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Crisis, adjustment and economic policy in Latin America

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The crisis in Latin America has a *sui generis* character, the elucidation of which has impelled the author to venture into virtually unexplored fields of interdisciplinary analysis and to make generalizations covering a variety of national situations. Within this framework, he asserts that many of the central problems which look like conjunctural distortions—shortages of foreign exchange, deficits in public finance—in reality stem from imperfect structural adjustments both in the international economy and within the Latin American countries, the treatment and cure of which will be much more than a short-term matter.

To all this is added a set of circumstances which hinder the application of appropriate solutions, such as the decline in the industrialized centres' ability to provide development aid, and the undermining of the leadership capacity of governments by the doubts cast on the ideological and programmatic commitment to guarantee sustained growth, a target difficult to attain when economic self-determination has sunk to its lowest in the recent history of the region.

Should this diagnosis be correct, the remedies are not to be found in the prescription-book of economic stabilization policies, although this does not mean that it is superfluous. The task of making stagnation acceptable, or growth rates far below those recorded in the past, poses questions that go beyond the economic sphere. In this sense, the true answers are to be found in the political sphere, because only there could the foundations be laid for the social consensuses which would enable State and society to join in a national commitment with the aim of regaining self-determination and access to development.

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It is by now a commonplace to assert that Latin America's economic crisis is the most profound, the most protracted and the most generalized since the Second World War. It is not so often said that after four years of declining per capita income and of sacrifices on the part of the bulk of the population, the intentions of the adjustment policy applied, with the natural lags and variants, by the great majority of governments are still far from being fulfilled.

The per capita product decreased by over 9% between 1980 and 1984 (ECLAC, several yearly issues). Its level today is similar to that attained seven or eight years ago. National income must have been still further compressed, to judge from the deterioration of the terms of trade (23%) and the increases in external debt servicing. There are countries, and in particular social sectors within them, that may well have lost between one-fourth and one-third of their former income.

One encouraging sign is that the balance-of-payments current account deficits have plummeted down from over US\$ 40 billion to US\$ 3 billion in the above-mentioned years. But perhaps that is not so much a symptom of convalescence as an indication that adjustment has followed an essentially recessive course (ECLAC, 1984). It should be noted that the trade balance climbed from a negative figure of TJS\$ 1.6 billion to a positive one of US\$ 37.6 billion. This remarkable result is not attributable to an increase in sales abroad—which shrank by a little over 2% in the period—despite the fact that movements in internal relative prices were generally favourable to the products described in technical jargon as marketable or tradeable. The correction of the balance, then, was linked to a brusque recessive contraction in imports which reached figures of about 40%.'

'The data cited probably give an over-pessimistic picture, inasmuch as the gestation periods in the development of new lines of production and new external markets are not explicitly taken into account. By way of illustration, it is worth while to point out that in 1984 the nominal value of Latin America's exports rose by almost 10%, as a result of the recovery of the United States economy in combination with the strategic effort made mainly by the larger Latin American countries with more flexible production capacities (Brazil, Mexico, Argentina, Venezuela).

In the years referred to the external debt increased from US\$ 275 to US\$ 360 billion, not so much because further freely disposable resources had been received but rather in consequence of the capitalization of interest agreed upon *de facto* in the renegotiation processes (Iglesias, 1985). With a slight recent trend towards improvement, debt servicing was equivalent to 35% of total exports of goods and services (1984) and also represented the principal item in government budget deficits. Indebtedness has become a burden whose weight is helping not only to suppress the traditional contribution of external saving to capital formation in the developing countries—in Central America, for example it had come to represent between 40% and 50%—but also to compel countries in crisis to become net exporters of capital or to set Draconian limits to the investment and development promotion capacity of governments over periods that seem likely to stretch beyond the present decade.

Despite the easing of world inflationary pressures and the fairly widespread implementation of severe measures to restrict the expansion of domestic demand (curtailments of public expenditure and of credit, increases in taxation and interest rates, incomplete adjustments to restore the purchasing power of wages, rationing of the foreign exchange supply), inflation, far from languishing, seems to be gaining new strength as time goes by. In the three-year period 1979-

1981, the weighted consumer price index kept to growth rates of not much more than 50% yearly, but thenceforward it went up by leaps and bounds, until it reached a rate of 175% in 1984 (Iglesias, 1985). In practice, in many countries the spectacular internal stabilization efforts have proved vain; what is more, the all too common presence of marked distortions in relative prices seems to forebode new upward readjustments in the future.

