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ECONOMIC AND POLITICAL TRANSITIONS IN SOUTH AMERICA */

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The views expressed in this work are the sole responsibility of the author and do not necessarily coincide with those of the Organization.

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Political instability has long been a characteristic of South American countries. The international economic crisis of the 1980's has made the problem worse. The most dramatic sign of the crisis is given by the inability of several Latin American countries to pay their external debt under the conditions originally negotiated.

After a period of deep pessimism, the recent round of successful negotiations concerning the rescheduling of the external debt of Mexico and Venezuela, has given way to the feeling that

Justified or not, this feeling makes it now possible to look beyond the short-term crisis and focus on possible long-term consequences of the current economic crisis. These longer term effects can be grouped under two general headings. The first concerns the capacity of the countries to resume a process of economic growth and social development once the emergency is passed. The second refers to the likely political impact of the economic crisis and what it will do to the prospects of democracy in the area.

We will explore in a very tentative way these issues in the pages that follow. We hope to be more provocative than systematic or thorough in the treatment of these issues. The main purpose is no more than to induce a discussion --as lively as possible-- of problems that are of great concern to Latin Americans.

The Scenario: a Generalized Economic Crisis

As is already well known, Latin American debt has increased by seven times in the period 1973-1983, reaching the astounding sum of more than 330 billion dollars by the end of 1983. This represents 56% of the region's GDP and more than three times the value of Latin America's exports. About 80% of the debt corresponds to private banks credits and about a half of that was obtained without any kind of government guarantees 1/.

The service of the debt is already eating up a large share of the foreign exchange generated through exports. The debt service ratio for Latin America as a whole reached about 65% of exports by the end of 1983. But for several countries, this ratio was closer to 80%.

Economic projections covering the rest of the decade indicate the existence of a very critical dilemma. Even assuming an optimistic 11% yearly growth in exports in nominal terms (around 4-5% real export growth) and nominal interest rates around 10%, GDP would grow at rates that would allow Latin American economies to do no better than to maintain unemployment at the high rates prevailing today (10% as an average for Latin America in 1983), without additional improvements throughout the 1984-1990 period. In fact in order to achieve this result, new external loans would be needed in a volume that would increase the debt by 1990 to 617 billion dollars thus reaching a debt-service ratio equivalent to 50% of the value of exports by the end of the decade. That is, no significant improvements in the ability to serve the debt would be achieved. In fact interest payments alone would represent about 27% of the value of exports by 1990 2/.

A projection by CEPAL, based in OECD countries growth of 3.5% real export growth for Latin America at 3% a year and real interest rates of 6%, would indicate a likely GDP growth rate for the region not higher than 4%, which would imply that by 1990 Latin America would be just recuperating income per capita levels already achieved in 1980. An entire decade would have been lost, as a consequence of the new restrictions imposed by the debt situation as well as by conditions prevailing in the international economy in the 1980's 3/. Moreover, Latin America would continue transferring net resources towards the US and Europe, at the rate of fifteen to twenty billion dollars a year.

Obviously, the situation varies significantly from country to country, depending among other things on how important foreign borrowing has become, as a proportion of GDP or exports, and on the use given to the loans. Those countries, like Mexico or Brazil, that put a large share of the resources in large investment projects have a better prospect than the Southern Cone countries, where external resources were mainly used to finance the consumption of non-essential, imported goods.

Medium-sized countries like Perú, Chile and Colombia are likely to face a rather critical situation. Cepal projections show that their debt to export coefficients would remain consistently above what is considered acceptable by international banks. This conclusion is supported by De Vries study in this same volume 4/.

As is also well known, the debt crisis has forced Latin American countries --under simultaneous pressure from creditor banks and the IMF-- to adjust to the new conditions in a radical way. Imports in the area decreased by 40% between 1981 and 1983, the consequence of demand contracu

tion schemes typical of IMF stabilization packages 5/. The goods and services available per capita decreased as a consequence, to the levels of 1977 and in some cases, as in Chile, to the levels of 1966! On the other hand, due to the drastically curtailed availability of external funds, Latin America was forced to transfer to creditors in industrial countries more than 20 billion dollars a year both in 1982 and 1983, in order to avoid a payments crisis.

