

# CEPAL

## Review

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UNITED NATIONS  
ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN

SANTIAGO, CHILE, DECEMBER 1990

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The following symbols are used in tables in the *Review*:

Three dots (...) indicate that data are not available or are not separately reported.

A dash (—) indicates that the amount is nil or negligible.

A blank space in a table means that the item in question is not applicable.

A minus sign (-) indicates a deficit or decrease, unless otherwise specified.

A point (.) is used to indicate decimals.

A slash (/) indicates a crop year or fiscal year, e.g., 1970/1971.

Use of a hyphen (-) between years, e.g., 1971-1973, indicates reference to the complete number of calendar years involved, including the beginning and end years.

Reference to "tons" mean metric tons, and to "dollars", United States dollars, unless otherwise stated.

Unless otherwise stated, references to annual rates of growth or variation signify compound annual rates.

Individual figures and percentages in tables do not necessarily add up to corresponding totals, because of rounding.

LC/G. 1642 - P
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December 1990
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UNITED NATIONS PUBLICATION
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ISSN 0251-2920
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ISBN 92-1-121168-9
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Printed in Chile

# CEPAL

## Review

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Santiago, Chile

Number 42

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## Adjusting power between the State and the market

*David Ibarra\**

The models that dominated economic science and policy in the first three decades of the post-war period have broken down and there are no consummate replacements. The outlook seems to be conservative. The late 1970s turned back the clock which was moving for two centuries in the direction of morally justifying State intervention intended to moderate or correct the social inequalities produced by market operations. Part I of this article explores these trends.

Today exceptional importance is given to economic efficiency and to liberalizing competition as a disciplinary incentive for producers and even for countries acquiring worldwide markets. Part II deals with these issues and part III examines, from the experience of the first world, how the Keynesian model is in decline.

Since the third-world nations do not usually produce universally accepted theses, changes in the models and ideologies of the North have to be assimilated a fortiori sooner or later. This normally generates discord of great importance between the dominant foreign doctrines and the reality of third-world countries. Part IV takes up this subject.

The clearest expressions of contemporary solutions for age-old tensions between the market and the State are found in the processes of opening to the exterior and privatization or deregulation. Parts V and VI study these questions.

The final part seeks to identify the justified demands for change in the styles of State intervention, with special reference to Latin America. Finally, some general conclusions are drawn.

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The author is grateful for the comments of José Alberro and Horacio Labastida, and for the able assistance of Teresa Durán.

## I

### The upward trend of State intervention

Explaining the ebb and flow of the theory, practice and ideology underlying the models of economic policy calls for a reference to history.

Modern institutions of production began by establishing liberalism as a form of economic organization. The British industrial revolution and Adam Smith created, explained and upgraded the market to the rank of supreme coordinator of the actions of the myriad of producers, intermediaries and consumers.

This gave rise to a sharp divide between the domain of politics and the domain of economics. For the first time economic power was privatized and a dichotomy arose between the State and the market, between private law and public law, between efficiency and equality. Hitherto, the social standing of each individual determined his position in production and economic power and political power were thus always united. For that reason, the State as a social institution was quite older than the market.

The ideological justification for this first and enormous truncation of the State's traditional power was the need to counterbalance despotism and the arbitrary passions of rulers (Hirschman, 1981). The political justification was the need to incorporate peacefully within the élite the nascent entrepreneurial groups; and the economic justification was the need to reorganize production and its institutions on foundations more consistent with the technological and institutional progress of the time.

From then on the pendulum began to swing in the opposite direction. Economic models, ideologies and especially social pressures led the State to recover some of its lost ground as a governing power. The unrestricted functioning of the market, although it facilitated capital formation and efficient production, rewarded only the winners of the competition. By so doing, it created social inequalities that were unsustainable over the long term and later proliferated monopolistic or oligopolistic forms of production which nullified many of the virtues of the classical model of competition. It gradually became clear that the market, with its unequal relations in the division of

labour and its formal equality among trading partners, was intrinsically unable to provide distributive equity (Bobbio, 1978). The idea of economic justice arose precisely at that time, advocating that ethical principles and the norms of social coexistence should prevail and regulate the market operations (Macpherson, 1987).<sup>1</sup>

With all its advantages, the economic organization of the market conceals the issues of the distribution of income and wealth and relegates them to a secondary level, giving primary emphasis to growth and accumulation. Thus, one of the key issues of any society does not receive due attention: the establishment of a community with goals not only for production, but also and inevitably, for distribution.

A free market leads to a concentration of economic power which becomes political power. For that reason, economic freedom ends up opposing the political equality and freedom increasingly demanded by social movements throughout the world. The dichotomy between private interest and public interest becomes obvious, especially during the phases of depression in the economic cycle, with their burden of social sacrifices which the market is incapable of correcting.

The market and democracy are disparate institutions; inspired by different values, they tug society in directions at times complementary, at other times the opposite, but always different.<sup>2</sup> Thus when dynamic tension threatens to tear the social fabric apart, political accommodations are usually made which bring into harmony –not logically but by consensus or imposition– goals as dissimilar as those of awarding the efficiency of the few while pursuing the equality of all (Ibarra, 1987).

<sup>1</sup> Strictly speaking, however, limits have always been placed on the legitimate action of the market, preventing it from being the only way for allocating resources, rewards or punishment. Transactions exist which are precluded from the changing sphere of commerce. Bribery, selling votes or government jobs, and simony violate the social rule that puts them outside the jurisdiction of the market.

<sup>2</sup> There are even important conceptual differences in the content they give to the term "freedom". Democracy understands freedom to be the capacity of a society's members to set norms for themselves with full autonomy. For the market, on the contrary, freedom means enjoying a sphere of action without State control. Consequently, the "liberal State" is where government interference is limited to a bare minimum. And the "democratic State" is where the organs of self-government are numerous (Bobbio, 1985, p. 197).

From the time of the British industrial revolution until slightly more than a decade ago, those axiological oppositions gave rise to a succession of reforms, all having as the common denominator an increase in State intervention and in legal norms so as to correct or compensate for the socially polarizing effects of the market.

Likewise, democracy, in its modern sense of granting equal rights to the whole population, is the result and the guarantee of the social struggle for equality, by attenuating the disparities resulting from the inevitable Darwinism of the economic organization of the market. The advanced Western countries were first organized as liberal societies and only very much later as democratic societies. Indeed, universal suffrage and civil rights for the whole population is a recent phenomenon. Previously the electorate consisted of privileged exclusive groups, to whom Governments had to answer for their administration.

For almost two centuries the evolution of labour legislation and controls over private activity or public expenditures faithfully reflected the results of the confrontation between the logic of the market and the logic of democracy. The public sectors of the different countries grew *pari passu* with the increase of the State's responsibilities in economic life, i.e., with repoliticization of the economy. Controls and protective labour laws, progressive taxes, antitrust provisions and the welfare State's complex of institutions were all established in response to the inequalities of distribution arising from free markets. Later, maintaining external equilibrium, the fight against inflation, anti-cyclical stabilization and the goal of full employment led the State to assume the function of administering the economy within stable paths of prosperity.

Reflecting the cultural and ideological climate dominant in the world during a good part of the present century, the developing nations followed interventionist trends. They added, however, a new dimension –this time taken from the planning experience of the socialist countries and the countries who rebuilt after the Second World War II– deliberate government involvement in production in order to overcome backwardness and poverty. That made an important difference: instead of placing controls on private activity or creating social-welfare institutions, public intervention in Latin America was guided, in almost all cases, into starting up directly

productive enterprises. More than a welfare State, there was a State concerned with encouraging, but also replacing normally weak private entrepreneurs.