Crisis and adjustment policy together have weakened the public and private capital formation process—the investment coefficient declined from 22% to 16% between 1981 and 1983—detracting from the flexibility of the economies as regards the promotion of structural changes or the absorption of their inevitable costs. And this is a determining factor in the countries' capacity to perfect their internal economic autonomy, or to gain a better footing in the international economy.

Hence it can be inferred that the Latin American crisis has its own peculiar connotations. It would therefore seem justifiable to make some attempt, even if only at the level of a first approximation, to identify its true causes. In particular, it is worth while to ask what are the characteristics that distinguish the depression of today from the cyclical fluctuations of the postwar period, giving it unwonted depth and nullifying the action of the time-honoured remedies.

I

The direction of the changes in the international economy

It is undeniable that the last half-century has witnessed a gradual but certainly cumulative series of changes which are now substantially altering the operation of the world economy. The most manifest symptom of these changes is a tightening of the bonds of interdependence—dependence of countries upon one another, together with the corresponding loss of economic self-determination on the part of national units. The chain effects following upon the upheavals in the petroleum market or in interest

rates reveal the existence of intricate mechanisms of international transmission of distributive pressures, as well as the impossibility of restoring for any length of time—except, perhaps, in the United States—national policies that run counter to the exigencies of the international cycle.

The materialization of more and more technological advances and innovations of other kinds, superimposed upon the former determinants of the composition of international trade, is rendering obsolete and incompletely

and perhaps unfairly altering the international division of labour still in force between the Third World and the industrialized centres. To check the accuracy of this first proposition, suffice it to list some of the ongoing processes of change, without probing far into their deep significance: many branches of economic activity that made steady and world-wide progress in the last three-quarters of a century are showing signs of decadence, while there is a vigorous upsurge of new spearhead sectors, as they are called, which, albeit not yet consolidated, are benefiting by a demand in process of formation and unsatisfied (UNIDO, 1983 and 1984); for that very reason, market and investment preferences for lines of production with a high technological content are gaining a firm footing, while traditional capital-intensive or labour-intensive projects are relegated to a secondary plane; albeit offering decisive advantages, the world-scale integration of the financial and merchandise markets means that, under pain of productive marginality, economic decisions formerly regarded as the special province of State regulations are placed outside the control of national governments; furthermore, rapid changes are beginning to take place in what used to constitute the energy basis of industrial organization, so that nowadays it can be confidently predicted that fossil fuel will shortly cease to be the *sine qua non* ingredient of modern production. The current energy pattern, already partly exhausted, could not be transplanted or fully reproduced throughout the world, without causing ecological catastrophes or overstepping environmental bounds and limits set by physical resources (Fajnzylber, 1983).

These readjustments will undoubtedly end by opening up a new development horizon, with beneficial results for both civilizers and civilized. Nevertheless, in the transition period through which we are passing, the gestation of these phenomena exerts a disconcerting influence, creates uncertainty, enforces sacrifices and enormously complicates—as is the case in Latin America—the government of social policies and of economic policies. Let us look at some of the consequences which seem to be overthrowing the ordered world of postwar prosperity.

In the first place, the stability of the comparative advantages that propped up the former international division of labour and the theories

of international trade is being seriously undermined. From one standpoint, for example, the competitiveness in manufactures painfully acquired by the developing countries through the use of highly labour-intensive techniques may well melt away in face of the proliferation of automated methods of production (robotization). From another angle, electronic control of production might eliminate the predominance of economies of scale and lead to greater differentiation of supply, with obvious benefits for the countries with small populations and markets.

Be that as it may, what is at stake is the restructuring of the foundations on which the new international division of labour must be erected. But perhaps this new division, however closely its emergence is attended by the intention of assigning great benefits to the pioneers, cannot be stabilized, or stabilize international economic relations, without a consensual formulation of agreements among all the countries involved. Nowadays, comparative advantages depend less and less upon the initial endowment of natural resources, or upon the plentifulness of capital or labour, and much more upon a stable world climate with a propensity to concerted action, as well as upon each country's persevering efforts to attain excellence in specific areas of production (Feinberg, 1983).

