at the level of early 1980s; in the cases of Mexico and Peru, it fell strongly. The data on public savings are impressive. In 1980, among the eight selected countries, only Bolivia presented negative public savings; in 1988 only Chile and Colombia (exactly the two countries that do not face a fiscal crisis) exhibited positive public savings. Public deficit was reduced in practically all countries, but it remains high. The only exception is Chile, which presents a surplus since the beginning of the decade. The deficit in Colombia is small. Mexico, which in this Table still shows a deficit, was finally able to control its public finances by achieving an extraordinarily high primary surplus.¹⁶

Table 4 presents some data related to the foreign accounts of the eight selected countries: debt/export ratio, debt/GDP ratio and interest burden of central government (external and internal).¹⁷ The Table clearly shows that the debt ratios remain very high, except for Colombia and Chile. In all countries the debt/export ratio deteriorated between 1980 and 1988. Transfers of real resources continue to be, on the average, very high. When they are small (Peru) or even negative (Venezuela, 1988), this may just denote a bad performance of the trade and real services balance and a significant current account deficit. Data relative to interest are not fully trustworthy. Interests paid by the Mexican central government seem to be excessive, but they are consistent with a primary surplus of 7 percent of GDP and a public deficit (PSBR) of 5 percent of GDP.

Table 4: Public external debt ratios in Latin America.
Selected countries.

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

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

Origins of the Fiscal Crisis

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

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

1), in their critique of the Washington consensus, observed that the Latin American crisis "did not originate in the weaknesses of the import substitution strategy but rather in the dynamics of the adjustment to the external shock that took place at the beginning of the 1980s. In fact, we consider that the principal constraints to growth today originate in the long-lasting features of the external and fiscal imbalances induced by the debt crisis that has still not reversed after ten years of adjustment." The three Argentinean economists underestimate the exhaustion of the import substitution strategy, but their definition of the origins and nature of the crisis is an excellent example of the fiscal crisis approach.

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

The inability to finance the state by taxes, particularly income taxes, is an essential feature of the Latin American countries that endure a fiscal crisis. Wealthy people do not pay taxes in Latin America. The tax burden tends to be systematically low, not only when compared with developed countries, but also with Asian countries with about the same level of development (Kagami, 1989). Tax systems tend systematically to be regressive in Latin America, as they are mostly based on indirect taxes.

The state in Latin America was originally financed by export taxes. In the second period, when rents from primary products exports were reduced, by indirect taxes and by taxes geared to the set up special investment funds. In the third period, in the 1970s, when these sources of revenue for the state were exhausted or demonstrated to be insufficient, foreign debt proved an easy alternative for financing the state. With the suspension of this source of financing, inflationary tax increased its role in financing the state. Income taxes always represented a minor fraction of tax collection.

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

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

The Appropriate Reforms

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

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

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

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

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

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

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

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

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

firms due to externalities, and asymmetry of information between suppliers and buyers.

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

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

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

Conclusion

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

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

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

Latin America is still immersed in economic crisis. Colombia, committed to fiscal discipline, was the only country to avoid the fiscal crisis. Two authoritarian governments, Chile and more recently Mexico, overcame or are overcoming it. But the transitional costs were very high. The Bolivian economy remains stabilized but did not resume growth. Venezuela engaged in a severe fiscal adjustment in 1989 and is so rich that it is resuming growth in spite of the limited debt reduction derived from the Brady Plan agreement on the foreign debt. Peru's and Argentina's crisis went so far and so deep, the hyperinflation episodes and the fall in income were so distressing, that at the present the costs of muddling through the crisis are higher than the costs of adjusting, including the costs of cancelling a part of the internal public debt. The Brazilian economy, much more powerful, in 1991 had not yet reached the point where crisis becomes unbearable to society. Most sectors of society still believed either that the transitional costs of fiscal adjustment were bigger than the costs of immobility, or that there exists some magic formula to avoid the transitional costs, or that these costs should and could be transferred to other sectors of the economy.