In spite of general recessionary conditions, the average rate of inflation went up for the region as a whole from 53% in 1980 to about 130% a year by 1983, an indication of the difficult problems faced by governments when simultaneously attempting to resolve an external sector crisis through successive devaluation of the domestic currency, while trying at the same time to avoid a deterioration in the situation of salaried workers that might result in serious political difficulties.

But, in spite of this, the social consequences of this drastic forced adjustment has meant, for several countries, severe reductions in wage levels, as in Mexico and Brazil, and a sharp increase in open unemployment, that went up from 7% in 1980 to 10% in 1983 for Latin America as a whole, with some countries reaching levels that go beyond 30%, as in the case of Chile.

What are the factors that led to the economic crisis? It is not our purpose to deal with this matter in any detail here, but a brief reference is unavoidable, if an effort is going to be made to avoid the same mistakes in the future.

In retrospect, the sudden availability of massive amounts of foreign loans in the late 1970's caught most Latin American countries unprepared. Some countries saw themselves suddenly in a position to obtain as many

external credits as desired. In order to be able to absorb these resources without a serious domestic inflationary impact, room had to be made for more imports to come into the country.

This was done in two ways: by reducing import restrictions and external tariffs, and by either fixing the exchange rate in nominal terms or by letting it lag behind domestic inflation rates. The exchange rate lag served the purpose of making imports even cheaper while discouraging exports. Thus, the surplus in the capital account was soon matched by an ever growing deficit in the trade balance. As interest payments began to accumulate, a growing deficit in the current account of the balance of payments showed up. By 1980, the deficit in current account for Latin America as a whole had already reached 5% of the region's GDP. In 1982, this ratio reached 6.5. ^{6/}

In some countries, this process coincided with deliberate attempts at trade and domestic market liberalization, structural reforms that were promoted by economists belonging to the monetarist school and that had had sudden access to economic decisions in several countries in the region during the 1970's.

The excess supply of external credit facilitated these reforms since the transition process from more interventionist policies towards laissez-faire type of policies necessarily implied adjustment lags in most markets that usually led to severe and prolonged disequilibrium. Output fell, firms accumulated stocks and were faced with stiff competition from

abroad. The access to external loans allowed some of the firms to survive the transition towards a highly competitive international environment, whereas others were not able to cope with the challenge 7/.

The latter consisted of those firms that had to borrow in a domestic capital market --characterized by real interest rates that were three or four times higher than the external rate. This huge difference was in turn the result, not only of higher risk and uncertainty in domestic markets, but also of market segmentation and oligopolistic control of a large fraction of the domestic capital market by newly emergent and powerful financial conglomerates.

But most firms, even when being forced to pay extremely high rates of interest, went on contracting new loans in the expectation of continued availability of funds and of high expected growth in demand.

Since funds continued pouring in, most firms began engaging in speculative ventures on the side, in order to help pay for high accumulated interest payments. As a result, the price of real estate, of land and other assets spiraled upwards 8/. As long as loans were forthcoming, there was always somebody willing to buy in the expectation of short-term capital gains.

These speculative "bubbles" were sustained by a private sector that was over-spending well beyond the income it generated. The excess of spending was in turn financed by foreign loans. Thus, contrary to conventional beliefs, and given that the largest proportion of new loans was indeed taken by the private sector, the process was not always fed by an excessive government

deficit, as by a private sector deficit that grew out of proportion.

This was reflected in large trade and current account deficits that had to be financed through ever increasing flows of external credits. Obviously, as in the 1930's, the process depended on the stability of expectations in order to be continued. As soon as these would change, there would be a stampede by foreign creditors to get out of the market as rapidly as possible, and by domestic speculators to hold (less risky) foreign assets, thus provoking an unexpected high demand for dollars, that would mostly end being transferred abroad. The subsequent loss of reserves would only reinforce expectations of an impending external sector crisis.

The process had to be stopped. Measures taken included maxi-devaluations, foreign exchange controls and drastic recessionary measures that would reduce the demand for imports.