It should be noted that together with the unremitting pressures as regards the distribution of the benefits of international trade, a yet more basic question now arises: namely, the sharing-out of exportable production among the different countries. The fundamental problem for the Latin American economies is that of defining which will be their stable sources of foreign exchange in the future, rather than striving to obtain better prices for the primary products which they already export, which, in a good many cases, are decreasingly in demand, and which are exposed to the risk of being displaced by substitutes or by rival products with more advanced technology.²

²Although a foothold has been gained in trade in manufactures, mainly under the regional and subregional integration programmes, in many respects the attainment of a dynamic insertion in international trade is still lagging a long way behind. Of the 18 most important export products, only

Secondly, the process of industrial integration on a multinational scale—whose promoting agents are the older and younger generations of transnational corporations—is benefiting global productive efficiency and the employment of factors *in situ*. But it does not yet offer satisfactory answers with respect to the distribution of income among the participant countries, or to formulas for offsetting the loss of economic self-determination, especially in periods of depression or when an unfavourable change takes place in the composition of certain countries' external demand (UNIDO, 1984). Here there is an incomplete process of institutional and legal change, inasmuch as the *de facto* incorporation of countries into a fused production system has not been perfected by an international set of rules establishing a system of reciprocal guarantees among the participant States.

The third effect of the uncompleted changes in the international economy has been to weaken, even if only for the time being, the industrialized centres' capacity to contribute to the development of the peripheral areas, since they are finding themselves compelled to devote the bulk of their energies to internal adjustments. The reduction of concessional aid to development, the obstacles to the replacement of capital and to the expansion of the lending power of the multilateral financing institutions, the rise in interest rates itself, all bear eloquent witness to this diminished capacity (ECLAC, 1984, 1985 a and 1985 b; Prebisch, 1981; Feinberg and Kallab, 1984; Haq, 1985). So does the fact that to the old-style protectionism with which the advanced countries covered, for example the non-competitiveness of their agricultural activities, is now added a new form of protectionism which arises out of the ageing of industries that are reluctant to give way before the redeployment of production on a universal scale.

Nevertheless, the most striking manifestation of what is being stressed here consists in the fact that for the first time since the Industrial Revolution in England, the leading western economy has become a net importer of capital; instead of exporting surplus financial resources, it

five (meat, fish meal, wool, soya and petroleum) could reap the benefit of high income-elasticities; the remainder are already recording static or declining growth rates.

has to draw upon international saving to defray internal expenditure, entirely reversing the traditional mechanics of balance-of-payments adjustments.

Lastly, it must be realistically admitted that the adjustments and changes in process of gestation within and among the industrialized countries are determining a programme of work in the international sphere under which treatment of the developing areas is relegated to a secondary place. Prior to reforming the old North-South *modus vivendi*, attention will undoubtedly first be devoted to the issues of trade, division of production, opening-up of financial and merchandise markets or financing of the reciprocal trade balances of the members of the First World (Bergsten and Krause, 1975; Norr, 1975). It seems unlikely, therefore, that the question of Latin American indebtedness will be thoroughly tackled while there is still disagreement as to the management of exchange régimes, of interest rates, of control of capital movements or of formulas for symmetrically adjusting persistent disequilibria in the balance-of-payments position of the main industrial countries (Clein, 1982).

Similarly, it may perhaps be idle to trust in a vigorous and sustained recovery of the world economic centres and even to rely upon their aid to development during the present decade. First they have to make sacrifices and concentrate resources—as industrial restructuring in Europe shows—on adapting manpower and physical facilities to the accelerated modernization enforced by the international technology race and the consolidation of the new spearhead sectors.

The generalized character of the crisis in Latin America suggests that its origin is mainly external, i.e., determined by the adjustments in the international economy. Similar effects are felt by countries markedly differing in size, degree of industrialization, political and administrative organization and economic development strategies.

In any event, for the reasons stated, solutions for the crisis cannot come from outside. Latin America must seek them in the organization of its own strength and enterprise, even in order to break through the inertia of the economic policy priorities of the industrialized centres. The way is not clear, there are countless obstacles; besides, the price of experimenting, failing and trying

again will have to be —is already being— paid. In the new circumstances, economic growth will no longer be easily achieved; governments will have to mobilize the whole of society around a nationalist and democratic effort, so that the sac-

rifices of economic reconstruction can be made tolerable and are not the cause of unbridgeable social fissures. Accordingly, the time has now come to examine, even if briefly, the internal situation of the Latin American countries.

II

The Latin American sphere

In the interval between the end of the Second World War and the mid-1970s Latin America made noteworthy progress in building new economic structures, bettering the average living conditions of the population, forming new social strata, and becoming industrialized and urbanized. During this period, the Latin American product was quintupled and industrial output sextupled, employment in the modern economic sectors increased fivefold, and a thriving middle class came into being.