It is not surprising, then, that public expenditure during the present century rose from 10% to 40-60% of the domestic product of the industrialized nations and reached the range of 30-50% in the Latin American countries. Long gone were the days when Governments accepted no responsibility whatsoever for the lot of the poor, for compensating for the economic cycle, for generating growth, when material wealth was socially admired rather than resented (DeJasay, 1985). The State became the *locus* where

the demands frequently found in different interest groups were not only settled but also met, and where the balance between the values of democracy and the market had to be determined.

The interventionist cycle—or the cycle of market regression—did not come to an end until the last decade, when formulations that had been brewing for a long time in some countries of the first world sprang to the fore and when many Latin American countries, having reached intermediate levels of industrial progress, were witnessing increasingly more serious struggles between stronger entrepreneurial classes and the traditional instigator State.

## II

### Economic models

On the level of ideas, economic liberalism, soon after it became the dominant model, had to face criticism, resist dissident doctrines and assimilate reforms dictated by the change of events or the evolution of theoretical thought.

Economists cannot claim to be innocent of participation in the turmoil of concepts concerning the roles of the State and the market. Leaving out schismatics and backsliders, the dominant ideological currents greatly influenced tremendous changes in public opinion. Analysis of the market's defects, monopoly, unfair competition and later, non-essentials, technically justified a broad range of government regulations. In the macroeconomic sector, the elimination of chronic unemployment, compounded fluctuations, or price and exchange-rate volatility removed any scruples about State management of the economy. In some cases the contribution of economic thought was a critique of market functioning—with proposed remedies; in other cases, ideological currents that had already become strong in political theses and practices were simply incorporated.

Today the critique is at the other extreme. Economists have stopped pointing out the faults of the market in order to dedicate themselves to identifying the faults of State intervention. They have been equally successful in this new terrain. Bureaucratism and bureaucratic power, excessive regulation, the lack of initiative, waste, welfare-State paternalism, abusive tax burdens, and the proliferation of parastatal enterprises are some of the

issues that have awakened the interest of economic scientists.

Once more the third world is following those trends in their dual aspect of economic doctrine and political ideology. The reason is simple: those nations do not, on their own, usually generate formulations with an appreciable degree of universality. The phenomenon of dependence is more patent in cultural, scientific and technical subordination than in economic relations, and a state of development is not always congruent with sociopolitical models, which usually unite or "harmonize", without vast gaps, the reality and culture of advanced countries.

For all the correspondence existing between world ideological movements and the specific circumstances of the third world, there is always some historical inconsistency. It is true that the ideas of political and economic liberalism gave enormous impetus to the modernization of Latin American societies in the last century. But it is also certain that they helped to accentuate or leave aside some very important socio-economic problems, such as the concentration of land or genuine democratization of governmental systems.

There was no flagrant inconsistency between the conditions in Latin America and the Keynesian model; actually they were rather complementary. Without fully reintegrating the economy into the domain of politics, the idea of placing the management of large economic complexes under public tutelage made it possible to form a social consensus that brought widespread benefits with it.

The State took over part of the role of the "invisible hand" in trying to resolve the cycles of prosperity and depression which escaped the powers of the market. Workers and the middle class benefited from guaranteed full employment in the present and greater future participation in the benefits of material progress. The stability of demand supported the generation of profits and multiplied the investment opportunities of private enterprise (Ibarra, 1987).

More than 30 years of world prosperity after the Second World War bear testimony to the efficacy of the Keynesian political consensus. Under its aegis the goal of full employment in the advanced countries could become, with no ideological contradiction, the growth objective of the third world, initiated and given impetus by State intervention. Thus Latin America undertook changes of tremendous magnitude, promoting industrialization, encouraging urbanization or forming middle-class strata. Moreover, the sustained expansion of world markets benefited Latin American foreign trade with unusual intensity, in spite of the import-substitution strategies.

Prosperity, however, had its costs and gave rise to new problems. Note how the banner of employment and growth, precisely because of their efficiency in harmonizing interests and concentrating social energies into a small group of issues, eliminated the reformist nucleus of democratic thought from public debate and the action of political parties. Indeed, by making economic development the central objective of the State's action and by becoming its main source of legitimation, the modernization of political systems was ignored. Thus, with very few exceptions, during the period of the greatest economic boom *the three decades following the Second World War* authoritarianism, *coups d'état*, the violation of human and civil rights were all frequent symptoms of a prolonged political crisis still in search of a stable solution in Latin America.

The Keynesian arrangement began to fall apart in the 1970s, owing to a complex combination of causes –which we can only briefly outline here– in the industrial countries. Fiscal equilibria broke down under the triple onslaught of the demands of the welfare State, support for private capital formation, and military expenditures. The rise of new industrial centres exacerbated worldwide market competition, transnationalized production and intensified technological change. Resources for meeting commitments to social justice began to thin out, owing to the community's resistance to tax increases,

and the fact that they had to compete with demands of higher political priority: military expenditures and those related to remaining in the vanguard of international economic competition. Moreover, where it was still in effect, the out-of-date post-war model made the inflationary and payment imbalances even worse, as happened in the United States when it tried to finance simultaneously the war in Vietnam and President Johnson's Great Society project.

Anglo-Saxon political analysis of those same phenomena emphasizes the presence of inflationary expectations, fed by the mass media, political parties and the proliferation of interest groups. Social demands mounting at an explosive rate outstripped the economic and administrative capacity of the State. That, along with the influence of intellectuals –creators of an adversary culture– weakened the popular will to obey or made societies more and more ungovernable (Steinfels, 1979; Crozier *et al.*, 1975; Bell, 1976).

Faced with these changed circumstances and attitudes, a new model gradually took shape, with values shared by neo-liberals and neo-conservatives, based on many of the following theses.

a) Strengthening the market as the proper mechanism for allocating resources efficiently and for absorbing the activities that overwhelm State administration. To the extent that it ceases to participate or intervene in the economy, the State will be able to elude more easily the demands of different interest groups which jeopardize the political legitimacy of the State when their demands are heard less and less. Where excessive demands doom many government programmes to failure, the public authorities should protect themselves by dispersing the responsibility for deficiencies as much as possible (Steinfels, 1974, p. 64).

b) Defending the traditional principle of equal opportunities, but rejecting the equalization of social or economic conditions (of income or results) as dangerous for freedom. The welfare State is not repudiated entirely, but it is restricted to providing services and security with a minimum of interference in private affairs, and to not ruining the incentives for investment and work. The past expansion of public activity is proof not of a Government's strength but rather of its and the political leaders' weakness in not rejecting irrelevant demands from different social groups (Crozier, 1975, p. 164; Kristol, 1981).

c) The rescheduling of social priorities in the agenda of government action: in the economic sector, employment or growth loses ground as dominant

policy objectives. Prior to them, price stability has to be ensured, incentives for investment and international competitive efficiency have to be re-established, and other so-called structural adjustments have to be made.

Unlike the Keynesian model (which sought to make the widespread distribution of benefits the basis of consensual agreement), the new approach seeks to underpin the working of the economy, by revitalizing profits and private capital formation, i.e., by submitting to the discipline of the market—without cushioning by the State—the rest of the productive agents and, of course, workers and consumers. In the long run, more investment and the absorption of technological improvements will raise productivity and facilitate growth, while simplifying the jurisdictional purview of the State will prevent the reappearance of excessive demands.