The adjustment was made worse by several reinforcing changes in the international economic scene. One already mentioned was the pro-cyclical behavior of private international banks. As soon as the first signs of the downward swing were observed, most banks reduced the availability of new loans to that minimum level that would prevent default and would just allow countries to continue the payment of interest on existing loans. In the short period elapsed between 1981 and the end of 1983, the net inflow of credits to Latin America fell from 41 billion a year to a mere 4.5 billion in 1983.

Foreign loans had been growing at a rate of 30% a year between 1973

and 1980. Even with interest rates as high as 14%, a 30% growth in available funds meant that even after meeting interest payments, economic agents could count with 16 dollars of fresh external resources per 100 obtained in new loans. Thus it was thought that there would be ample opportunities to pay back the debt and still make a profit 9/.

When, suddenly, the growth rate of external credit became negative, many debtors were not able to meet interest payments any more, let alone payment of principal. The ratio of nonperforming loans for domestic banks rose sharply. This deterioration in the balance sheets of the banks created additional panic, forcing governments to intervene in order to avoid a financial crush. It was now the government rather than the private sector that had to respond for a massive volume of non-performing loans vis a vis the international banks. Of course, the severity of the crisis had been largely amplified by the international banks' own panicky behavior as soon as the crisis started.

Other reinforcing factors are quite well known. The reversal of world growth expectations, after a long period of high growth rates in most industrial countries throughout the 1960's and early 1970's, followed by economic stagnation in the early 1980's, had a doubly negative impact: it reduced the demand for debtor countries exports, and it reinforced protectionist tendencies in industrial countries themselves.

This fact, plus the sharp increase in the rates of interest at which external loans were made available --increasing from negative rates in the mid-1970's to real rates above 6% since 1981-- produced a third negative

result: that of a sharp deterioration in the terms of trade of the Latin American economies. Terms of trade deteriorated at rates of 7% per year since 1981 up to 1983.

A clear indicator of the reinforcing impact of these negative trends, is given by export figures. Latin American exports fell, both in value and quantum, in 1982 and again in 1983. This contrasts with a sustained growth rate of between 7% and 8% in real terms during the 1960's and 1970's.

As the debt crisis picked up momentum, the IMF came into the picture. The adjustment policies advocated by the IMF have followed the same pattern as in the 1960's: balance of payments disequilibrium were to be eliminated by a combination of exchange rate devaluations and contractions in aggregate demand. Only that, in the present crisis, the main factor contributing to balance of payments deficits was not an excess of imports over exports, but the large interest payments that arise from the spectacular increase in the debt. Thus, disequilibrium was not the result of deficitary flows, but it consisted mainly of a "stock" problem: the large size of accumulated external debt.

Attempting to remedy the deficit by traditional flow-adjustment mechanisms, like exchange rate devaluation and recessionary policies was clearly insufficient. The excessive financial burden could not be covered by trade surpluses alone.

The IMF's insistence in using these conventional tools to solve a non-conventional problem is what forced rates of devaluation and of

monetary contraction that go well beyond what would be required for a more traditional trade flow adjustment 10. This is what sets on maxi-recessions and maxi-devaluations followed by an upsurge in inflationary pressures. What has been called "hyper-stagflation" is not uncommon during this process of adjustment.

The consequences of this "shock treatment" over an already debilitated economy is to accelerate bankruptcies, plant closings and loss of jobs. Real wages fall with devaluation, and social conditions deteriorate further.

The IMF has thus far been unable to compensate for the severe downward plunge through additional financing or more flexible and gradual adjustment processes. The Mexican case shows that only after a country has proved willing to adjust, almost irrespective of social costs, including higher unemployment and in the Mexican case declines in real wages of up to 30%, only then a country is able to obtain conditions that do not seem incompatible with the resumption of economic growth and less severe social conditions.

The situation is even worse for countries that entered the crisis with high rates of unemployment and deteriorated social conditions for large segments of the population, like the cases of Argentina and Chile. Other countries are painfully trying to defend their weak democracies from generalized dissatisfaction with policies that reduce their already low standards of living, as the Dominican Republic, Ecuador and Peru cases show. Yet others countries, like Brazil, seek to insure a process of transition to democracy that is certainly not facilitated by IMF-induced maxi-stagflation.

