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Review

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UNITED NATIONS
ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN
SANTIAGO, CHILE, APRIL 1992

CEPAL

Review

Santiago, Chile

April 1992

Number 46

CONTENTS

In memory of Fernando Fajnzylber. <i>Gert Rosenthal</i> , Executive Secretary, ECLAC	7
Latin America and the internationalization of the world economy. <i>Mikio Kuwayama</i> .	9
Privatizing and rolling back the Latin American State. <i>David Félix</i> .	31
State-owned enterprise reform in Latin America. <i>Antonio Martín del Campo</i> and <i>Donald R. Winkler</i> .	47
The Central American entrepreneur as economic and social actor. <i>Andrés Pérez</i> .	69
Why are men so irresponsible?. <i>Rubén Kaztman</i> .	79
Erroneous theses on youth in the 1990s. <i>John Durston</i> .	89
Decentralization and equity. <i>Sergio Boisier</i> .	105
Reorientation of Central American integration. <i>Rómulo Caballeros</i> .	125
MERCOSUR and the new circumstances for its integration. <i>Mónica Hirst</i> .	139
International industrial linkages and export development: the case of Chile. <i>Alejandra Mizala</i> .	151
The ideas of Prebisch. <i>Ronald Sprout</i> .	177
Guidelines for contributors to <i>CEPAL Review</i> .	193
Recent ECLAC publications	195

WORLD BANK

Privatizing and rolling back the Latin American State

David Félix*

The author holds that the economic benefits from rolling back the State are likely to be disappointing – partly because of adverse conjunctural factors – while the rolling back will be impermanent. For economic and political reasons, the centre of gravity of economic policy will remain a mixed economy with a large interventionist public sector.

There are various reasons for this hypothesis. Firstly, in contrast with Eastern Europe, disaffection with the economic scope of the State among the various social groups and economic agents is only partial. Moreover, maintaining the current policies of rolling back the State depends on the achievement of successful and stable economic results, and the author feels this is unlikely for three reasons: the failure of macroeconomic stabilization programmes; the prolonged decline in public investment, which will endanger the efforts to restructure production, and the mistiming of this effort by the region with respect to the behaviour of foreign investment and external financing at the world level.

The last section of the article analyses the relevance of a small open economy model and indicates its shortcomings as a guide for designing development policies. The section also examines some policies which have been used to offset asymmetries in the region's markets. It is concluded that dirigisme rather than laissez-faire will be the pole of attraction in economic policy in the coming period, although this does not rule out other simultaneous or successive combinations of these two types of policies.

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Introduction

The push in Latin America to privatize public assets is a recent addition to more general efforts over the past decade to restructure the debt-ridden economies of the region into outward-oriented free market economies. Motivating these efforts has been the hope that the restructuring would enable the countries to resume normal servicing of their foreign debts and regain access to foreign capital markets for sustaining a revival of economic growth. In the early 1980s the time needed for the turnaround was usually estimated in IMF, World Bank and U.S. Treasury documents at 3 to 4 years. More recent documents tend to leave the time frame unspecified. This retreat to vagueness is a response to the poor results to date. Most of the debt-ridden economies are by most socioeconomic yardsticks worse off today than when they began the restructuring. The current stress on privatization relates to this failure.

Privatization was not stressed in the initial IMF-guided restructuring programmes. These focussed rather on achieving macroeconomic stability through slowing the rate of monetary emission and reducing the fiscal deficit, and on improving resource allocation by "getting prices right," i.e., by freeing financial, product and factor markets from controls and subsidies. The import substituting industrialization (ISI) strategies that Latin American economies had been pursuing with varying intensity since the 1930s were fingered as the fundamental source of the price "distortions" and macroeconomic disorders. When successive restructuring programmes failed to produce the expected turnaround, the failures were explained away for a time by further enlarging the indictment of ISI. In an interesting transformation, many of the criticisms of ISI from Latin American economists on the Left – that it had fostered an excessively rent-seeking, technologically dependent, low job-generating industrial sector, and had worsened already highly concentrated distributions of income and wealth – were adopted by free market economists of the Right. To the latter a redoubling of the restructuring effort was called for because ISI had left the economies in even worse shape than originally estimated.

But as macroeconomic disorders deepened, output stagnated, and debt servicing arrears spread through the region, the adequacy of the *leyenda negra* – the "black legend" of the alleged ill-effects of ISI – weakened as a cover story for the failures.

A supporting villain was therefore added –the State itself, which was accused of being oversized, over-staffed and overextended in areas better done privately, while its deficit financing was said to be fuelling inflation and crowding out private investment. From around 1987 on, rolling back the State by selling off public firms and turning over various infrastructural and social services to private firms, outright or by contracting, became more prominent components of the restructuring programmes.

This new improved cover story fitted in with Washington's broader goal of eliminating national barriers against the free international movement of goods, services, capital, enterprise and everything else except, of course, labour, subversive ideas and unfair trading practices by foreigners. Flushed with the triumphs of Reaganomics, the White House turned the Department of State, the Agency for International Development (AID) and sympathetic foundations and think tanks loose on Latin America in an ideological full-court press to promote privatization, the liberating of markets and the unleashing of entrepreneurs.

This ideological campaign has also been backed by more tangible inducements and pressures. Eligibility for Baker Plan loans and Brady Plan debt writedowns has been restricted to the heavily indebted countries willing to undertake free market restructuring and to privatize. Pliant international financial institutions (IFIs), like the IMF, World Bank and Inter-American Development Bank, lend more readily to recipients on Washington's approved list.

The desire of foreign creditor banks to liquidate their Latin American loan portfolios has added to the pressures to privatize. Latin American lending, a honey-pot to foreign banks in the 1970s, had become in the 1980s a nightmare of interminable negotiations, reschedulings and involuntary new loans to stave off open defaults. Despite these alleviants, interest arrears have been rapidly accumulating since the mid-1980s, plunging the market prices of Latin American loan paper to levels that are driving the banks towards debt-equity swaps as a way to stem losses from liquidating their loan portfolios.

Within this trend, swapping for public assets has the greater potential. By the mid-1980s, few private assets remained available at distress prices, most large Latin American firms and their owners having been reliquified by governmental bailouts and "international portfolio diversification," i.e., capital flight. Swapping foreign debt for private

assets also required monetary emissions to purchase the foreign debt, which undermined efforts of debtor governments to slow inflation by curbing the expansion of "high-powered money." Their initial enthusiasm for debt-equity swaps flagged, therefore, and many closed their swap facilities, causing the creditor banks to redirect their pitch for such facilities to swapping for public assets, since such swaps can reduce the foreign debt without requiring monetary emission.