From a political viewpoint, it is a question of increasing the power and influence of entrepreneurial groups *vis-à-vis* other segments of society, in order to ensure international survival and reopen the road to or the hope for sustained prosperity.

Without a doubt, the new models reflect not only the state of economic sciences but also the circumstances and political climate of the leading countries of the industrialized world, seeking how to steer their changing societies or solve their problems. The proliferation of interest groups may complicate government action, making it necessary to erect barriers to "excessive participation" and to the pressure these groups exert on the budget and work-load of the public sector. It is also possible that the increase in the trade unions' negotiating power may have obstructed the mechanics of the market. Furthermore, the subsequent advance of the welfare State would probably have required tax increases or profits lowered beyond limits acceptable, in one case, to taxpayers and, in the other, to the business community. In its turn, the internationalization of economies limits the benefits that can be redistributed in favour of workers or the population at large, and even forces these benefits to be reduced so as to avoid losing the struggle for competitiveness, except where those costs are offset by improved productivity. Hence the pressures of the world-wide race for technological change.

Whatever the reasons may be for the shifting of models in the first world, the reality thereof obliges the developing nations to adjust to a new kind of

historical discord between their reality and the dominant economic doctrines. Assimilating that discord will require in many cases enormous efforts and sacrifices, in the political sphere as well as in economic relations. In Latin America, more power has to be given to private entrepreneurs, despite the fact that democratization would rather call for increasing the participation of groups now only partially incorporated into modern life. The satisfaction of social demands has to be delayed even further, when the welfare State is still in an embryonic stage of development. Linkages to the exterior have to be strengthened when, in many cases, national identities are not yet consolidated. State intervention in production has to stop, when the enormous task of fully changing the direction and style of development is still under way. Political legitimization has to be sought in fields other than employment and growth. And furthermore, all the foregoing has to be achieved while protecting and coordinating in some way present trends, paradoxically inclined towards democracy and the modernization of political regimes.

Reforms and readaptations in the strictly economic sector are not any less demanding. First, a higher priority is given to achieving price stability and the balance of payments than to expanding production. Second, protectionism has to be fought against; the structure of relative prices has to be changed in favour of exporters; wage hikes have to be held below inflation rates; legal systems favouring foreign investment have to be established, to the point of making external demand the driving force of economic growth. Third, the severest fiscal discipline must be applied and sustained at all costs—mainly by reducing expenditures and investments, although also by raising the prices of public goods and services and increasing indirect taxation—while progressive taxes are lowered; State intervention must be reduced and public enterprises privatized or closed, until the market provides the impetus for development through private investment.

It is essentially a question of rapidly and radically changing the previous pattern of economic development. Private enterprise would exercise leadership instead of governance. The domestic market, which hitherto gave impetus and guidance to the development process, would have to be replaced by demand from international markets. At the same time, the rapid pace of change in the international



economy multiplies the discrepancies to be overcome and the adjustments to be made in Latin American export structures, making productive reconversion and incorporation into the world-wide technological revolution requisites for survival in external competition.

In short, an extraordinary number of demands for reform is accumulating from both inside and outside the social systems of Latin America. Tensions overload government decision-making processes, obstruct the functioning of the economies and test the very resilience of political systems. Transferring responsibility for development to the market and the private sector demands major cultural changes. One such change consists of accepting trends in income distribution which would go against the sense of justice and equality as democratic values. Another change implies instilling in the business community a spirit of solidarity in the exercise of national responsibility, to the extent that economic power, unprecedented in this century, is placed in their hands.

"Not all the general goals of a nation are intrinsically compatible with any prevalent social order whatsoever. Whenever a conflict arises, we are obliged to choose between abandoning either the goal or the present order; if we choose the latter, we run the risk of using means which could defeat the end being pursued" (Lowe, 1987, p. 19). Such is the basic dilemma, the historical inconsistency of inserting oneself *a fortiori* into an international community where the standard view of the world is different in important aspects from the reality of the state of development, history and institutions of the Latin American nations. Certainly, if a disposition exists to impose the changes regardless of social costs, or if there is an overwhelming avalanche of world geopolitical forces, then any development pattern becomes possible, even if it is abhorrent to political democracy. That is what happened with the colonial model imposed by the conquest of Latin America, which destroyed the native economic systems and caused the downfall of the indigenous population in the sixteenth century.

### III

#### Changes in economic policy

The circumstances described above are reflected directly in the radical change of approaches to economic policy. Not only are social objectives changed and narrowed, but other means are also chosen to meet them, while goals and instruments interchange positions.

Real growth of production and employment are no longer the basic and direct purpose of policies in the industrialized countries. The new economic models consider growth to be a by-product of the functioning of markets. Consequently, what is now essential is to eliminate obstacles, guarantee economic freedom and give productive agents the freedom to develop their activities.

If the welfare State is to be limited domestically, the objectives of aid to third-world development are likewise changed. The industrialized nations become more protectionist, while financing on soft terms granted to the periphery stagnates or is reduced. Moreover, the problem of the Latin American debt, which drains resources essential for development, continues unabated. Long gone are the days of

Truman's Point IV programme or Kennedy's Alliance for Progress.

In this context, more emphasis is given to controlling inflation than to fighting against unemployment. The desire to gain credibility on the anti-inflationary front leads Governments to remain unmoved in the face of increased unemployment, which reach figures of 7% to 11% during the past decade in most of the industrialized economies. Thus in some cases, fiscal policy no longer makes up for fluctuations of supply and employment in order to set ceilings to the expansion of nominal demand, for the purpose of counteracting expansionary impulses that feed inflation. And, in other cases, recognition of the inconveniences and limitations of manipulating aggregate demand by fiscal policy puts an end to old-style government activism.<sup>3</sup> To a large extent, the high degree of economic interdependence and

<sup>3</sup> Even in the United States, where little has been done to eliminate fiscal deficits, the Gramm-Rudman-Hollings Act establishes objectives formally necessary for correcting those imbalances over time (Cloud, 1989).

particularly the very rapid integration of financial markets have been diminishing the autonomy of national policies, especially those that potentially claim to adhere to fiscal activism typical of the 1960s (Sachs, Warwick and McKibbin, 1988; Volker *et al.*, 1987; Polak, 1988; Fisher, 1987).

By eclipsing the Keynesian model, monetarism comes to occupy a pre-eminent place among government policies. On the one hand, although temporarily, it substitutes for fiscal policy as the principal means for maintaining the channel and flow of the economy's nominal demand, abandoning its traditional function of regulating exchange rates (Williamson and Miller, 1987). On the other hand, the expansion of a monetary aggregate becomes the supreme goal of economic policy by taking it to be determinant, or at least univocally linked to the rate of expansion of nominal aggregate demand.

Economistic reduction of social goals reaches its most complete expression when the regulation of the money in circulation either alone or together with financial time-deposits becomes the social goal *par excellence*. The nineteenth century values of spreading and enhancing political freedoms and individual rights and the twentieth century values of full employment, growth and social rights are thus laid to rest. Is it any wonder that economic policy is losing its popular legitimating force in our time?

In relation to managing the balance of payments immediately after the Bretton Woods system (1972) was abandoned, exchange-rate stability ceased to be an objective of economic policy and became an instrument to adjust the effects of monetary policy. Indeed, when the expansion of a monetary aggregate was raised to the category of a goal, floating exchange rates had to be adopted as a means to eliminate the balance-of-payments deficit.