Summing up, the debt problem plus deteriorated international economic conditions, reinforced by contractionary economic policies, has generated the worst economic crisis that Latin American countries have had since the 1930's. The conventional ways of handling the crisis, not unlike some of the suggestions in the pre-keynesian days of the late 1920's and early 1930's, run the risk of aggravating what is already a devastating phenomenon, deteriorating to dangerous levels the conditions of living for a large majority of the population in Latin America. The process has already had a profound political impact, increasing political instability in most countries in Latin America.

The Sources of Political Instability

Political scientists have written many books about instability in political systems. I will just refer here to two popular views of why political regimes in Latin America are so unstable. One is the "dismal politics" interpretation, that puts the problem in the inability of a country to reach some broad social consensus about the goals of society and the acceptable, legitimate means to achieve those ends.

In the absence of such an "agreement on fundamentals", social and political forces compete fiercely with each other, frequently proposing mutually exclusive visions of "the good society" and of the strategies to move towards it. Maximizing short-term political gains in a battle to conquer state power, becomes the dominant way of political behavior. Whatever institutions are there to help solve society's conflicts, are subject to

immense tensions and contradictory forces, adding to a generalized feeling of instability.

Another widely-held view is that political instability arises because there is too much inequality in society, be it measured in terms of income, employment and education opportunities or access to political power. Massive poverty would be a clear outward sign of profoundly unstable societies. Thus, attacking poverty becomes, according to this view, a high priority objective for any country that wants to develop and strengthen a stable political system.

This would be particularly true in the case of open, democratic systems where the discontent of the poor can be freely expressed with a possible destabilizing impact on the political regime.

What is striking about Latin America is that , at least by looking at over-all economic performance and at indicators of poverty in pre-crisis days, the region seemed to have made notorious progress during the last several decades. The region's GDP growth rates continually increased from a respectable 5.2% average in the 1950's, to 5.6% in the sixties and 5.75% in the 1970's. At the same time, the proportion of the population living under poverty decreased from 51% in 1960 to 40% in 1970 and around 35% in 1980 11/.

Although this is not a spectacular record, it is a fairly acceptable one. It would not seem to be a result consistent with the increased political instability, observed in Latin America in the 1970's and 1980's, and certainly not with the political catastrophes that occurred in many countries, out of which emerged highly repressive military regimes.

We are of course aware of the simplified nature of the argument that states that too much poverty is bad for political stability, and for democracy. And yet, it is this simplified view that has been present in the international scene, at least since the Alliance for Progress and later in the "redistribution with growth" strategies promoted by the World Bank.

Of course, massive poverty has the effect of delegitimizing a political regime vis a vis the intellectuals, the young, the Church and significant political leaders. Through this indirect means it does debilitate any political regime.

But it is our contention that it is not the existence of the poor per-se that increases political instability. The poor have no power, no organizations to voice their discontent. Political systems become really unstable when the more organized sectors in society --usually not the poor but the middle groups-- become sensitized to existing inequalities by the economic hardship that they themselves have to suffer, when general economic conditions deteriorate very sharply.

It is when the economic crisis directly involves the highly organized middle groups that the cracks in the political system are made evident. The cases of Peron's Argentina, or Brazil, Uruguay and Chile under current military regimes, are examples of a generalized economic crisis that increases uncertainty, deteriorates living conditions, reduces job opportunities and makes access to preferred consumption goods difficult for the middle groups.

This is what unleashes massive protests by the middle class and their

organizations. Middle groups discontent becomes a debilitating force for any government and prepares the ground for regime change. It is this type of process that seems to be underway as a consequence of the current economic problems in several countries in Latin America. Plant closings, bankruptcies, government employees' layoffs are severely reducing the number of good, stable jobs that the Latin American middle class got used to taking for granted. Unemployment among highly qualified university graduates increases sharply. Youth unemployment typically approaches the 40% mark. Small business is badly hurt by lack of demand and rocketing interest rates. Highly indebted middle-size firms are at the verge of bankruptcy, dependent on the goodwill of the same financiers that led their banks to the verge of default and that often took their own money to a safer place abroad.

The all-embracing nature of severe economic hardship and high uncertainty about the future, predispose the more organized sectors in these societies to try dramatic political changes that would offer some hope of solving the very same problems that seem untractable and unsolvable to the regime in power, be it a military regime or a newly emerged democracy struggling along to survive the economic crisis. As a consequence, political instability increases.