The campaign to privatize is having special resonance in economies teetering on the brink of hyper-inflation, such as Argentina, Brazil and Peru. With their tax base and real tax revenue diminished by capital flight, the Tanzi-Olivera effect,¹ and the diversion of economic activity to the untaxable "informal" sector; and with dollarization eroding the "inflation tax",² one-off revenue injections from the sale of public assets have become –especially to the current Argentine and Peruvian governments– a desperate way of fending off the withering away of the State.

My general thesis is, however, that the economic benefits from rolling back the Latin American State are likely –in part because of adverse conjunctural factors– to be disappointing, while the rolling back will be impermanent. For political and economic reasons, the centre of gravity of economic policy will over the long term remain a mixed economy with a large interventionist public sector, rather than the small open competitive economy norm that rationalizes the current push to roll back the State. I will now elaborate on the main reasons for this conclusion, beginning with the political-ideological ones.

¹ This refers to the fact that the real tax on firms and households diminishes as the lag between assessment and payment and/or the rate of inflation increases. Obviously, if the nominal tax and the penalty interest rate are fully indexed, the Tanzi-Olivera effect is zero. Neither condition, however, has prevailed in Latin American countries.

² The decline in purchasing power of existing private domestic money holdings resulting from inflationary emissions of new money to finance fiscal deficits serves as a "tax" on the money holders. Shifting one's domestic money holdings to foreign currency, e.g., dollars, is a way of evading the "inflation tax". Complete evasion requires the foreign currency exchange rate to rise at least *pari passu* with domestic price levels.

I

The fragile political backing for privatization

In contrast with Eastern Europe, where disaffected intelligentsia, initially with broad popular backing, have been pressing for wholesale privatizing and market liberalization in order to dismantle command economies and the Communist Party's monopoly of power, disaffection among leading power groups in Latin America with the economic scope of the State is merely partial. The collapse of East European illusions that market liberalization and capital inflows would quickly elevate consumption to West European levels may well reorient the policy dynamics of that region toward the mixed economy—whether under the aegis of fascism or social democracy is unclear—but it is unlikely to bring back the command economy. The *status quo* in most Latin American economies, on the other hand, has been for many decades the mixed economy. Until the 1980s, business, the salariat and a large segment of the urban working class prospered as the public sector expanded. Public investment “crowded-in” private investment, sparking the sustained growth of GDP and formal sector employment, while accompanying public subsidies and protective barriers sheltered private gain. Because of these ties, political support for efforts to extricate from the current crisis by market liberalization and privatizing is fragile, with none of the major power groups unequivocal ideological converts. The business elites and intelligentsia are split on privatization and free trade, while unions and the public sector salariat are generally hostile.

The business split is mainly between locally owned firms which had developed and prospered under ISI by supplying the domestic market, and those with more cosmopolitan economic links. The former have generally been hostile to free trade and the wholesale selling-off of public firms, since import protection and privileged transactions with the public sector and its para-State bodies had nurtured their past growth and current survival. During the heyday of ISI, the establishment of para-State bodies and the strengthening of lucrative public-private linkages was accepted in the mainstream development literature as the growth pole approach to economic development: a way

of exploiting external economies and of focussing entrepreneurial efforts in technologically backward economies. Today, such relationships are dismissed by many development economists as mere “rent-seeking.” This revisionism derives, however, more from changing ideological fashion than from warranted fact or theory, neither of which, as is argued further on, justify such categorical dismissal.

The “cosmopolites” are the industrial exporters: export-import trading firms, large financial and service firms with international ties, agribusinesses, and transnational subsidiaries. The latter have been in all the functional categories of the economy, but became especially prominent in manufacturing during the expansionary decades of ISI, when Brazil and Mexico, for example, were the first and second highest recipients of private foreign investment of all the newly industrializing countries (NICs). Today some U.S. transnationals support President Bush's Hemispheric Free Trade Initiative because it would allow them to close some of their Latin American production lines and service the depressed local markets by direct imports,³ while others have joined privatizing consortia where the managing partner of the privatized enterprise is a European State-owned corporation, thus manifesting a pragmatic perspective on free trade and private vs. public ownership. The locally owned “cosmopolites” have generally survived the “Lost Decade” more comfortably than the locally owned ISI firms, in part because they were the main beneficiaries of the government bailouts

³ See the statements by spokesmen for Goodyear Tire & Rubber and Procter & Gamble before the Joint Economic Committee, United States Congress, at its May 22, 1990 hearings on the Hemispheric Free Trade Initiative.

earlier in the decade. Rolling back the State does not include for them rolling up such generous safety nets.⁴

Organized labour and the salariat have especially strong reasons to oppose free market restructuring, since the economic burden has fallen most heavily on real wages, salaries and employment in the public and private formal sectors, and on public social and educational services built up during the ISI era. Privatizing threatens to further increase income inequality by tearing up social contracts protecting labour and other social advances achieved in the ISI era that still survive the restructuring programmes.

Income inequality in Latin America has been increasing as long as anyone can remember, but until the 1980s it did so with pauses and occasional reversals. Inequality rose during prosperity, when there were more gains to trickle down, and levelled off or declined in depressions, when rents and profits tended to be hit relatively harder (Felix, 1983). The "Lost Decade" breaks with this pro-cyclical pattern: it is the first extended depression in which income inequality has continued to worsen. Between 1980 and 1987 average real income of wage/salary earners fell 15% in the Latin American private formal sector and 30% in the public sector, while the combined

employment of the two sectors rose a bare 3%. Concurrently, in the urban informal sector the number of economically active persons rose 55%, while average real income fell 42% (PREALC, 1990a and b). Such prolonged deterioration of income and employment of the organized working and salaried middle classes, accompanied by downward mobility, would seem to be an especially explosive political mixture. Indeed, the fact that the explosions have been muted thus far is a puzzle.

Some of the answers may lie in the demoralization of the Latin American intelligentsia. Themselves heavy economic losers in this process, and generally critical of the liberal restructuring efforts, they have not been able as yet to produce a persuasive alternative paradigm around which to unite the discontented: one that gives political pizzazz and convincing coherence to an alternative revival strategy, as the Prebisch Doctrine had once given to ISI. Víctor Urquidí, a long time doyen of the Latin American development theory class, sums up the malaise in his plaintive observation that "no one in Latin America thinks anymore about development, but only in a limited way about how to recover some growth" (Williamson, 1990, p. 337).