However, in the face of the resulting violent fluctuations in parities and interest rates, monetarist absolutism soon had to pull in its reins. Today, monetarist policy, according to some, should recover the function of limiting the swings in the exchange rate and help to control aggregate demand. In that way exchange-rate movements would cease to validate the domestic inflation of countries, forcing them to use other economic-policy instruments to control inflation instead of simply adapting to it. There are also those who reject the idea of using nominal anchors for stabilizing exchange rates as a guideline for monetary policy, in so far as they think that international trade is determined by the real magnitude of transactions.

The controversy remains unresolved. In practice, however, the industrialized countries' central banks have taken an intermediate road: without setting precise goals for stabilizing exchange rates, they have tried to bring exchange markets and interest rates to order through *ad hoc* intervention, with ample coordination between countries, which should also produce stability in the international financial system.

On the other hand, the centres unanimously agree that income policies—the consensual or forced management of the wages of certain productive agents—should be eliminated as an instrument for fighting inflation. The perception is that the use of income policies could create a lack of flexibility in the medium and long term by politicizing the economy and reducing the free market's area of influence.

Important changes are also taking place at the micro-economic level. The most significant structural change is designed to intensify competition in the market-place and reduce the State's share in value added. The deregulation of economic activity, including the financial sector, the privatization of State enterprises, the benign fiscal treatment of profits and reinvestment, and the reduction of the trade unions' power are all part of a set of measures that seek to increase efficiency, lower costs and reinforce incentives for private-capital formation.

These are the main elements of the structural reform put into effect in the early 1980s with different ranges and results in the industrialized countries, as the way to encourage production and producers, without recurring to the fiscal stimuli of demand that were so important in the Keynesian model.

In general, the main doctrinal trends in vogue downgrade government action to guide development, raise growth rates or provide employment for the work-force. Monetarists hold that Governments cannot effectively fight the ups and downs of the economic cycle. Increasing either expenditures or the money supply can perhaps cause the economy to grow momentarily, but that effect passes and a longer-lasting inflation is left behind.<sup>4</sup> The school of rational expectations is even more pessimistic. Indeed, it holds that economic actors, when they have

<sup>4</sup> Hence the recommendation that central banks should abide by a rule of steady expansion of the money supply in order to achieve price stability and thereby ensure a favourable investment climate on which long-term development depends (Friedman, 1968).

complete economic information, anticipate changes of government policies, thus cancelling their effects. Therefore Governments cannot change the course of the economy, except when they enact unexpected measures, but that can hardly be repeated without the productive agents foreseeing it. Fiscal and monetary policies, then, are barely strong enough to determine some short-term fluctuations in a long-term trend difficult to alter by deliberate government action (Lucas, 1972; Sargent and Wallace, 1983). Only the supply-side current, already on the wane, attributes a certain efficiency to economic policy for promoting capital formation, thereby making higher rates of development feasible. But those results depend on fiscal policy cutting welfare-State expenditures and increasing fiscal incentives for investment and saving, along with eliminating regulations and privatizing public activities (Gilder, 1968; Raboy, 1982).

In a nutshell, the dominant views are that government action is of little relevance as regards shaping economic phenomena and meeting the objectives of employment, growth and equity. And when they do admit more influence, they make it depend on the possibility of more generous compensation for the contribution of investors and savers *vis-à-vis* the rest of the population.

Economic policy is no longer actively promoting employment and growth or pursuing the correlative goal of an increasingly more equalizing distribution of income. To a large extent, employment, real growth and national income distribution are adjustment variables, i.e., they adjust *ex professo* when the higher objectives of price stability or competition in international markets are attained.

Therefore the elimination of income policies (price and wage controls) is relevant to the new model concerned with lowering costs and moving relative prices in favour of capital and exports, as well as reducing the negotiating power of trade unions. Also relevant is a fiscal policy less inclined to correct cyclical fluctuations and more interested in changing relative prices and the allocation of resources over the long term.

The metamorphosis of economic policies, with their objectives and instruments, is also the cause and effect of highly important cultural changes. Economic well-being, i.e., development as the social goal *par excellence*, is beginning to be less important than improvement of the quality of life of the populations

in the advanced nations.<sup>5</sup> That is a result of the interaction of many social phenomena. High indices of material security and well-being enjoyed by first-world countries from the beginning of the post-war period, the ageing of their populations and recognition of the ecological limits of the planet are some of the many factors that explain the change over the long term in the value systems of the industrialized West, not to refer again to other factors of an economic nature (Inglehart, 1977).

Even so, the doctrinal pendulum would seem to be about to swing timidly back towards theses that allow the State a more active role in economic affairs. At least some areas of possible agreement are beginning to take shape, where disparities between facts and theory are examined in a fresh and eclectic way, over-restrictive presuppositions are abandoned, and a more rigorous basis for some economic conclusions is sought.

Of course the Keynesian belief in fine-tuning the economy or creating full employment through the easy expedient of a massive injection of public expenditures is disappearing. Also on the wane are monetarist approaches which claimed to solve problems of stability and even growth with fundamental and automatic rules for expanding the money supply. In contrast, there is agreement about the importance of the formation of expectations in determining the behaviour of economies, the presence of markets in structural disequilibrium or where open competition is not dominant, as well as the imperative need to provide much sounder micro-economic bases for macroeconomic designs. Even though a consensus is still lacking, some venture the opinion that the ingredients of a new neo-classical synthesis are beginning to take shape. State administration of the economy<sup>6</sup> is combined with economic freedom at the micro-economic level, with incentives for employment and production and the removal of labour-market rigidities. The restriction placed on the

<sup>5</sup> In the United States, Japan and Europe, investment and saving have been declining in relation to the product since the 1970s. Those highly significant behavioural changes in the economic agents and families probably explain a good part of the drop in development rates in the first world over the last 20 years (Agheveli *et al.*, 1990, and Bosworth, 1990).

<sup>6</sup> Macroeconomic management implies guiding not only the levels of aggregate demand through fiscal and monetary instruments, but also the relative price structure of important variables, such as wages, exchange rates and interest rates.

autonomy of national policies by international interdependence is supposed to be solved by the industrialized countries coordinating their actions as a way of administering the world economy (Malinvaud, 1977; Friedman, 1985; Fisher, 1988; Dornbusch, 1990).<sup>7</sup> With regard to development, the superiority of competition is maintained, but import-substitution practices or deliberate policies for the promotion of industry and trade are no longer completely condemned, nor are they condemned with the same unanimity.<sup>8</sup>

The new paths opened up by contemporary economic thought and empirical analysis lead to more considered and cautious, less ambitious and assertive positions about the contribution of economic theory to achieving goals and formulating government strategies. Of course, the doctrinal crisis of economic science is hardly over and a new model is a long way off. Nevertheless, partial advances and the will to revise dogmas and admit different policy-setting viewpoints are beginning to provide interesting and practical theoretical contributions.

#### IV

### The models as seen from Latin America

In Latin America, the new macroeconomics' lack of confidence in non-market solutions and the pressures of the economic crisis *expressed in severe disequilibria in budgets, prices and payments* have led to pre-eminence being given to short-term stabilization policies. The preferred instruments are fiscal adjustment and monetary restrictions, except in some countries where hyper-inflation made it necessary to use income policies. Moreover, the new models have become even stronger by being promoted simultaneously by the international financial institutions, bilateral aid agencies of the industrialized countries, and commercial banks. The resulting overlapping conditionality was beyond the resistance of Governments weakened by a severe lack of foreign exchange and resources.