Military Governments and the Efficiency Myth

In the case of military governments, it is precisely the increase in instability brought about by the economic crisis that persuades them to try and avoid regime change. The argument usually goes along

the following lines: The military regime, however unpleasant it may be in many aspects, is the only one that can guarantee social discipline and economic efficiency, and both are badly needed in times of economic crisis.

Of course, this type of statement is totally negated by the facts. If there is something we have learned from the recent wave of military governments in Latin America, it is their total inability to deliver on their commitments. Thus, economic policy has not become more efficient. In fact in many cases the reverse seems to have been the case. This has been only in part due to policy mistakes, i.e., using the wrong policy instrument to solve a certain problem. Other factors are explored below.

The main lesson concerning the military in power is not so much that they are prone to policy mistakes. One has to remember that these governments have in fact had access to the most sophisticated technical advice from orthodox economists, native and foreign, trained in centers of academic excellence. And yet the results have been disastrous.

Let me stress here three factors that I think have heavily contributed to economic catastrophes as the ones unleashed by the rightwing military regimes of Argentina, Brazil, Uruguay and Chile in recent years. These three factors have to do with the nature of authoritarian rule.

The first is that the authoritarian government usually had no feedback mechanisms that would allow for corrections after policy mistakes had been made. These governments operated literally in a vacuum. Since they believed to be the possessors of a superior rationality and of a unique

scientific truth in economic matters, chosen policies could not be wrong. If results were not encouraging, that was not an indication that the prescription was wrong, but that the doses proved to be insufficient.

A second feature --a paradox in governments that have had all the power in society-- was the slow decision-making processes that seem to characterize these regimes. They find it very difficult to make changes once a particular course of action has been decided. This has to do with vertical, bureaucratic structures like the military, and the enormous inertia that is built into the system of making decisions in such a structure, particularly when dealing with matters they have not been trained on.

A third factor is that legitimacy for these regimes is directly related to their capacity to demonstrate that they are better at solving problems than previous regimes were. When results contradict this, they cannot afford to be proven wrong. So they tend to stick to a given course until the very end, or at least until other costs became much higher.

Staying in a course that does not particularly help to solve economic problems causes unrest even in those in the business community that have been loyal government supporters. In the face of increased opposition to their policies, military governments are then forced to increase repression, social control and violence over individuals and institutions, just to be able to persist in those "solutions" that had been recommended to them.

Clinging to power at least until the crisis is over, and meanwhile persisting in tough recessionary policies in a framework of increased repression, puts additional strains in society that are hardly bearable. In fact, it is at this stage that very disquieting signs begin to emerge:

sporadic violence and terrorism, widespread hunger strikes, student and labor unrest, national days of protest, etc.

These are signs that the fabric of society begins to be destroyed, that social antagonism is reaching a breaking point, that government vulnerability can only be hidden by repetitive shows of force by the dictator

At this stage, a country is actually facing not just an economic crisis with serious political consequences. It is mainly faced with a crisis of governance, such as the one observed in several countries in Central America during recent years.

Since we are writing about transitions in South America and not in Central America, it is important to emphasize the main line of argument here. And that is that short-sighted attempts to support and strengthen military regimes in order to increase the possibilities of a rational way of coping with the economic crisis and reduce uncertainty, tends to have precisely the opposite, unintended effect of increasing and not reducing political instability.

A crisis of governance has immediate security implications for the international community. Once the governance issue becomes internationalized, domestic economic problems and even political transitions to democracy become secondary objectives vis a vis international security considerations. The temptation to favour the status quo by powerful external and domestic forces becomes overwhelming.

Economic and Political Transitions

What are, then, the alternatives for transitions that may lead South American countries out of the economic crisis, while at the same time strengthening democratic rule?

One view, prevalent today in some conservative circles in Europe and the U.S., would argue that in order to solve the economic problems of South America, or those of European countries for that matter a high degree of social discipline is required, which does not exist because of excessive collective pressures exercised by labor or business organization over the economy. This view argues that collective action --a variation of monopoly power-- would involve a distortion in society's goals. By lobbyin for special benefits, social organizations would force inefficiencies in the way resources are allocated and this would lead to low productivity, loss of international competitiveness, and finally to a nation's economic decline. This trend would be reinforced by an inerventionist, excessively regulatory government. These forces would prevent a country from recuperating from the externally-induced economic crisis.