The neoliberal approach to the Latin American crisis involves international pressure. This pressure entails formal conditionalities on the part of the multilateral agencies and informal ones on the part of governments of the

advanced industrial countries and the international business community. I criticized this approach in several instances: because it does not acknowledge enough the gravity of the fiscal crisis, it compromises excessively with internal and foreign creditors, it does not provide for a reasonable burden sharing, it is based on a misguided assessment of the nature of inflation, its stabilization programs are too costly, and, most importantly, because even if succeeds in stabilizing, it does not offer effective strategies to recover public savings and promote the resumption of growth.

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

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

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

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

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¹ - On the fiscal character of the crisis, see also Jeffrey Sachs (1987), Bresser-Pereira (1987, 1988b), Fanelli and Frenkel (1989), and Reisen and Trotsenburg (1988).

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

³ - The "Washington approach" is the dominant approach in Washington and more broadly in the industrialized countries, but not necessarily a consensual one. Richard Feinberg, commenting Williamson's paper, left clear that, although there is a movement towards "a centrist consensus" in Washington, there are many doubts: "An example, the role of the state. We agreed that there should be some trimming and streamlining. But do we want the final product to be a sleek high performance Jaguar or a minimalist Yugo"? (1990: 22).

⁴ - In relation to the management of the foreign debt crisis this group forms what Susan George called "the system" (1988). This system is commanded by the Treasury, and has as basic arms the Fund and the Bank. The other finance ministers of G-7, on one side, and the chairmen of the more important international banks (around 20), on the other, complete the "system". In the early phase of the debt crisis, the Federal Reserve Bank, then governed by Paul Volcker, represented the U.S. government. Since the Baker Plan (1985), the influence of the Fed began to diminish, practically disappearing after Volcker left its governorship in 1987.

⁵ - Economic populism has some classical contributions: Canitrot (1975), O'Donnell (1977) and Diaz-Alejandro (1981). These papers plus recent contributions by Sachs (1988), Dornbusch and Edwards (1989), Eliana Cardoso and Ann Helwege (1990), and myself, alone (1988c) and with Fernando Dall'Acqua (1989), were put together in a book, *Populismo Econômico* (São Paulo: Editora Nobel, 1991).

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

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

Krugman, Pedro Malan, Persio Arida, Richard Feinberg, Roberto Frenkel, Rogério Werneck, Rudiger Dornbusch, Sebastian Edwards, Werner Baer and Yoshiaki Nakano.

⁸ - As notes in Table 3 inform, the criteria are not the same for all countries. For some countries state-owned enterprises are included, for others they are not.

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

¹⁰ - There is, obviously, an alternative: to finance growth with foreign savings, particularly with foreign direct investment. This is in part the route presently being followed by Mexico. Foreign investment and capital repatriation permitted Mexico to overcome stagnation and start economic recovery.

¹¹ - On the "pragmatic" aspect of the approach I am proposing, see my paper "A pragmatic approach to state intervention" (1990), where I analyze the pragmatic approach East and South-east Asian economists use to deal with their problems.

¹² - The populist and nationalist approach shuns off any type of adjustment, proposes that fiscal deficits and higher wages are functional in invigorating aggregate demand and growth, denies that state intervention was too high, and that the protectionist import substitution strategy is exhausted. The number of proponents of these ideas in Latin America was drastically reduced in recent years. The correspondent practices, however, continue to be widespread.

¹³ - There is a redundancy in this expression since a fiscal crisis is always a crisis of the state. "Financial crisis of the state" is an alternative expression with the same meaning. Fiscal crisis of the state, however, serves to stress that the state is in a crisis.

¹⁴ - This critique is originally due to Sachs (1987).

¹⁵ - We could exclude from current revenue and expenditure the state-owned enterprises. In such a case the simplest way to consider their savings (or dissavings) is to add to the identity the profits (savings) or deduct the losses (dissavings).

¹⁶ - I have no knowledge of any study of public savings in Latin American countries. As for Brazil, the information exists but, as everywhere, it excludes the state-owned enterprises. An economist who used the public savings concept in a pioneering way was Rogério Werneck (1987) in his study of the economy of the Brazilian state.

¹⁷ - These ratios, together with the data in Table 3, particularly the public savings ratio, are excellent indicators of the fiscal crisis. An additional and important information would be the total public indebtedness (internal and external, including state-owned enterprises), but I have not been able to find these data for the eight countries. The interest burden of central government gives an indication.