Others see it differently. The Inter-American Development Bank in its 1990 report, *Economic and Social Progress in Latin America*, purports to see underway "a silent revolution" involving a "fundamental and critical reassessment of the role of the State." But since the report's statistics mainly record economic and social regression rather than progress, the observation may be more in the nature of PR hype designed to counter the gloom. And the reference to the silence of the policy revolution may be merely putting a rosy face on the fact that many of the political leaders currently trying to implement the "revolution" –e.g., Fujimori in Peru, Pérez in Venezuela, and Menem in Argentina– had been either silent about their chosen policy direction or had even fulminated against it when campaigning for the presidency. This doesn't suggest deep groundswells of support from silent majorities for the policies.

In any event, a policy revolution that depends on extending the already prolonged silence of the discontented is unlikely to carry through unless positive and sustainable results begin to show up rather quickly. This brings us to three conjunctural reasons why that is unlikely.

⁴ A prime illustration is the opposition of Chile's free marketers to a proposal that requires five major Chilean banks, bailed out in 1983, to start servicing their debts with the Central Bank. The bailout terms had set the interest rate on the debt well below the market rate and did not penalize delinquency, so there has been little incentive for the rescued banks to service their debt. A recent audit of the Central Bank by Cooper Lybrand warns that the accumulating debt, already 10% of GDP, will continue expanding faster than GDP, eroding Central Bank solvency. Since the rescued banks are judged incapable of fully servicing their debt from current earnings, the *Partido Por la Democracia*, a member party in the governing coalition, has proposed requiring that the banks regain solvency through additional injections of equity capital or be liquidated.

Leading the attack on this proposal has been the *Instituto Libertad y Desarrollo*, an institute which is a stronghold of Hayekian libertarianism and the major think tank of the Pinochetist wing of the Chilean elite. According to Carlos Cáceres, its president, the proposal undermines the rights of the current shareholders and amounts to renationalizing the five banks. Cáceres was the Treasury Minister who in January 1983 advised foreign banks that the Government was taking over responsibility for servicing their loans to private Chilean firms. *Laissez-faire*, anyone? For details see *El Diario* (Santiago, April 30 and May 7 and 8, 1991) and *El Mercurio* (Santiago, May 9, 1991). The Cooper Lybrand report is published in the *Diario Oficial* of Chile, January 24, 1991.

1. The failure of macroeconomic stabilization programmes

The first is that macroeconomic stabilization, now generally agreed to be a *sine qua non* for economic revival, continues to elude the IMF's orthodox monetary-fiscal approach as well as more recent heterodox approaches based on wage/price freezes. The immediate reason for both failures is the inability to cut back fiscal deficits sufficiently. The more basic reason is that most debtor governments fatally overloaded their fiscal possibilities when, in the early 1980s, they undertook too generous bailouts of their ailing private banks and large firms and, acceding to creditor bank pressure, also guaranteed *ex post* the servicing of foreign bank debts of their private sector. The IMF not only failed to protest against such overloading at the time, but also compounded the damage by discouraging the use of capital controls to halt the concurrent capital flight. The private sector's foreign liabilities became "socialized" as a fiscal responsibility, while the lack of capital controls hamstrung the governments from taxing the beneficiaries to garner the foreign exchange needed for the increased debt servicing. This reduced their alternatives to monetizing the enlarged fiscal deficits with Central Bank credit, financing them by selling bonds in local financial markets, or holding down the deficits by cutting back non-financial current and capital expenditures. The IMF objected to the first and favoured the last two alternatives, but in doing so tended to overlook critical boundary conditions.

One is that combining financial market liberalization with a sharply augmented fiscal deficit can make for explosive interactions between the domestic interest rate and domestic debt accumulation. In the event, the private buyers of bonds have exacted high risk premiums, since they have the option of fleeing to safer foreign securities. Deficit financing with "bonds" has thus consisted of open market sales of very short-term treasury bills yielding annualized real interest rates of up to 40%. With such terms fiscal interest payments zoomed, setting off self-generating debt/deficit spirals. The very high real rates also crowded out private productive investment, while the rising fiscal debt servicing crowded out public investment. To bring down real interest rates, the governments therefore shifted to monetizing the deficits. This usually meant exceeding monetary targets agreed to with the IMF, which tended to

react by suspending its lending; a signal for the rest of the creditor consortium also to suspend lending. Higher inflation and capital flight would then typically force the governments back to the IMF to negotiate another short-lived agreement. The heterodox stabilization programmes, such as the Austral and Cruzado Plans, have sought to escape this futile whipsawing by resorting to direct wage/price controls, but their success has been short-lived: they too have been defeated by ongoing fiscal deficits.

A second constraint is the hyperinflation boundary. The frequent resort to monetization has tended to fuel inflation and wage/price spiralling and to democratize currency substitution, with the less affluent households joining the wealthy in dollarizing cash balances and liquid savings. As dollarization spreads, the elasticity of the inflation tax with respect to the inflation rate declines, monetization loses its ability to lower real interest rates, and the government, which cannot print dollars, faces bankruptcy. In recent years, Argentina and Brazil have tried to pull back from hyperinflation by freezing private treasury bill holdings and time deposits and by forcing their suppliers to accept payment in long-term bonds. The immediate side effect has been falling output and employment. A longer-run side effect of such Samsonian acts is to raise still further the private risk premiums for holding treasury paper and maintaining local deposits. Sapping domestic capital markets hardly advances the "silent revolution."

2. Restructuring vs. decapitalization

Another conjunctural reason is that the prolonged situation of public and private underinvestment and deteriorating stocks of physical and human capital thwarts the effort to restructure productive capacity. Instead, aging plants, rising transport and communications costs, the loss of human skills from prolonged idleness, emigration, and deteriorating educational and health facilities, feed on each other, putting productive capacity on a downward slide and reinforcing supply-side bottlenecks hindering a sustained recovery.

Table 1 summarizes post-war trends of capital accumulation relative to labour force growth in six Latin American countries. All six suffered a major decline in the 1980s from the respectable accumulation rates of the preceding three decades. Argentina

Table 1

**GROWTH OF THE STOCK OF NON-RESIDENTIAL FIXED CAPITAL RELATIVE TO
THE LABOUR FORCE, 1950-1989^a**
(Percentage change over each decade)

	1950-1960		1960-1970		1970-1980		1980-1989	
	Ke/L	K/L	Ke/L	K/L	Ke/L	K/L	Ke/L	K/L
Argentina	43.9	30.7	81.6	42.2	47.8	46.0	-32.1	-16.3
Brazil	56.4	137.1	26.0	57.9	114.1	108.3	-31.0	-0.8
Colombia	73.2	6.8	1.8	8.2	65.0	27.1	13.6	15.4
Chile	70.8	20.3	28.0	33.6	-3.3	-1.1	-7.3	-8.9
Mexico	58.1	48.7	216.2	26.2	60.1	28.3	-10.9	0.6
Venezuela	185.7	130.0	-26.2	-6.0	67.5	38.8	-33.5	-27.5

Source: Series compiled by the ECLAC Economic Development Division as part of its project on capital accounts and growth.