Exchange policy, ever since the use of floating rates became widespread, has been used mainly as a valve for adjusting everything from the export sector to inflation. Efforts to stabilize exchange rates have generally been frustrated because of the extraordinary size of the disequilibria in payments and prices. The interruption of credit flows from international banks and the net transfer of saving to other countries either as debt service or capital flight directly destabilize exchange markets and public finance. Other factors are the immediate effects of opening economies to other countries, which will be discussed below.

Consequently, balance-of-payments adjustments have been mostly recessive, by having to be based on cutting down imports, given the longer period needed to increase exportable supply and the unusual size of the deficit on current account. Paradoxically, despite all the efforts to open economies, they are in fact closing.<sup>9</sup>

Fiscal policy has had to concentrate on eliminating budget deficits and seeking domestic sources to finance them, owing to the lack of external resources. The biggest spending cuts are in State investment and social services. Except for public-service rates or prices for goods produced by parastatal agencies, reform efforts on the side of government revenues have generally been minor or their effects have been largely counteracted by the drop in growth rates of production.

<sup>7</sup> It is easy to infer from the above that the return to Keynesianism is not only more cautious but also follows more conservative concepts regarding the welfare State. The liberalization of labour markets is seen as a necessary condition for reducing unemployment –beyond the natural rate– and achieving macroeconomic stability; the distributive effects of this liberalization are either ignored or considered a lesser evil.

<sup>8</sup> The prudence of recent theoretical approaches leads to the statement that protection should not exceed comparatively low limits or that the more complex the systems of State intervention, the greater the risks of falling into accumulative errors and inviting the frequently distortional action of pressure groups (Krugman, 1987). But, at the same time, they admit that when the unrealistic supposition of perfect competition in many international markets is no longer accepted, government intervention in favour of national enterprises may lead to better results (Helpman and Krugman, 1989; Levy and Nolan, 1989; Pompet, 1988).

<sup>9</sup> In relation to the product, Latin America's imports have fallen from 15.6% in the period 1976-1980 to 11.6% from 1985 to 1988.

Thus fiscal adjustment has also had strongly recessive results, in so far as it blocks public-capital formation to a large extent, and also by demanding that national bank resources be preferably channelled to financing budget deficits, making credit for private enterprise less available and more expensive. Many social demands have been eliminated, as witnessed by the cuts in social expenditures, investments and real salaries of civil servants. Despite this, other social demands have arisen and perpetuate the fiscal deficit. The conversion of private external debt into sovereign risk,<sup>10</sup> the large-scale transfer of Latin American savings to other countries and the high interest rates paid to citizens who bought government securities constitute expenditure items which normally represent 30% to 60% of central governments' budgets.

With very few exceptions, the inertia of external and domestic debt service, the decline in growth, as well as other restrictive factors in each country, have postponed or rendered impossible the goal of full fiscal adjustment. The same is true for the balance of payments, owing to the fact that the reconstruction of export sectors has been slow because of the natural inflexibility in transferring resources from one sector to another, especially when the process of physical and human capital formation is weak.

There seems to be more consolidation with respect to distribution, since the weight of the adjustment fell asymmetrically on certain social sectors. In almost all the countries there has been a decline in real wages –and their percentage of the product–, employment, and public outlays for social well-being, while rates for public services have risen and subsidies for mass consumption declined. Wage sacrifices have been relevant for raising interest rates and for changing relative prices in favour of so-called "marketable products". They have also been relevant for allocating the real income losses related to the deterioration of the terms of trade and the transfer abroad of savings.

Lower wages, apart from having social and political repercussions, have in some countries generated successive waves of impoverishment. The lower buying power of most of the population weakens market demand. Idle installed capacity raises unit costs, while the structure of demand is separated from the less flexible structure of supply. In these circumstances, either because of inflation in the costs of mass-consumption industries or because of excessive demand in industries that serve upper-class consumers, price and payment imbalances are worsened. This creates a need to reinforce measures for restricting demand which lead to repetitive cycles of depression.

The same sequence of events and policies weakens the capital formation process, i.e., it postpones indispensable structural adjustment on the supply side. The activities most affected are precisely those that are not consolidated. Indeed, new activities are usually the easiest to remove –no created interests are hurt– and they run greater risks despite having higher priority in long-term economic change. For example, solving the payments bottleneck mainly means increasing export capacity, and that implies investing in increasing or diversifying production, in improving the physical infrastructure –transport, communications, ports, storage facilities– and in creating support services –marketing, financing, insurance, computer services, technology and training.

The theses in vogue concerning structural change look to the market for solutions. A low, uniform and gradually descending import tariff and exchange policy as an instrument for balancing external accounts are two of the main procedures for changing relative prices in favour of marketable goods.

Without denying the suitability of the goals of the approach described above, it has often been too general actually to increase exports; in other cases, it has proved insufficient for breaking supply bottlenecks, and perhaps in still others –the successful cases– high social costs had to be paid.

Without a doubt, changing the relative price structure is the prerequisite for attracting entrepreneurial activity towards the export sector. Even so, given the congenital limitation of third-world resources, it is difficult to undertake the immediate manufacture of a broad range of new products for international markets with a good chance of succeeding. Likewise, the effective competitiveness of the developing countries is

<sup>10</sup> In 1982, the external public debt was half of Latin America's foreign debt. By 1985, it had reached 70% (ECLAC, 1990b).

determined not only by production costs but also by a series of deficiencies in infrastructure, managerial capacity and support services. In order to remove these obstacles, public investment programmes must effectively promote export trade, and *ad hoc* industrial policy measures must be taken to allow for the manufacture and marketing of specific goods that can enhance dynamic comparative advantages.

Changing Latin America's external trade basically implies replacing the decisive role of exports that make intensive use of natural resources or labour with exports less vulnerable to decreasing yields and the inelasticities of world demand. It should be noted that vanguard activities in external trade –pharmaceutical, petrochemical, synthetic fibres, ceramics, computer and communications equipment, software, transport equipment– make intensive use of know-how and usually enjoy increasing yields.

These two characteristics, together with the fact that many markets are oligopolistic, invalidate the full applicability of the analytical model of the free-competition market. Different policy models have to be used, where State promotion and intervention can be appropriate (Helpman and Krugman, 1989; Brian, 1989; Gilroy, 1989; Levy and Nolan, 1989; ECLAC, 1990a). Efforts should be concentrated, therefore, on selectively identifying the nuclei of specialization in dynamic activities, and then do the same with respect to government support for technology, financing and insertion into external markets.

In other words, in addition to general policies for creating a macroeconomic framework conducive to structural change, micro-economic policies must be implemented to meet specific objectives where greater development potential is thought to be found and where public and private efforts can work together. Limited resources, imperfect or non-existent markets, and restrictions attaching to stabilization programmes render utopian the simultaneous attempt to achieve productive excellence in a multitude of activities and products.

Without question, the more rapidly and radically protectionist measures are dismantled, the more the change in relative prices will benefit producers of marketable goods. But that in itself does not shorten the turnaround time of investments nor the delays in transferring resources between sectors. On the other hand, the faster the process of opening the economy, the more severe the loss of jobs and production, and the greater the immediate disequilibria in payments.