The convergence of rising external demand and the thrust of domestic import substitution paved the way both for an intensive economic modernization process and for acceptance of what we shall call here "development ideology". It was at once the cause and effect of prosperity that the legitimacy of the Latin American State, as well as its capacity for convocation and for political mobilization, gradually shifted away from the older Latin American reformist traditions and the ideals of economic justice and open participation in politics, and rested more and more firmly on the capacity of governments to foster and achieve economic growth (*Pensamiento iberoamericano*, 1984).

This growth, with its power to increase the income of almost all social strata without the necessity of directly tackling the difficult questions of distribution, became a substitute for social reform, a harmonizing influence that mitigated political tensions and the integration factor *par excellence* of the Latin American societies. Thus, it passed almost unnoticed that the goal of economic growth had ceased to be an instrumental objective —the means of attaining higher ends— and had become the very backbone of action on the part of the Latin American States and the source of the legitimacy of their

governments. With this in view, the new ideology postulated that economic progress would be bound to generate, almost automatically, political modernization and social justice.

The new approaches were rapidly consolidated, because in many instances they deferred open conflicts and made it possible to give almost everyone a little more, to maintain a concentration of income compatible with a respectable capital formation process, to open the way for the emergent economic groups and to render tolerable —in the expectation of better things— the widening gaps in levels of living and consumption that separate us from the industrialized societies. It was not everywhere, however, that harmony reigned. The intensive economic growth that had taken place since the war subjected each country's body of institutions to severe pressures. In some cases, genuine modernization of political and social life has occurred; in others it has not been possible to escape the formulas of authoritarianism; and in yet a third group, democratization and authoritarianism have alternated in shaky equilibrium, with no clear and definitive settlement of the question.

Even so, the outstanding fact is the switch-over from politics to economics. Growth, by virtue of its efficacy in facilitating the reconciliation of interests and in concentrating the energies of society on a limited set of problems, assumed the leading role and eliminated from public discussion what had traditionally constituted the very essence of political action. The instrumental advantages were many; it should be noted, by way of illustration, how the thorny problems of upward social mobility were solved in gradual and orderly fashion through the multiplication of jobs which accompanies economic expansion.

It is not surprising, therefore, that gov-

ernments should have gone on from being passive arbiters in economic affairs to become by *antonomasia* promoters of economic development and agents responsible for achieving it. And that is why the Latin American State has wholeheartedly joined in the world trends which determine a spectacular increase in the breadth of public functions and in the weight they carry in the economies.

A first component of government expenditure is aimed at correcting the effects of distributive inequalities, an intention prompted in the internal sphere by considerations of equity, if not by the political need to reduce potential sources of conflict, and in the external sphere by the revolution in expectations brought about by the Welfare State and the consumerism of the industrialized nations.

A second item in public budgets that has been rapidly expanding through time is constituted by outlays on the promotion of economic development, i.e., expenditure relating to programmes specifically designed to facilitate the development of private enterprise.

In Latin America there is a Statist tradition whereby governments encourage or assume responsibility for specific activities in terms of general development interests. But State interventionism does not figure as a means of socializing economies, but as a formula for making up their leeway in a shorter space of time or as a corrective of the defects of economic behaviour with a view to keeping it faithful to the service of individual interest, expressed through market laws. Even government-owned enterprises, rather than competing with or displacing those of a private character, support and complement them. These public bodies are usually providers of physical infrastructure (roads, ports, dams, airports), of basic services (energy, transport, financing, education) or of inputs in common use (minerals, steel, chemical products, fertilizers), which benefit the expansion of private businesses in all sorts of different ways.

Setting aside the financing of the control machinery of the forces of law and order, the economic necessity of stimulating the private entrepreneurial sector, together with the political need to protect the weaker population groups, peremptorily called for expansion of the Latin American public sectors in the sphere of produc-

tion and of distribution (Cardoso and Faletto, 1979). To put it concisely, for several decades dynamic equilibrium was achieved on the basis of rapid growth of the product—sufficient to combine substantial increases in productivity and net absorption of manpower from the subsistence sectors—, accompanied by a capital formation process which evolved slightly faster and by public expenditure which was also gaining importance in the composition of aggregate demand. The incorporation of manpower previously left marginal to the modern sector of the economy satisfied social demands and mitigated biases towards concentration in income distribution. On their side, the technical and professional middle classes met with similar responses in the multiplication of opportunities for moving up into better jobs, created by economic expansion itself.

The model described, albeit functional at a given time in the past, could not be indefinitely prolonged without adjustments. Its limits were first encountered when the State apparatus began failing to meet, or only partly meeting, the proliferation of social demands—to some extent suggested by the achievements of advance societies—while, on the other hand, the increase in public expenditure became a burden and a factor of rigidity in the market economy.