^a Ke/L is the net stock of machinery and equipment, divided by the labour force, while K/L is the net stock of all non-residential fixed capital divided by the labour force.

and Venezuela have clearly been decapitalizing, and undoubtedly Peru has also, although direct estimates are not yet available. An especially severe decline of the stock of machinery and equipment per worker also characterizes Brazil, such declines being reflected in aging and obsolescent installations. The declines in Mexico and Chile fall short of decapitalization, but began much earlier in Chile than in the other five. Only in Colombia has the decline been less than critical.

Table 2 shows that a slackening of productivity growth in the 1970s preceded the fall-off of accumulation in the 1980s, this slackening being mirrored in the decline of the "residual" in all six countries after 1973 (the residual is the percentage of GDP growth unaccounted for in a statistical sense by the growth of land, labour and capital inputs and the quality improvements embodied in each). The particular values adopted for the augmentative factors and distributional coefficients are rather arbitrary, so not much can be inferred, in the absence of additional information, from the inter-country differences in residual levels. But the application of a single set of coefficient values to all countries and periods means that large declines of the residual, such as those that show up for all but Colombia after 1973, are probably correlates of declines of productivity growth. In other words, more of the measurable inputs were needed to produce the same aggregate output growth in 1973-80 than in the preceding post-war decades.

Was this because of the accumulating rigidities and distortions of ISI, as the "black legend" explanation of the Lost Decade asserts? Table 2 doesn't

support such reductionism. Chile during 1973-80 was liberalizing *à outrance*, and Argentina followed Chile's lead in the last half of the 1970s. Yet it is Colombia, which stayed on its ISI course, that shows the smallest percentage decline of the residual. To the extent that the residual reflects disembodied technical progress, its general decline as shown in table 2 does fit in with the dependency accusations levelled at Latin American ISI, which assert that, unlike the Asian NICs, industrial growth in Latin America was not weaning industry from heavy dependence on imported products and processes.⁵ But that's small comfort for "black legend" devotees: their indictment is levelled not so much against dependency on imported technology as such, but rather against policies that intervene in technology markets in order to improve the licensing terms and encourage indigenous innovation.

Another shared element that might also help account for the general decline of the residual is the borrowing binge of the 1970s. The ready availability of foreign bank loans during 1973-80 and the financial liberalization that eased access to the loans may have also encouraged a loosening of financial discipline and a decline of X-efficiency in the private and public sectors of the six countries. The fact that Colombia, which restricted private access to foreign credit suppliers much more than the other five, had the least decline of its residual supports this inference. So also does the fact that Chile's public firms survived the country's severe 1982-83 financial

⁵ See, for example, Dietz (1990).

Table 2
ANNUAL GROWTH OF REAL GDP, AUGMENTED FACTOR INPUTS AND
FACTOR PRODUCTIVITY, 1950-1980^a
(Percentages)

	1950-1973			1973-1980		
	GDP	Inputs	Residual	GDP	Inputs	Residual
Argentina	3.6	3.3	8.3	2.3	3.0	-23.3
Brazil	6.9	6.3	8.7	7.0	6.7	4.3
Chile	3.4	2.1	38.2	3.4	2.8	17.6
Colombia	5.1	3.1	39.2	5.0	3.6	28.0
Mexico	6.5	5.3	18.5	6.4	5.8	9.4
Venezuela	6.6	5.1	22.7	4.1	6.7	-38.8

Source: Series compiled by the ECLAC Economic Development Division as part of its project on capital accounts and growth.

^aThe inputs are increases of the labour force augmented by years of education, increases in the stock of non-residential fixed capital augmented by technical improvement per annual vintage, and increases of land in use. For labour, the assumption is that a 1% increase of years of education embodied in the labour force raises unit labour productivity by 0.5%. For capital, the annual vintage improvement is assumed to be 2% for machinery and equipment and 1% for non-residential structures. The land input growth is a weighted average of acreage expansion in crops, pasture and forests, with the highest weight given to cropland. The weights for aggregating the augmented inputs are 0.6 for labour, 0.3 for capital and 0.1 for land.

crisis in good shape because the Pinochet régime, in its determination to shrink the public sector, had denied its State-owned enterprises access to outside credit during the borrowing frenzy. But an explanation that fingers private lending and financial market liberalization is not comforting to "black legend" devotees either.

3. The global debt deflation cycle and the Cargo Cult

A third conjunctural element working against the success of the "silent revolution" is its mistiming. A major motive for taking the privatization and market liberalization path has been faith that commitment to the path would induce enough foreign investment and foreign loans to jump-start and then sustain economic recovery. In the most desperate of the debt-ridden economies, such as Argentina and Peru, this faith is taking on the dimensions of a Cargo Cult.⁶ Fervent obeisances to the Bush Administration's "New World Order" and incantations about

⁶ Cargo Cult is the term anthropologists apply to religious cults that have sprung up in Melanesian islands that had housed World War II American bases. The goods discarded by the bases, which had materially enriched the islanders during the war, ceased to exist when the war ended and the foreigners departed with their ships and matériel. Since then, the cultists dance and chant before red crosses, battle helmets and other symbols of the lost bonanza in the hope of inducing the return of the ships.

"rejoining the First World" waft northward to induce the return of foreign capital inflows. The reality, however, is that Latin American countries are not merely encountering competition for such flows from an East Europe also avid for foreign loans and investment, but are also running up against a global asset and debt deflation cycle that is shrinking international flows of loanable funds and direct investment. Associated with this contraction, moreover, is a "flight to quality": riskier loans and investments are being cut back the most, which bodes ill for Latin America and probably for most of the East European countries as well.

The falling real prices of capital assets are the downside of the puncturing of the prolonged post-war boom of capital values that peaked toward the end of the 1980s. Thus, the real value of household wealth, which between 1982 and 1989 rose 37% in the U.S. and 83% in the U.K., fell in 1990 by 8% and 15%, respectively (The AMEX Bank Review, 1991). Comparable declines are well underway in other English-speaking countries, have begun registering in Japan, and may soon encompass other parts of the First World. Asset price deflation is producing widespread financial stress and rising bankruptcies because it uncovers the substantial debt-leveraging that firms and households had resorted to in purchasing and building up their capital assets. For example, the liabilities of U.S. and British households during

1982-89 grew nearly twice as fast as their assets (The AMEX Bank Review, 1991). Falling values of loan collateral and debt defaults are in turn putting at risk banks and other financial intermediaries, which react by restricting their lending. This increases the financial trauma of highly leveraged firms, forcing them to sell off more assets in declining markets and to curb investment, current production and employment, thus depressing each others' sales and further reducing cash flows for debt servicing. A comparable debt/income interaction involving households is depressing consumption.