When it is a matter of expanding, changing or diversifying production, demand can adjust much more rapidly than supply. There are also demands which macroeconomic policies cannot meet, when it is a question of specifically promoting particular activities, creating new comparative advantages or attaining productive excellence in specific areas of specialization. And there are conflicts or trade-offs between the objectives of stabilization, structural change and distributive equity, which oblige choosing combinations of them, knowing that they will have to be reflected in the costs of one or the other.

If the goal is to reduce social sacrifices and the time needed to consolidate complex processes of stabilization and adjustment, the macroeconomic strategies will have to be accompanied by specific industrial policies; to lower the sights on stabilization efforts at times in order to facilitate an orderly change in supply capacity; and to accept the need to complement purely market solutions with State intervention, be it to give incentives to priority activities or to ensure minimums of distributive equity, compatible with social and political stability.

The roots of price instability in Latin America are usually more complex than those of inflationary processes in the industrialized countries. In these latter countries, excessive public or private expenditures, external shocks or cost increases explain to a very large extent the emergence of pressures to raise prices. In Latin America, in addition to these factors that are often present, another series of inflationary factors comes into play: export trade poorly adapted to the structure of world demand<sup>11</sup> –which creates chronic exchange-rate tensions; the abrupt interruption of the flows of external savings –which raises interest rates tremendously; the rise in unit costs due to the increase of idle capacity –a product of the downward slope of demand and the enormous distributive adjustments that have been taking place; and unresolved distributive struggles, exacerbated by the unequal distribution of the adjustment costs.

<sup>11</sup> According to data from ECLAC, Latin America's share in the value of world exports fell by 50% between 1950 and 1980; a trend which has not been corrected despite recent efforts, as can be seen by the fact that it was further reduced from 5.5% in 1980 to 3.8% in 1989.

Fiscal policy has been incapable of fulfilling its normal functions and serving at the same time the external and domestic debt. Thus Governments have been forced to loosen the reins on expenditures or cease to invest in physical or human capital formation. Disequilibria in payments, in turn, exert pressure on the exchange market and distort expectations, feeding primary price rises which then make exchange adjustments necessary. That process, barely outlined here, obstructs private and public investments that could solve the lack of exports, efficiently substitute for purchases abroad or improve the competitive capacity of countries; and what happens with physical investments also takes place with human capital formation, as shown by the downward impact of the adjustment on social expenditures, wages and unemployment.<sup>12</sup>

For that reason, inflation in Latin America is far from controlled, as witness the fact that it reached record figures of 1 000% in 1989. Orthodox stabilization programmes can to a certain extent attenuate inflationary spirals, but at the cost of stagnation. And when discipline is relaxed or production expands, they return with more virulence. That explains why instruments are used which have been discarded in the industrial centres, such as income policies. That particular instrument, together with the conclusion of corporatist pacts, has been used to hold down inertial inflation and potentially could put distributive effects of adjustment and stabilization programmes in order.

<sup>12</sup> In Latin America from 1980 to 1987, overt unemployment increased by 16%, modern-sector employment practically stagnated, average wage earnings plummeted by 27.9%; real minimum wages deteriorated by more than 10%; social expenditures, except in Honduras and Trinidad and Tobago, dropped in relation to government expenditures and the product (ECLAC, 1989a and PREALC/ILO, 1988), while the population with incomes below the poverty line grew from a third to around 40% of the total during the first half of the 1980s (García *et al.*, 1988).

In essence, the combination of orthodox stabilization policies and open-trade policies, even though it incorporates objectives of unquestionable priority, appears after a decade of experimentation to be insufficient for ending inflation or promoting rapid structural change in Latin America's external trade and production. That very same combination of policies has had markedly adverse effects on income distribution by not including explicit goals to protect distributive equity (Bourquinon *et al.*, 1989).

The other structural ingredient of the economic strategies of many Latin American countries has led fiscal adjustment to incorporate the transfer of many public functions to the market. Equalizing public expenditures with actual revenues is undoubtedly a *sine qua non* ingredient in the fight against inflationary tensions. Likewise, many countries in the region have clearly excessive economic regulations, and over-extension of the public sector into areas of direct production is also common, hardly consistent with present and future priorities for changing productive facilities.

The critique of State intervention has its merits. But there are also ideological excesses that lead to condemning any government interference as misled, as if market shortcomings, distributive disparities and underdevelopment gaps had suddenly disappeared. Privatizing State enterprises and deregulation are usually considered the procedures for depoliticizing economic processes. Nothing is more misleading, in so far as it involves changing social objectives and because political interaction with civil society—except in dictatorships—is an obligatory ingredient for administering economies (Singh, 1989). For this reason, the combination of fiscal crisis with ideologized processes of transferring the functions of the State to the market at all costs, can erode government capacity to guide development and protect fundamental social rights.

## V

**Regulation and privatization**

Economic regulation and State participation in production are phenomena characteristic of modern societies. Although there are differences of degrees, both imply the organization of government action to influence, direct or control the conduct of productive agents and citizens. The very existence of market institutions depends on the force of regulation and the adoption of specific organizational forms guaranteed by the State. Once the market system is established, regulatory measures originate from the need to correct the undesirable effects of its functioning and to complement it where it functions inadequately.

The fashionable model has reinforced the thesis that State intervention should be evaluated basically by market criteria. The criterion of economic efficiency alone—in part for being relatively new in steering public policy—explains, however, little of the history of government intervention. In reality, the presence of the State in the economic sector has been up till now more for social reasons than for calculations of productivity. The establishment or defence of individual and social rights, protection of human life, the correction of distributive biases, the supply of public goods, or simply the healing of divisions within civil society have been so many other objectives of State intervention. In the third world, the urgency of closing the underdevelopment gap has made it important to create other areas of government action. The most frequent cases are those protecting nascent industries or State investment in the production of goods considered to be strategic, when private enterprise, either because of weakness or because of high risks involved, does not have the capacity to give them impetus with appropriate speed or direction.

State intervention or the suppression thereof always has a regulatory character, in so far as it seeks to meet needs of the community. Limiting the abuses of monopoly or promoting economic efficiency are other goals, which, when opted for, involve an inevitable hierarchy of values. Therefore, it is a typically political—not technical—process, where the choice of objectives depends, in the last instance, on the array of social forces, the more influential ideologies, and the history and particular needs of each country.

Hence the characteristic features of State intervention and the boundaries between the public and private sectors vary enormously from nation to nation, resisting purely technical explanations. Today, however, in the face of the twofold onslaught of new models and bitter international competition—plus the economic crisis in the case of Latin America—a certain convergence is taking shape in the styles of State intervention. Even so, significant differences subsist and will subsist, arising from the different problems and institutional political environments existing between countries.

Historically, State intervention in advanced economies has had characteristics unlike those in developing economies. In the advanced economies, direct State participation in production is less frequent—there are no left-over gaps to fill—and the needs related to welfare-State institutions and military defence are much greater. The contrary is true of the developing economies, in so far as the promotion of new production and wealth has had primacy over any other objective, at least in the last half century, although excesses have certainly taken place in military expenditures.