Some German economists see this as the main factor behind economic decline in Europe. They have coined the term "Euroesclerosis" to decribe the phenomenon 12/. Their main policy recommendation is that in order to get over the current economic crisis, productivity has to be increased, international competitiveness regained and that there is no shorter way to do this than to eliminate all sorts of distortions affecting the optimal allocation of resources. This can only be achieved through free markets 13/.

Distortions may originate in the government or in the monopolistic power of corporate organizations. The power of both should be drastically

reduced. Ideally, no organization for collective action should be stimulated because of its negative impact on economic efficiency.

This view has also been adopted by conservative circles in South America. We will argue here that the argument is basically wrong in the South American context. Because, one thing is to argue that some European societies may have become too structured, with too many, and too powerful corporate organizations influencing decision making and not allowing competitive markets to operate. But another thing altogether is to borrow the argument and apply it uncritically to South American realities.

The problem of these countries is not that they have become too structured and that powerful social organizations represent too much monopoly power. In fact the situation is just the reverse. If anything, the problem of South American society --not unrelated to the weakness of democracy in the region-- is that Latin American societies are not sufficiently structured. Social organizations that might act as intermediaries between individuals and the State are either too weak or non-existent.

When social organizations are suppressed, there is no way to insure stability in collective behavior. There is no backbone that structures society. In semi-industrial countries, with very severe economic problems yet to be solved, the government has to devise ways and institutions through which collective interests and perceptions of the various groups can be frequently voiced, and where these groups have to confront their own views and demands with some perception of the national interest, of the truly

collective good.

The alternative, in the framework of political democracy, is that these views are voiced every five or six years when a president is elected. Frustrations have accumulated in the intervening period, without proper institutions to process demands. Collective feelings are unknown. Popular masses can move in any direction. They become prone to the influence of traditional "caudillos" under populist banners, as the history of Latin America so persistently shows.

What this unstructured social and political system does is to institutionalize uncertainty, the limits of which are not clear. Any outcome is possible from the political process. Several of the possible outcomes may be threatening to this or the other group. Decision and behavior are dominated by the short-run, since no long-run predictability is possible.

Private investment is not forthcoming, given high uncertainty. The government comes in, effectively crowding out the private sector. More state power, now in the economic sphere, makes political confrontation at the level of the State even more determinant of the future.

Our conclusion from this line of argument is that suppressing social organizations is not an scenario that makes it possible to stabilize democracy in South America.

Thus, one must be aware of the very different nature of the problems faced by some advanced industrial societies today, and those faced by South American countries trying to simultaneously solve serious economic problems,

and structuring a stable democratic system. In fact, if some historical parallel relevant for several South American countries today could be drawn, it would be that of post-war Europe or even that of the U.S. in the 1930's.

The problems in South America today consist of the need to reconstruct their economies, but also to find again a sense of a unified national community. They consist also of making internal peace possible among the antagonistic groups that have been fighting each other for decades, and of finding a civilized way of solving the conflicts between these groups. A high priority objective should also consist of human rights, protection, after years of continued violations.

In order to achieve this, a broad political consensus has to be built and ample democratic political coalitions must emerge. This becomes a condition not only for democratic stability, but also to reduce uncertainty about the economy and make possible that private and public agents make long-term investment decisions.

Civil society has to be organized and structured in a way that conflicting interests can be expressed and cooperation developed between private and public agencies in order to solve the very serious problems that are to be faced: reconstructing a bankrupt industrial sector, opening job opportunities in the rural sector through the development of all the agricultural potential, stimulating exports and import-substituting activities to increase the capacity to pay the external debt. And, last but not least, help solve the

grave social problems inherited from years of recession, over-indebtedness and inadequate economic policies.

In other words, our argument is that the problem of inefficiency in these countries is not only, not even mainly, an economic problem. Inefficiency is more related to the deficiencies in the political and social institutions through which a society and its various groups become structured, or even to the lack of such institutions.