How far the asset/debt deflation spiral descends depends in part on whether the United States, Germany and Japan can coordinate their fiscal and monetary actions to halt it. Currently, the prospects look dim, since the monetary and fiscal policies of the U.S., preoccupied with its recession and the Gulf War, and of Germany, preoccupied with the heavy economic cost of unification, are working at

cross purposes. But even aside from this, tables 3 and 4 (reproduced from UNCTAD, 1990, tables 27 and 28), suggest that asset/debt deflation could go on for at least a few years more.

Table 3 shows the impressive extent and duration of the global lending boom. International bank loans, exclusive of inter-bank transfers, rose from negligible percentages of the nominal values of world trade and world gross fixed investment in 1964 to about 75% of each by 1987. They also rose over 20 times faster than the current dollar value of world output. Yet table 4 shows that during 1982-88 the growth of international bank and bond lending was exceeded by the expansion in the values of domestic bank assets and equities. It is easy to understand why Latin American and East European governments strapped for hard currency should mistake this prolonged financial bubble for a permanent situation on which they could safely base their restructuring strategy. But bubble it is turning out to be, and of a

Table 3

**INTERNATIONAL FINANCIAL OPENNESS: THE INTERNATIONAL BANKING
SYSTEM COMPARED WITH WORLD PRODUCT,
TRADE AND INVESTMENT^a**

	1964	1972	1980	1983	1985	1987
<i>As a percentage of the world product^b</i>						
Net loans by international banking system ^c	0.7	3.7	8.0	12.0	13.2	14.8
Gross size of international banking market ^d	1.2	6.3	15.5	21.8	25.3	27.9
<i>As a percentage of world trade^b</i>						
Net loans by international banking system ^c	6.4	25.7	35.2	57.3	63.9	72.9
Gross size of international banking market ^d	10.6	43.8	67.8	104.0	122.2	137.2
<i>As a percentage of gross world investment in fixed assets^b</i>						
Net loans by international banking system ^c	4.0	18.2	39.2	66.3	72.42	78.2
Gross size of international banking market ^d	6.7	30.6	75.4	120.5	138.7	147.3

Source: Estimates by UNCTAD Secretariat; BIS (Bank for International Settlements), *Annual Report* (various issues), Basle; and J. P. Morgan, *World Financial Markets* (various issues), New York, Morgan Guaranty Trust Company.

^a This table relates total outstanding bank loans at year-end with world product, trade and gross investment in fixed assets during the year, in current dollars.

^b Excluding Eastern European countries.

^c Outstanding claims of banks reporting to BIS, excluding interbank redeposits.

^d Outstanding claims of banks in almost all the European countries, Bahamas, Bahrain, Canada, Cayman Islands, Hong Kong, Japan, Netherlands Antilles, Panama, Singapore and United States, including interbank redeposits.

Table 4

SIZE AND STRUCTURE OF WORLD FINANCIAL MARKETS, 1982 AND 1988

	1982		1988	
	Value of assets (billions of dollars)	Percentage of total assets	Value of assets (billions of dollars)	Percentage of total assets
Bank assets ^a	8 887	64.1	17 005	46.6
National	6 218	44.8	11 500	31.5
International	2 669	19.3	5 505	15.1
Capital markets	4 977	35.9	19 507	53.4
Eurocapital	-	-	40	0.1
International bond markets ^b	259	1.9	1 085	3.0
Securities markets	1 591	11.5	9 563	26.2
Bond markets	3 127	22.5	8 819	24.1
Total	13 864	100.0	36 512	100.0

Source: See table 3; the data on capital markets are from Salomon Brothers International. All data are end-year.

^a Gross total bank balances.

^b Eurobonds and foreign bonds.

size that suggests that, even with policy coordination, the slackening of international loans and investment is likely to persist for at least a few more years. This credit squeeze is likely to slow the growth of world output and trade and dampen the exporting prospects on which the restructuring had also been premised.

The initial reaction of Latin American governments to the darkening international scene has been to redouble their liberalization efforts. Thus President Salinas of Mexico, who had repeatedly stated that Mexico's economy was not ready for anything more than selective preferential trade agreements with the United States, abruptly changed his tune when his May 1990 European trip to promote lending and investment commitments drew blanks. On his return, he requested negotiations with the United States and Canada for a full-scale trilateral free trade compact, his main motive, according to press reports, being to reassure foreign capital that Mexico's free market restructuring was irreversible. The Bush administration has responded favourably to Salinas' request, preliminary negotiations are underway, and IFI lending has been stepped up to help Salinas win Mexican hearts and minds for free trade. But the response of private foreign capital remains more tentative, reflecting the U.S. recession and global financial tightening (Moffett, 1991). Foreign direct investment rose in 1990, but nearly three-fifths of it went to tourism (Banamex, 1991, pp. 291-292).

Argentina, which started out from a more desperate situation, has been trying to speed up sale of its State assets, but is encountering increasing difficulty in attracting serious bids. After many delays and contretemps the Menem government managed to sell ENTEL, the State telephone monopoly, in two geographic blocks. But in each case the operating company of the purchasing consortium is a foreign para-State enterprise: Telefónica of Spain for the southern block and STET of Italy for the northern block. Similarly, the recently privatized government airline, Aerolíneas Argentinas, is now operated by Iberia, the Spanish government airline.

The front-end contributions to Argentine State revenues have been minor, as most of the consortia payments are in bank debt paper, on which Argentina had built up sizeable interest arrears. The paper had been selling at less than one-fifth of face value in the secondary market, but the Argentine government accepted it at full value in the debt-equity swaps, awarding the entire discount to the buyers. Moreover, foreign exchange gains from the front-end receipts will be exceeded by foreign exchange outflows, especially as the privatizations are enhancing monopoly profits. The privatized telephone firms have been given substantial rate-setting freedom, and the privatized airline has been allowed to buy out its main domestic competitor.

Considerations of human capital and x-efficiency do not apply to these privatizations. Competition is

not increased, and management is merely transferred from Argentine to Spanish and Italian bureaucrats. Since Argentinians are mostly descendants of Spanish and Italian immigrants and themselves have an excellent level of culture, the reason for turning management of the country's demoralized public sector over to public firms of these two respective motherlands cannot be innate human capital shortfalls or the inherent inefficiency of public management. One cause of the disarray in the Argentine public sector—an economic elite with a deficient sense of national commitment⁷—will not be cured by this privatization, and indeed will tend to further intensify the accusations of unethical behaviour and corruption that have enveloped these aspects of the Menem government's asset sales (*The Economist*, 1991, p. 38 and *Latin American Weekly Report*, 1991, p. 2).