Distinctions in meaning can also be made in the case of regulation. In the industrialized nations, regulation up to the end of the 1950s was predominantly concerned with questions of tax reform and redistribution, the system of competition, free entry into different industries, or price control. Beginning with the 1960s, regulatory efforts changed course in pursuit of objectives of public interest, such as environmental protection, the quality of consumer goods, the end of discrimination in the work-place, highway safety, or rules of conduct to be followed by the participants in some markets. Hence the intense proliferation of social regulation institutions over the last two decades have generated costs for productive activities and responded more to general interests of the population than to the demands of producers.<sup>13</sup> This explains the rise of resistance, especially when intense international competition is reducing the room

<sup>13</sup> The number of regulatory agencies in the United States doubled between 1960 and 1980, and the federal budget for those agencies trebled during the 1970s, with regulatory costs estimated to be a maximum—probably exaggerated—of US\$200 billion a year (Penoyer, 1981; Breyer, 1982).



for manoeuvre and profits in a growing number of activities.<sup>14</sup> The basic question begins to reflect tensions between opposite social goals. A better quality of life –more leisure, environmental protection, economic security– which the populations of the first world demand with different degrees of intensity, generates costs and limits the capacity for international competition –another main objective– with newly industrialized countries, whose social aspirations are more modest.

In the developing countries, regulation has lagged behind in many aspects and taken on some trends of its own. Both phenomena are partially rooted in the different circumstances in which these nations move. Their frequently small markets and meagre industrial diversification have limited the scope of antimonopolistic regulation. Environmental protection and quality control of consumer goods have had to be modified owing to budget limitations,

the need to meet other basic needs, and the insufficient supply of products with better specifications.

In contrast, import-substitution strategies and the defence of national entrepreneurs greatly increased the body of regulations relating to external trade and foreign investment in Latin America, as well as the investment of development banks and financial institutions responsible for administratively allocating credit to the benefit of national priorities. In the same way, the hope of making macroeconomic stability compatible with the structural change of supply led at different times to the proliferation of exchange and price controls, and more recently, to the implementation of income policies. Finally, the protection of essential consumer items and the need to direct private investment along the lines of industrial policy explain why many regulatory subsidies were granted.<sup>15</sup>

## VI

### The doctrinal debate and reality

#### 1. Privatization

The welfare State's long period of growth in the first world, plus the explosion of regulations for public-interest purposes that began in the 1960s, created fiscal tensions and tensions among interest groups, which led to major changes in the policies and ideologies that support them. There were at issue here not only a natural resistance to paying taxes and the consequent disincentives to invest, save and work, or the proliferation of contradictory social demands, but also the generation of higher costs, which placed the enterprises of several industrialized countries in a situation of inferiority in international markets.

Those ideological trends have found fertile ground in the third world. Fiscal deficits had reached the level of 6% to 15% of the product since the 1970s, as a result of governments' attempts to compensate for the depressive effects of the decline of external demand and the deterioration of the terms of trade, oil shocks, the rise in interest rates and the interruption of

credit flows from commercial banks. At first, attempts were made to postpone the adjustment on the premise that the international markets would soon "normalize". Later, the implementation of restrictive adjustment and stabilization policies became indispensable, a trend reinforced by the doctrinal leanings of the international financial bodies and the development agencies of the industrialized nations.

The main purpose of stabilization programmes is to correct fiscal deficits; the liberalization of external trade and foreign investment form part of the nucleus of structural reform. Consequently, privatization is seen as a hopeful means not only to hold down expenditures but also to gather additional resources

<sup>14</sup> Previous economic regulation was not always resisted; it favoured different entrepreneurial segments. At times, it protects producers from the excesses of competition; at other times, it aims to eliminate market defects and at still other times, to improve the information available to productive agents.

<sup>15</sup> Precisely these regulations and the institutions created to apply them are the ones that have to be dismantled because of the widespread change of strategies towards external openness, the broadening of market functions, and the State's decision no longer to satisfy with the same historical abundance the demands of many interest groups. Financial liberalization implies introducing organic changes much deeper than the simple admission of actors from abroad. Strictly speaking, financial liberalization would lead to eliminating a good part of the systems of administered allocation of credit, that is, to renouncing or greatly simplifying national priorities, granting a lesser role to development banks, government financial institutions, cash holdings or preferential lending institutions, as well as creating market institutions for freely channelling savings (Zysman, 1983).

through the sale of assets, in order to balance public accounts. Deregulation, in turn, is seen as the way to remove obstacles to the functioning of the market, as well as to end overt or covert subsidies and avoid excessive demands from interest groups which overburden government budgets. Both privatization and deregulation are seen as a political and economic way of giving entrepreneurs better incentives for investment and growth. Thus fiscal pressures are combined with doctrinal formulations to provoke a dramatic change in the perceptions of the State's role in economic affairs in Latin America.

Even so, the principal justification of privatization has been not so much financial pressures but rather economic efficiency. It is commonly pointed out that private enterprise raises productivity in the use of resources, to the extent that ideal conditions of competition generate Pareto optimality. Even though a more or less widespread opinion on the inferior economic efficiency of public enterprises continues to exist, there is little empirical evidence to back it up and the explanations given differ greatly.

According to the exponents of the property-rights school, government enterprises are inefficient because their managers do not seek to maximize the income or wealth of the owners (the citizens), pursue their own ends, and are comparatively less well paid; these enterprises also face excessive controls which reduce their scope for action and initiative (Alchian, 1965). Others emphasize the lack of market competition—particularly in the case of public monopolies—or the poor financial discipline when there is automatic access to credit and it is impossible to go bankrupt (De Alessi, 1980; Echert, 1979). Still others underline the alliances between government bureaucracy and the directors of public enterprises to strengthen political influence and expand expenditures and investments beyond what would be optimum from the viewpoint of the correct allocation of resources (Niskanen, 1975).

In general, critical conclusions point out that public enterprises tend to pursue multiple goals, innovate more slowly, follow price policies more loosely adjusted to the evolution of costs, have lower levels of and greater variability in profits, and invest at higher levels than do private enterprise.

It is reasonable to accept that more intense competition tends to improve efficiency in allocating resources, but it is also reasonable to recognize that reality does not correspond entirely to the model of perfect competition. Monopolies, non-essentials,

higher returns to scale, indivisibilities, and the production of public goods explain in practice why many State enterprises were created. And even though technological and institutional changes may correct the faults of the market, many of the same conditions persist that once justified State intervention in strictly economic terms.

In a certain sense, the ideological dimension of the debate leads to confusing the question of private or government property with the problem of competition. Transferring a public enterprise to entrepreneurial hands can be simply transforming a public monopoly into a private one, or substituting complex and costly regulatory systems for controls inherent in direct State production. Likewise, competition can be increased without changing the property regime, especially when a policy of openness to other countries is in place and the directives and goals of public enterprises are modified (Thompson, 1986). Strictly speaking, more important than the size of the public sector is the efficacy with which parastatal enterprises use the resources at their disposition or fulfil the different objectives they are given (Cook, 1988).

Resolving the debate on efficiency by empirically examining the behaviour of public versus private enterprises also does not lead to a definitive conclusion. The first difficulty is the fact that government enterprises rarely have economic efficiency as their only objective. Few analytical efforts are dedicated to determining how efficiently they meet their objectives. Despite that, private results do not always appear to be superior to public results either in the industrialized countries or the third world (Millward, 1988; Yarrow, 1986; Hanke, 1987; Borchering et al., 1982; Pier W. et al., 1974). Moreover, when public production is compared to private, no attention is usually given to the alternate costs of regulating, monitoring and controlling private production when there is a monopoly or other market defects, as well as costs for meeting redistributive goals without using State enterprises (Borchering et al., 1982).