Thus, the most important problem is one of governance, not of too much government. Of reducing uncertainty through consensus-building mechanisms and concerted action, rather than through the suppression of collective action. Of integrating excluded groups to social organizations and democratic institutions. Of developing, by these means, a sense of belonging to the nation and a sense of solidarity with national interests that go beyond sectoral interests. Of institutionalizing ways by which long-run maximization is possible, by reducing uncertainty and mutual annihilation threats. The lack of these elements is what makes for extended social and economic inefficiency and instability in these societies, and not the interference with market forces.

Policy Approaches

The economic constraints posed by the debt problem will make efforts at democratic transitions fragile in South America.

Economic policies must take this into account. What is needed are viable policies rather than all-embracing "economic models". These policies

must seek not only to put the countries back in the path of economic growth, as indeed they must, but also make possible, as a by-product, a reversal in the trends towards increased social polarization and marginalization of large segments of the population that have characterized recent economic experience in South America.

For this to be achieved, the population must perceive that the costs and economic sacrifices are fairly distributed. And governments must be able to propose policy measures that will mobilize key political and economic actors in the simultaneous pursuit of a stable and equitable society, and economic growth.

The awareness of the depth of the crisis and of the devastating effects it has had on society, opens the possibility of more consensual politics. The theme of political alliances and social pacts is very much in the foreground of the public discussion in South America today, and it will remain as a most relevant topic during the foreseeable future. Political pacts seek to strengthen the democratic system, whereas social pacts seek to organize interests in those societies, not unlike what European countries did immediately after the war.

The economic tasks facing any democratic government in South America in the 1980's are formidable. In a context of scarcity of foreign exchange, industry must be revitalized to meet the challenge of increased exports and of satisfying the basic needs of a population whose living conditions have deteriorated badly during the crisis. Agricultural policy has to be oriented toward import substitution of essential food products and to the improvement in the standards of living of the rural population. Macroeconomic policies must be revised in order to move towards a fuller utilization of existing

domestic resources, particularly of labor. Social services have to be improved in order to at least begin a reversal in the in-miserizing process to which the urban poor have been subjected to during years of high, permanent unemployment and reduced government expenditures in the social sectors.

Progress in these areas will be difficult and probably slow. To these tasks, the government must add the management of the crisis situation that involves the debt problem, the domestic financial crisis of local banks and productive enterprises, the lack of domestic savings and the need to attract new foreign investment.

Pragmatism will be required in order to deal with these problems. Concerted actions by the government and the private sector will be essential. Avoiding a full reversal towards a closed economy and autarkic economic models characterizing some phases of the post-war industrialization strategies in Latin America will also be required. Regional economic integration schemes will have to be revitalized. Policies to induce a much higher level of domestic savings will become of the highest priority. Wage increases should be made consistent with the challenge of enhanced international competitiveness for domestic industry.

Facing these challenges and at the same time avoiding the temptation of authoritarian remedies requires, let us stress it again, consensus-building as the highest priority. This encompasses consensus about "rules of the game" in both the political and economic spheres, as well as about the kind of economic policies to be pursued.

As the European lesson teaches us, times of deep political crisis and economic destruction also provide the unique opportunity of going to the roots of the problems of political antagonism, of mutually exclusive confrontational national projects by various groups in society, and of generalized uncertainty and instability that are behind the inability of countries, at certain junctures, to perform beyond mediocrity in the economic sphere, and to govern themselves with a consistent respect for democratic values.

Needs for International Cooperation

From what has been said in previous sections of this paper, it is quite clear that political and economic stability in South America in the 1980's is an objective that will require not only mobilizing a wide spectrum of political forces and social groups at home. International cooperation will be an essential component if the challenge is to be met.

Numerous examples can be given of possible concerted actions in the international economic scene. There is clearly a consensus, that the debt crisis has dramatized the close interdependence between economies in the North and in the South. It is more clear than ever that the macro policies of industrial countries have a direct impact on the ability of Latin American countries to meet their debt obligations. Thus, the monetary and fiscal policies of the U.S. government have had a dramatic impact on the debt-payment capacity of Latin American countries. A 1% increase in U.S. interest rates implies additional interest payments for Latin American countries in the order

of 2.3 billion dollars.^{14/} On the other hand, high interest rates plus recessionary policies in the U.S. and Europe have certainly caused a deterioration in the terms of trade of South American economies in recent years. Thus, the need for more coordination of macroeconomic policies at the international level becomes self evident.