Chile's major programme of privatization during 1985-88 was less patently a case of selling public possessions in order to procure short-term resources. Alleviating the fiscal squeeze resulting from the 1982-84 bank and other bailouts was an important motive, but more compelling was the desire of the Pinochet regime to put its free market strategy back on track after the embarrassment of having to renationalize much of the private sector as part of the bailouts. Nevertheless, Mario Marcel (1989) foresees in his analysis of the privatization projects that net fiscal losses will set in after 1989 because the firms were sold well below their present value and half the receipts from their sale were allocated to non-revenue generating uses such as tax reduction.⁸ He also concludes that on balance the privatization crowded out rather than augmented private investment, since the privatized companies were acquired primarily through indebtedness and they have been channeling most of their profits to cash dividends.

Brazil's ambitious national privatization programme includes safeguards against repeating the flawed Argentine and Chilean experience. It was introduced by the Collor de Melo government in March 1990 as part of the more comprehensive Plan Collor, which also included a macro-stabilization programme centered on a freeze of private financial

assets as well as tax and tariff reforms. The subsequent collapse of the stabilization programme and the stalemating of the reforms slowed implementation of the privatization programme, but it is still moving forward, with the first of the State enterprises on the privatization list scheduled to be sold in Autumn, 1991.⁹

The safeguards include valuation and bidding procedures intended to maximize transparency and minimize corruption, favouritism and monopolization. By law, the receipts can be used only for debt reduction and social programmes. There is also a more nationalist tinge to the programme than in the case of the Argentine and Chilean privatization. Foreign capital may purchase 100% of the non-voting shares, but only 40% of the voting shares.¹⁰

The privatization in Brazil has been surrounded by less of an ideological brouhaha than in Argentina and Chile. Its supporters include "neo-structuralists," economists of the Left who now contend that since the State is bankrupt it should sell its industrial assets and focus on rebuilding the physical and social infrastructure. Backing also comes from managers of State enterprises, which had been drained financially by the central government over the past 12 years. In the late 1970s they had been forced to borrow abroad beyond their internal requirements to ease national foreign exchange shortages, while in the 1980s the central government made them hold down their prices in order to dampen inflation, and diverted their shrunken investible surpluses to the general fiscal budget. Many frustrated managers therefore hope that privatizing their enterprises will free them to raise prices and attract private capital to finance investments.¹¹ Many private Brazilian industrialists, on the other hand, while opposed to the expansion of the State industrial sector, also oppose rolling it back.¹² The belief that the privatization programme will

⁹ A description of the programme and the State enterprises on the privatization list can be found in BNDES, 1991. BNDES (Banco Nacional de Desenvolvimento Econômico e Social) is the government development bank in charge of the privatization.

¹⁰ These safeguards are embodied in Congressional Law 8031 of April 1990 which authorizes the privatization programme.

¹¹ An implicit assumption is that the new private owners will retain the former State managers.

¹² This is the position that Antonio Ermirio de Morais, a highly influential São Paulo industrialist, has been publicly promoting. My assessment of Brazilian opinion relies heavily on Schneider (1990) and Castelar Pinheiro and Oliveira Filho (1991).

⁷ "People are not involved", the ambassador's wife says. "And you must remember that anybody who has money is not an Argentine. Only people who don't have money are Argentines" (Naipaul, 1980, p. 108).

⁸ Mario Marcel, 1989, pp. 5-60. This is the most thorough *ex post* study to date of the 1985-88 privatization programme.

raise aggregate savings and investment is expressed more fervently by the politicians and financial journalists who support it than by its advocates among economists.

There is obviously no track record yet by which to test the validity of these views, but there are inconsistencies which suggest that caution, if not outright scepticism, is in order concerning the expected gains from the Programme. Many of the State enterprises are oligopolistic or monopolistic firms which dominate the supply of key primary and intermediate industrial materials and services, such as steel, petrochemicals, fertilizers, non-ferrous metals, fuels, electric power and telecommunications. If, when privatized, they are allowed to raise price margins freely, costs and prices would be pushed up throughout the economy. In the original Collor Plan, this danger was to be averted by the stabilization programme, import liberalization and tax reforms. Since these accompaniments have fallen by the wayside, it is not clear what instruments other than a severe monetary squeeze and/or price-wage controls remain to prevent privatization from injecting additional inflationary shocks into an economy that is already teetering on the brink of hyper-inflation. In Brazil, these two instruments have been associated with recessions and resurging inflation rather than surging savings and investment, and there is little reason to think that privatization will enable the two instruments, shop-worn from overuse, to produce

better results. At a more general level, the notion that privatization raises aggregate savings and crowds-in private investment has a very thin basis in macro-economic theory: it is possible, but unlikely.¹³

The track record on educational expenditure in Brazil also suggests that the notion that the revenues from privatization will flow strongly to social programmes should be taken with a grain of salt. Deteriorating primary and secondary schools notwithstanding, over 80% of the central government's shrinking educational budget has been going to higher education. Virtually all university entrants come from private schools, as the quality of the public schools has fallen too low for them to be able to prepare their graduates adequately for the stiff university entrance exams. Since public universities are tuition-free, the central government has thus been using most of its educational outlays to provide free university education for the children of the wealthiest 10% of Brazilian families. It need not wait, therefore, for privatization revenues to augment its education budget. By charging tuition at its universities, it could increase the funds available for schools serving the lower 90% and for the award of university scholarships based on real need. Although such a move is widely recognized as sensible and long-overdue, it is also widely judged to be too hot to handle politically. What, then, would protect the privatization revenues from also falling victim to this lack of political commitment to serving the poor?

II

The dubious case for minimizing the public sector on developmental grounds

Latin America is a heterogeneous economic region, and conjunctural factors are having a varying impact on the region's economies. From an economic development perspective, however, the economies share various structural shortcomings that have kept their productivity and material welfare levels well below those of the economically advanced economies. These factors have been extensively analysed in the literature on late development, and overcoming them has been the objective of the dirigiste industrialization policies –including import substitution

industrialization– pursued by all the late industrializers in this century, albeit in different combinations and with varying success.¹⁴ If the free market and privatization drive in the region really represents a permanent “revolution” in development strategy and is a basic rejection of the dirigiste path rather than a

¹³For a comprehensive assessment pointing to this conclusion, see Werneck, 1989, pp. 277-308.

¹⁴For a more detailed treatment of many of the points briefly touched on in this section, see Félix, 1989, pp. 1455-1469.

limited crisis-driven deviation from that path, it should have a convincingly superior theoretical paradigm for guiding such strategy.