To pick out only one element in the intensification of social demands, reference may usefully be made to demographic pressures. The region's population growth rates are still among the highest in the world, despite having already entered upon their declining phase. The rate of expansion of the labour force, however, will remain at maximum figures—between 3% and 4% per annum—until the end of the present century. This enormously restricts the real influence of economic policy as regards satisfying the aspirations of large segments of the population: the marginal sectors, the rising generations or the groups of women that are seeking to enter the labour market in the modern economic sectors.

Hence the widespread propensity of the Latin American governments to incur deficits in their public accounts and to run into debt abroad. While demands became more numerous and more pressing, the readiness of enterprises and populations to pay heavier taxes or finance

public expenditure with genuine savings was definitely lessening. Confronted with this paradox, governments continued to regard public expenditure as still the key to growth and with it the stability of the whole social edifice. Accordingly, they resorted in varying proportions to deficit financing or to external borrowing, in the hope of gaining time for the completion of internal changes or of seeing favourable modifications take place in the international sphere.³ With insufficient or falling income the curtailment of public outlays might be necessary, but it ran counter to the postulates of development ideology and, above all, eroded the governments' social bargaining capacity, at the very time when they needed it most (Stepan, 1979).

Furthermore, in the economic sphere the foregoing constraints coincided in a good many countries with problems deriving from the exhausted validity of national development patterns, due either to the slackening of the dynamic impulse of import substitution, or to market size limitations, or to shortcomings in methods of integration in the international economy, or to the necessity of tackling other structural or organizational changes in production (Collier, 1973; O'Donnell, 1973). In any case, the renovation of national development patterns made considerable demands on government budgets in respect of providing the new physical and services infrastructure for private enterprise, socializing a significant proportion of the costs of investment in productive activities or of their restructuring, and subsidizing the branches where it was desired that investors should concentrate future growth efforts.

Nevertheless, the factor precipitating the crisis was of external origin. The scarcity of foreign exchange markets which followed upon the second oil shock (1979), complicated by the fall in export demand and prices and the interruption of international credit flows precluded continuity in the pursuit of the development objective, inasmuch as the capacity for manoeuvre of traditional economic policy was surpassed.

³It should be noted, for example, that during the 1974-1976 recession in the world economy the Latin American countries, still having room for manoeuvre, almost without exception carried on their growth strategies *à l'outrance*, following a clearly anticyclical policy.

And here occurs a pernicious reversal of the questions of the cycle and of structural change. Looking after the immediate problem of the shortage of foreign exchange implies a previous transformation of the insertion of countries in the international economy. It is not a matter of simply exporting larger quantities than are sold already, since they would neither find a market nor bring in long-term profits, but of striving to place a new constellation of products as yet not even moderately clearly identified.

Overwhelmed by the disequilibria in external payments, in public finance and in inflation, governments have found themselves compelled to renounce growth, to introduce severe adjustment programmes and to permit the accentuation of the existing disparities in income distribution. But in doing so, they not only place at risk the delicate dynamic equilibrium of the social forces, but break with the ideologically accepted view of the State's responsibility for raising the population's standards of living in consonance with democratic progress. This is why in Latin America the economic crisis may culminate in a political crisis, in a crisis of the legitimacy of States that find themselves incapable of meeting the highest objectives to which they have committed themselves in what might be described as a basic social consensus. It is not that outbreaks of social violence are foreseen; rather, the risks are those associated with a stage of impoverishment and tension in relations between the State and the civil community, which make the reorganization of the Latin American societies an extremely difficult undertaking.

It is often maintained that Latin America has been more profoundly affected by the international depression than, for example, the developing Asiatic countries of the Pacific Basin, their heavier external debt being identified as the causal factor. The analysis is accurate. What is overlooked is the complex of socio-political circumstances in respect of which the two regions differ and which are determinants of everything from the behaviour pattern of the economies to the definition of viable policy options.

In the American continent the western values of liberty, democracy and political pluralism have perhaps penetrated more deeply; whereas less intensive is the social cohesion born of a

national identity in which individualism is subordinated to the consciousness of belonging to a collective body with interests transcending those of its members. The former characteristic leads even authoritarian governments to choose comparatively more complex blends of economic and social objectives, because there is also a wider variety in the demands of the population on which

their political legitimacy depends. The latter, in another way, likewise brings with it complications in the conduct of public affairs, especially in the selection of non-coercive mechanisms for inducing economic agents willingly to direct their behaviour towards the attainment of objectives of national scope (Upset, 1982; Lowi, 1979; Hirschman, 1982).

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