Trade policies are also in disarray. It is ironic that those very conservative governments that have been the best at preaching the virtues of free trade to countries in the South, when faced with a difficult employment situation or for that matter to political elections at home, tend to resort to the same protectionist policies that were exhibited as proof of less developed countries economic irrationality.

Interdependence in this context means recognizing that South American countries will not be able to service the external debt, unless rapidly expanding markets in industrial countries allow them to increase exports at a fast pace. The trend should be towards freer access to industrial countries' markets and not the opposite.

The difficult area of debt rescheduling is another one where the piecemeal approach does not work. Negotiations have become permanent and finance ministers are forced to spend more time in New York and Washington than in solving pressing economic problems at home.

This is another area where more efficient ways of solving problems have to be found. It has taken three years and three rounds of negotiations for oil-rich Mexico to renegotiate half her debt, in a timetable consistent with recuperation of her economy. This very process is creating enormous

domestic tensions in Brazil, Argentina, the Dominican Republic, Ecuador, Bolivia and Chile.

The debt problem is a political and a technical problem. There are numerous technical propositions to deal with it in a more structural systemic way, establishing a new framework for individual country negotiations. They deserve more attention from the countries in the North.

Looking now at political problems, it is clear that industrial countries should be more interested in political stability in South America. In previous pages we have warned of the danger of a "centroamericanization" of South America, due to a potential crisis of governance, as a consequence of extreme economic hardship. It is in this light that a more ambitious program of reforms in the international economic system becomes urgent. Long-term debt rescheduling, increased international liquidity, enhanced role for concessional multinational aid, schemes to more effectively stabilize export earnings of developing countries, support to regional economic integration are but a few of the actions that industrial countries should consider supporting.

As has been suggested before, IMF stabilization programs are inadequate to handle the adjustment required by South American economies, if repayment is to be made consistent with reflating their economies and resuming a growth path. Indeed, there is a vicious circle that has to be broken. Without expansion of the domestic economy, there is no solvency for local debt-burdened producers. Their inability to pay back their debts creates a solvency problem to the domestic financial sector that in turn cannot pay their external

obligations. This means that room has to be created for expansion of the domestic economy. This in turn implies a flow of external resources compatible with a gradual adjustment of the economy throughout a period perhaps as long as ten years. Obviously, this is far from the one --or two-- year horizon that dominates IMF programs.

Assistance to bridge the technology gap, to improve export performance and to modernize agriculture are developmental needs that have been totally obscured and thus postponed by the international economic crisis.

But beyond these actions, there is the urgent need of a clearer understanding of the relationship between economic and political problems. There will not be stability in South America until strong, stable democratic regimes emerge in the area.

These will not be viable unless there is a deep understanding and encouragement for all kinds of consensus-building actions at the country level. Respect for pluralism, for nationally-defined political formulas responding to local conditions, and real and effective repudiation of authoritarian regimes and commitment to democratic principles and values, are attitudes that could mark the beginnings of a new era of cooperation and understanding between Europe, the U.S. and South American countries.

What can we offer from Latin America? The painful lessons of living for years under repressive dictatorships has led to a renewed commitment to democratic values in South America. This includes significant factions in the left. The new themes proposed by intellectuals and many political leaders in

South America, of which President Alfonsín is a foremost example, are themes that appeal to deep moral values: respect for civil and political rights; the need for effective, democratic participation in society; a reaction against statism and a new-found commitment to economic and political decentralization as an effective way of making economic efficiency and democratization a reality; less dogmatic and less ideological economic schemes.

What is emerging is the realization that the ideal of a self-governing democratic society requires a space for the development of creative initiatives at all levels, including a dynamic private sector as well as a commitment to incorporate into full political and economic citizenship those groups that have been traditionally excluded from the benefits of development in South America.

Of course, it is agreed that the process will take a long time and that it will require a difficult mix of vision and economic realism cum political moderation. It will also require drawing on the reserves of goodwill that still exist in these societies and that, we hope, are also present at the international level.

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