The closest to such a normative paradigm is probably the small competitive open economy model, which purports to demonstrate that the most effective way to offset developmental shortcomings is to give domestic markets full freedom to integrate with world markets, since this would allow the forces of competition to "get prices right," i.e., unify the internal with the world relative prices of all internationally traded goods and factors, so that domestic effective demand is fully met, regardless of shortfalls, by foreign and domestic sourcing in proportions determined by comparative costs and profitability.

The defects of the model as a comprehensive paradigm are well recognized in the literature on economic theory. Even the formulators of free market policy in the international financial institutions and Latin American economic ministries use it more as a promotional tool to sell policy to the public than as a serious guide to designing policy. Nevertheless, since dirigiste policies play up the defects of the model, it is useful to identify the major faults that dirigisme is intended to offset.

One is that the model is merely an exercise in comparative statics. Having no time dimension, it can offer no insights on processes, policy priorities, speed of change and other essential policy questions having to do with dynamic relationships. This flaw belatedly caught the attention of economists enthused by the Argentine, Chilean and Uruguayan free market programmes of the 1970s, when those economies crashed in the early 1980s. The crashes spawned a *post mortem* debate on the correct sequencing of liberalization measures, but although the debate showed a new awareness among free market economists that the path to a stable, free market outcome is narrow and slippery, no consensus was reached on which sequences of liberalizing reforms can make it through successfully and which are likely to crash. The debate is on again today, with the main focus shifted to Eastern Europe. Once again, the outcome is inconclusive, though a further analytic advance has emerged in that some participants concede that initial conditions in the East European economies may preclude more than a mixed economy outcome. This belated recognition of a commonplace of the exact sciences—that initial conditions affect final outcomes as well as transitional paths—is

also a rejection of the claim that the small competitive open economy model is a relevant normative paradigm for all Third World economies, regardless of their heterogeneity.

This model's incompleteness is further manifested by the exclusion of international labour market integration from its optimal arrangements or, for that matter, from its analytic purview. Although advanced economies closely regulate immigration from low wage countries, the proponents of free market restructuring, while vigorously attacking policies that restrict domestic labour mobility, are singularly silent about policies that restrict international mobility of this resource. This reticence is probably because free international migration opens up a can of worms with regard to considerations of welfare and of the limits political stability imposes on the speed and level of migration in both emigrating and receiving regions.¹⁵

Price formation is another shaky feature of the open economy model. Free markets are assumed to act as pure auction markets, in which trades are made only at market clearing prices, these "right" prices appearing to each market agent as parameters that he is powerless to manipulate in order to improve his position. This view is at odds with the main thrust of modern market analysis, in which auction markets are a relative rarity and firms in the more typical markets, rather than being passive "price-takers," manipulate prices as part of their market strategy. Prices as a strategic variable mean not merely that individual firms have some price-setting power, but also that announced prices typically have fringes of side terms—publicized as well as unannounced quantity discounts, rebates, bonuses and penalties—that may vary between rival firms and discriminate between classes of clients, thus blurring the operational meaning of "right prices." Strategy also implies that market competition is a bargaining game in which asymmetries of information and bargaining power between rival firms and between sellers and buyers shape the bargaining outcomes.

¹⁵ The factor price equalization theorem of static international trade theory has been used to make the case that free trade is an adequate substitute for international labour migrations. President Salinas is currently trying to persuade U.S. unions and other opponents of mass immigration from low-wage regions that a free trade pact with Mexico would curb the flow of Mexican migrants across the border. For Mexico, however, this theorem as a welfare justification for free trade is no more than a tattered fig leaf. Even the static conditions required for equalization of relative factor prices have been shown to be too onerous for the theorem to be taken seriously as a policy guide.

Collective action by Latin American economies to offset some of these asymmetries dates well back into the *laissez-faire* era, taking three main forms. One was price-fixing agreements between domestic primary goods producers, with the government brought in as enforcer during depressed periods when free riding tended to get out of hand. The inter-governmental commodity agreements of more recent vintage are extensions that seek to overcome international free riding by primary producing countries.

The second form was action to tilt toward the host country the Ricardian rents associated with foreign-owned production of primary commodities for export. Differentially heavier taxation of such rents dates well back in Latin America: to the taxing of Peruvian guano in mid-19th century, and that of Chilean nitrates later in the century. The motivation was not necessarily developmental. In the Chilean case the landed oligarchy, then in full control of the State, substituted nitrate taxes for land taxes, and spent the tax relief windfall primarily on consumption. Later, the developmental motive for nationalizing Ricardian rents—to expand the nation's investible surplus, elevate skills by requiring foreign firms to employ and train nationals for technical and managerial positions, etc.—became more prominent. The consumption motive also persisted, but with some democratizing of the gains, usually stemming from political democratization that helped employees of the foreign firms to induce the State to display neutrality or even support with regard to their efforts to exact higher wages and fringe benefits. Nationalizing the foreign firms was often the final stage of a prolonged struggle over Ricardian rents. It is not clear why reselling to foreign investors should remove these rents as a future bone of contention between investors and the host country.

Ricardian rents, which derive from the disparate quality and accessibility of natural resources between countries, also have a dark side with regard to natural resource-based production inputs: the "Dutch Disease" to which resource-rich primary exporters are prone. This term was coined to describe the adverse effects on the competitiveness of Dutch industry brought on by the Netherlands' natural gas export bonanza in the 1970s. By pushing up the exchange rate, the gas exports cheapened competitive industrial imports and squeezed industrial exports. In this case, the "disease" was mild and short-lived, as Dutch industry was able to draw on its ample technological and managerial prowess to adjust and

recover. In primary exporters lacking such prowess, however, the "Dutch Disease" is more chronic and virulent. It limits the ability of market forces to diversify the economy during export bonanzas, contributing to the "Growth but not much Development" outcome characterizing many such export bonanzas. The potential cures for the "disease" are all interventionist.¹⁶

A third form of intervention—the establishment of government banks in order to lower the cost and increase the availability of credit to private borrowers—also dates back in Latin America to the 19th century. Initially these were State mortgage banks, established at the behest of the landowning elite to tap the lower-cost London bond market and relend on generous terms against land as collateral. In the past half century the gamut of State banking has been enlarged to provide easier credit for industry, construction, peasant agriculture, etc. Though usually a response to particularistic demands, there is a broader theoretical legitimacy to using State banking as a development tool, although this does not extend to many of the ways it has actually been used. For reasons inherent in loan contracts, international financial markets tilt against less-developed economies, thereby creating opportunities for collective action to reduce capital costs.