In any case, the old consensus on the impact of public enterprises on development is clearly gone. Only slightly more than a decade ago it was thought that direct government investment not only contributed to fulfilling economic plans but also made it possible to enter strategic sectors, create external economies and make up for the deficiencies among

entrepreneurs or in capital markets (Nurkse, 1959; Prebisch, 1952; Rosenstein-Rodan, 1943). That explained actions from the creation of development banks to the formation of enterprises in the basic sectors of the economy (energy, steel, capital goods, transport).

Today, the validity of development theory and the very need of an industrial policy to close the gap, and of course, the wisdom of the welfare State<sup>16</sup> are all questioned. The task of industrial policy in the neo-classical framework is to change the allocation of resources between industries so as to make them more efficient and attract positive non-essentials. Put that way, the State would appear to have no particular advantage for accomplishing that task over the market and private agents. Even so, the circumscriptive criterion of efficiency in the use of resources does not adequately explain the designs of industrial policy that most countries have been putting into practice.

In fact, industrial development has sought not static efficiency but the creation and consolidation of activities that generate employment, exports, high value-added products or the manufacture of widely used inputs. Thus industrial policies reflect the political need to correct the market and cater to values or attain different social objectives. The presumed inefficiency in the resulting allocation of resources is proved by the failures of some countries and refuted by the experience of others. The history of East Asia would seem to validate the thesis of the compatibility between State intervention and rapid processes of productive modernization and growth.<sup>17</sup> Also, in most Latin American countries, gross domestic product enjoyed its highest growth during the period when government activism was strongest.

<sup>16</sup> Richard Caves refers to industrial policy as a category of measures in search of an analytical frame of reference or as a political slogan in search of respectability (Caves, 1986). Hirschman thinks that development economics, after the important advances of the 1950s and 1960s, has entered a phase of decline. He attributes this to the fact that it is a discipline born of distinct ideological currents with internal tensions that have turned out to be destructive. And also to the fact that it creates exaggerated expectations, which, when they are not met, cause disillusionment and frustration (Hirschman, 1981).

<sup>17</sup> Japan and then Korea, together with other Asian countries, raised and still maintain protectionist barriers and schemes to promote select industries, which has not led to inefficiencies or a weakening of the spirit of entrepreneurial innovation (Zysman, 1983; Helpman, 1989; Levy, 1989).

The virtues of privatization have been exaggerated in more than one regard. Frequently corporate change is difficult to achieve, budgetary benefits are meagre and the political costs are high. In particular, social and distributive objectives are customarily assigned to public enterprises; these would have to be sacrificed as incompatible with private entrepreneurial behaviour.

Even so, it cannot be denied that at the present time numerous cases exist in which the deficits of public enterprises excessively drain the fiscal coffers, especially when these enterprises have to respond to new demands for expenditures related to servicing the external and domestic debt, as well as the change in relative prices in favour of exporters. However, these cases would have to be rigorously examined to see if it is a question of inefficiencies properly speaking – a comparatively greater use of physical inputs – or forms of subsidizing and meeting other government objectives.

It is highly probable that the fiscal crisis and the intensification of external competition make economic efficiency more important as an objective. There is a risk, however, in reducing social objectives, in the sense of subjecting everything to the achievement of an economic goal that is in itself narrow.

It is also risky to base privatization policies on the needs of short-term public finances. If the State sells enterprises which have a strategic function for development or social equity, owing to shortages of liquidity, it would be sacrificing an important element for meeting urgent needs. Moreover, if the sources of financing are domestic, instruments of monetary policy will enable any government to obtain the same resources through credit. Indeed, if the sales are to be equitable, the present value of the future flow of net revenues of the enterprise should be approximately equal to its selling price and correspond to the market interest rate. In terms of monetary flows, the effects of a sale or a loan would be analogous, although the distribution of the funds from the transactions among the saving population would vary (Vernon, 1988, a and b).

Stated plainly, if profitable enterprises are sold, fiscal imbalance will increase in time. Naturally, if revenues obtained in that way are used to reduce government indebtedness, the fiscal imbalance would not be adversely affected; but then little or nothing would have been gained or lost, given the normal

differential between the rate of profit and the rate of interest. And if enterprises in the red are sold, the rational buyer would have to obtain the compensation of receiving deliberately undervalued assets and the right to raise prices in the future to match expenditures with revenues, apart from the advances he might make in raising productivity. That is precisely what explains why, when enterprises are privatized, prices rise or the covert or overt subsidies given by the public enterprises are revoked.<sup>18</sup> Obtaining other results would presuppose that the State sells above or below the market value of the enterprises to be privatized.

It has to be admitted that the presence of defects in the market could justify reservations about what is said in the previous paragraph. In industrialized countries with large capital markets, privatization can take place simply by selling shares on stock exchanges. However, in many developing economies, the privatization of enterprises involves slower and more complex processes in order to sell them as complete productive units (Cook, 1988).

Even so, privatization can be financed by repatriating capital or attracting foreign investments, where foreign credit sources are non-existent or very restricted. In that case, the sale of public enterprises could well mean a temporary relief in fiscal maladjustments and those of payments, depending on how the resources thus obtained are used.

Except for special cases, privatization usually has less of a macroeconomic scope. Few enterprises are large enough to affect overall economic behaviour or completely solve budgetary imbalances (ECLAC, 1989b). Moreover, the fact that State enterprises are only sold once and in naturally slow processes lessens the macroeconomic effects even more.

The transfer of enterprises to the private sector may increase economic efficiency in the static sense. The entrepreneur is undoubtedly less inclined to subsidize or meet social objectives and is rarely disposed to absorb losses year after year. It is also true that the sales would lighten the administrative burden of the State. Even so, there are costs that affect or can affect the development momentum, especially in third-world countries. Managerial or administrative talent is generally scarce. This affects the private sector as well as the State. Likewise, private financial resources are limited and there are

inevitable trade-offs between investing them in purchases of State enterprises or undertaking new productions which would support the transformation of productive structures. Consequently, the massive sale of public enterprises –when that takes place– even though it has immediate fiscal effects, can in the medium term tie down financial resources and entrepreneurial capacity in predominantly obsolete activities which are by definition no longer, or in the process of ceasing to be, strategic for building the economy of the future.

Perhaps the restrictions mentioned can be avoided in some cases by means of direct foreign investment. As a general solution, however, foreign investment would produce well-known unfortunate effects in the economic order, if not also in the institutional and political order.

In any case, the most notable effect of privatization and deregulation is to encourage the consolidation of social agreements, through which the role and power of entrepreneurs in the economy are increased. For this reason, and to coincide with the dominant doctrinal theses in the Western world, those processes usually reinforce the business community's confidence in government policies, with direct effects –hopefully– on the stability of the exchange markets and, together with other factors, on the private propensity for capital formation.

## 2. Deregulation

The ideological debate on deregulation occurs again between those who want to broaden the domain of the market and those who are concerned about preserving intact the realm of public action or, what amounts to the same thing, the tension between economic freedoms for private production and the social need to limit those freedoms in order to meet goals of a different kind.

Other doctrines have arisen in opposition to the traditional thesis that regulation is the answer for the defects of the market and protects public interests (Wilson, 1980). According to some of these doctrines, regulatory agencies are born as enterprises, legislatures, political parties or factions, or come to be dominated by the groups to be regulated or interest groups (Stigler, 1971; Mazmanian, 1980). This gives rise to rents, i.e., highly concentrated benefits which are the incentive for covering the costs of lobbying and the political struggles involved in obtaining *ad hoc* regulatory statutes.

<sup>18</sup> If the aim was to revoke those subsidies in order to lessen fiscal pressures, more direct means would exist for doing so.