Such opportunities exist because financial markets are inherently non-clearing markets, loan contracts being inter-temporal and the future uncertain. Lenders use various criteria, based ultimately on subjective judgment, to reduce default risk. They screen borrowers, quantity-ration credit to those that pass the screening, collateralize loans, appraise spending and cash flow projections of borrowers, and incorporate default risk premia in their lending terms. Conservative lenders rely more on screening and credit rationing; risk-taking lenders screen more loosely but raise the risk premia. The lending terms also incorporate liquidity premia to protect against inflation, interest rate changes and other market risks that raise the opportunity cost of being locked into long-term loans. Liquidity premia are therefore lower in financial centers that are rich in specialized institutions and instruments and have well-developed resale markets for spreading the liquidity risk in long-term lending. The greater availability of long-

¹⁶See Marcelo Diamand, 1972. His special empirical focus has been the "Dutch Disease" as a deterrent to Argentine industrialization. See, for example, his "Argentina's Pendulum: Until When?", in Diamand, 1986.

term credit and the lower liquidity premia in such markets relative to those in less developed financial markets provide the economic rationale for using the greater visibility of the LDC State in foreign financial markets in order to overcome informational barriers that exclude private applicants from less-developed countries.

Liberating the feeble financial markets of less-developed countries does not eliminate the tilt. Local firms continue to incur a higher cost of capital than their advanced country competitors, because high risk premia still need to be paid in order to keep local financial capital from draining to the more diversified and liquid financial centres and to attract loans from these centres. The motive for using the State as financial intermediary therefore persists. And in Latin American countries, where financial asset holdings are especially highly concentrated,¹⁷ this motive is reinforced by equity concerns. A policy that strengthens the power of financial capital to keep domestic interest and tax rates hostage to capital flight, would augment the already highly concentrated wealth and income distribution of the region and exacerbate its endemic instability.

The acquisition and production of new technology, so central to the economic development process, also offers important opportunities for collective action to offset market biases. The international market for technology is inherently monopolistic and two-tiered. In the top tier are the leading innovators of each industry: large firms that also have ample reverse engineering capacity and skills for replicating the innovations of rival firms. Such firms have a mutual incentive to share technologies in order to minimize duplicative technological research, preemptive patenting and other costly stratagems of technological competition. They typically join in cross-licensing agreements, and organize joint R & D ventures for sharing costs and risks of major technology projects. The lower tier consists of the remaining firms of each industry who, lacking the innovative threat capability needed to break into the top tier, have more circumscribed access to innovations of the top tier firms, for which they have to pay monopoly prices.

¹⁷ For example, the 1977 Banco de México survey of household income and expenditure showed that around nine-tenths of private financial assets were held by the top 10% of Mexican households. See Martínez Hernández, 1989.

Since Third World firms are generally in this lower tier, from the development perspective there are sound reasons why their governments should try to improve their terms of access by limiting licensing fees, untying technology packages, etc. The effectiveness of such efforts has varied greatly. South Korea has had considerable success (Amsden, 1989), but the Latin American countries, with the partial exception of Brazil, have had much less. Indeed, in their current anxiety to entice foreign investors, Latin American governments have suspended virtually all such efforts.

However, the central importance of technological progress for sustaining economic development is unlikely to allow the current submissiveness to the dictates of the technology producing countries to be permanent, because heavy dependence on foreign sourcing of domestic technology retards the ability of domestic producers to adjust their production processes and output mixes flexibly and denies them and the economy earnings from technological rents. Using the State to overcome various technology market shortcomings that impede the development of indigenous innovative capacity has been a prominent part of the economic history of today's developed economies, which has given it grudging intellectual respectability among free market economists. They accept the theoretical case for State financing of research: i.e., that market forces alone will encourage only bankable projects (those whose contribution can be privatized and marketed profitably by the innovating agent). They also accept the two main theoretical justifications for protecting and subsidizing new ventures: that learning curves lower production costs and learning-by-doing stimulates technological innovation. Their argument against interventionist policies to promote technology is, rather, that for various political economy reasons governments are likely to do this badly. The small open economy model boils down to a second-best development model, but to them it remains the best in town.

Setting aside political economy complications, the aforementioned flaws in the small competitive open economy model imply that, in the language of complex systems analysis, dirigisme rather than laissez faire is the pole of attraction toward which late-developing economies will gravitate if their policy dynamics are governed primarily by economic efficiency and a reasonable consensus on growth and distribution. Dirigisme and mixed economy are, of course, vague concepts used also to describe the

policy stance of advanced capitalist economies. However, the key market biases that work against late-developing economies mean that the economic logic rationalizing their dirigisme goes well beyond the public goods arguments used to support State intervention in advanced economies, and this impels less developed economies toward a more comprehensive economic role for the State than in advanced economies.

Two political economy complications emphasized by free market economists do, however, roil the policy dynamics involved in this approach. The first is that the human capital shortcomings that keep labour productivity in less developed economies relatively low may also be expected to depress the efficiency of the public bureaucracy. Assigning that bureaucracy even more comprehensive economic responsibilities than are required of their advanced country counterparts is therefore an inconsistent strategy that is likely to overload the public sector's administrative capacity and retard rather than advance economic development. The second complication is that interventionist policies tend to be diverted from their developmental functions and to become merely protected sources of income for rent-seeking groups with economic and political influence. To free market economists, these two forms of government shortcomings suffice to offset the market failures, leaving the small competitive open economy model with its minimalist State as the guiding star for developing economies.

The evidence, however, supports only the existence, and not the sufficiency, of the government shortcomings. The differences between Asian and Latin American NICS as regards the scope of their

dirigisme are much too small to account for the greater macroeconomic stability and accumulation rates, and lesser technological dependency and income concentration of the Asians (Bianchi, Kagami and Muñoz, 1989). The inference is that development is to an important degree path-dependent, with institutional and cultural differences in initial conditions between countries accounting for some of the differences in effectiveness with which similar development strategies are being implemented.¹⁸

What does this imply for the long term? One possibility is a paradigmatic stand-off, with the Latin American elites remaining narrow rent-seekers and the masses prone to salve their discontent at the worsening inequalities with unfeasible populist quick fixes, in which case neither the potential of dirigiste development nor the market efficiency of the free market strategy would be attainable. The other is that as the Lost Decade drags on, desperation will generate a deeper sense of commitment to the larger society. In a sort of symbolic Bonfire of the Vanities, the elites will temper their rent-seeking and tax avoidance and the masses their quick-fix populism in order to regain some developmental momentum. Such ennoblement would greatly improve the implementation of either of the strategies. But since the dirigiste development approach has much the greater potential, why should we expect the ennobled Latin American NICS to settle for the second-best small competitive open economy alternative?

¹⁸ A path-dependent explanation of the superior performance of Asian over Latin American NICS is given in Félix, 1989.

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