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Author(s):	Kaufman, Robert R.
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THE NEXT CHALLENGES FOR LATIN AMERICA

Robert Kaufman

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Robert Kaufman is Professor of Political Science at Rutgers University. This paper is based on a seminar he gave at the *Center for Advanced Study in the Social Sciences* on 16 May 1996 entitled "The Next Challenges for Latin America: Growth, Welfare, and Democratic Consolidation"

In the last decade, Latin America has experienced an astonishing political and economic transformation. Democratization has been one major component of this transformation. Military dictatorships that once ruled most of the countries of South America have been replaced by competitively-elected governments, and in Mexico, the days of dominance by a ruling party seem numbered. New constitutional regimes emerging within the region are far from perfect democracies, but the trend toward greater political pluralism is deep and unmistakable.

Economic changes within the region have been no less dramatic. In the space of a very short time, societies that had relied for decades on import-substituting strategies have lowered trade barriers, privatized state-owned enterprises, and implemented deep fiscal adjustments. Countries such as Chile, Mexico, Argentina and Peru now rank among the most open economies in the developing world. And even in Brazil, where opposition to market-oriented reforms persisted well into the 1990s, government policies have eventually moved in the general direction of trade liberalization and privatization.

These changes -- both political and economic -- were difficult to bring about, but they are now a *fait accompli*. For the rest of this century and beyond, Latin America will face a new, more complex set of challenges which are likely to differ in three important ways from the "first round" of reforms already undertaken. In the first place, the terms of the policy debate have changed. During the past decade, market-oriented reformers were pitted against the adherents of more traditional import-substituting models; in coming years, the debate will focus more on the extent to which governments should actively promote sustained and equitable export-led growth. Strengthening state capacity will also receive greater attention. During the 1980s, the primary emphasis was on shedding public functions that no longer seemed compatible with fiscal stability or economic efficiency; the new emphasis is on improving the ability of governments to implement economic and social policies and to provide basic public goods such as law and order. At the political level, finally, concerns about ousting military dictatorships and preventing a return to authoritarian rule have been displaced by an emphasis on consolidating and deepening new democratic institutions.

In this paper, I survey a number of themes related to each of these three sets of issues: economic and social policy, state reform, and democratic consolidation. In-depth treatment is, of course, well beyond the scope of the paper, but it is possible to highlight some of the big questions that are likely to be salient in the medium-run future.

I. Public policy: growth and social welfare

The first round of stabilization and trade reform undertaken during the past decade has created a strong momentum for the continuation of "market-friendly" policies in the future. In part, this is a consequence of past experience: the successful responses of export-oriented East Asian economies to the debt crisis; the profound failures of heterodox policy experiments in Brazil, Argentina and Peru during the mid-1980s; and the turnarounds which followed the reforms instituted in Argentina and Peru during the early 1990s. In some countries, the political influence of export-oriented business groups has also played an important role in encouraging policy continuity; Chile is the clearest example. A third important factor, finally, is the pivotal role that external finance has come to play in sustaining balance of payments positions. Most Latin American governments now place a heavy premium on policies that will gain the confidence of portfolio investors, and the approval of international financial institutions such as the IMF and the World Bank.

The importance of these influences was evident in presidential elections held in 1995 in both Argentina and Peru, in which all of the major candidates pledged to maintain reforms already undertaken in their societies. Economic nationalism has also weakened in Mexico and Brazil, and as we have seen in the recent Mexican peso crisis, severe balance-of-payments difficulties are much less likely than in past decades to lead to a return to import-substituting policies.

The sharp decline in support for "inward-oriented" strategies, however, has by no means implied the establishment of a strong consensus about what policy alternatives are most desirable. Among policy-making elites, two important debates have appeared on the political agenda. One set of issues concerns macroeconomic stability and growth: the extent of discretion governments should exercise over monetary policy, and the viability of an activist industrial policy modelled along East Asian lines. A second big question is how to alleviate the deep poverty and income inequality which has persisted or worsened throughout the previous period of economic reform.

A. *Debates over growth strategies: macroeconomic and industrial policies*

Continuing uncertainty about economic performance provides the backdrop for emerging debates over growth strategies. In the early 1990s, growth returned to the region after a decade of stagnation, and despite the severe shocks produced by Mexico's peso crisis, many countries appeared on the verge of a new round of expansion in 1996 and 1997. But the sustainability of these recoveries remained problematic, and the extent to which they could be attributed to economic reform remained an open question.

The clearest success story, of course, was Chile, which had by 1995 experienced over a decade of high growth, at least in part as a consequence of the radical reform initiatives launched during the Pinochet years. In other countries, however, the story was less clear-cut. Argentina and Peru also experienced high growth during the early or mid-1990s, but so did Brazil, where reforms were much less extensive. Such growth was arguably a function not only of economic reform but of declining world interest rates and a resumption of capital flows to the region. These flows were not an unmixed blessing; as recent experience has shown, they contributed to speculative bubbles in asset markets and overvalued exchange rates that undermined the effort to expand exports.[1]

Even before the collapse of the peso in December 1994, the Mexican case posed the most troubling issues for market-oriented adjustment strategies. Stabilization and trade reform of the late 1980s did result in some modest growth during the early 1990s, but that recovery must be seen as disappointing, given the depth and consistency of the adjustment effort. In fact, by 1993, growth had ground to a halt, and concern over exchange rate appreciation and growing trade deficits had already begun to surface in some quarters.[2] Moreover, although Mexico appeared in 1996 to be recovering from the 1994 crisis (with the help of massive external financial assistance), the event intensified the region-wide debates about the lessons that might be drawn from the experience of this "model reformer."

Prior to December 1994, the principal issue with regard to monetary policy was whether to delegate control to central banks with mandates that were not subject to the day-to-day supervision of presidents, finance ministers, or congressional politicians. Arguments in favor of independent central banks are well-known; they are supposed to deter the manipulation of monetary policy for short-term political purposes. Ironically, however, the peso debacle occurred only a few months after the Bank of Mexico had been removed from the

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1. See Moises Naim, "Latin America: Post-Adjustment Blues," *Foreign Policy*, 92 (Fall 1993): 133-150; Mario Damill, et al, "Latin American Growth Prospects: News Stemming from Recent Experience," unpublished ms., CEDES, Buenos Aires, April 1993.

2. For a recent review of the debates leading up to the peso crisis, see *The Wall Street Journal,* "How Mexico's Crisis Ambushed Top Minds in Officialdom, Finance." Thursday, July 6, 1995, p. 1.

jurisdiction of the finance ministry, during the watch of Miguel Mancera, one of the region's most respected central bankers. Just why these arrangements did not prevent expansionary monetary policies is unclear, but the apparent failure of the conventional wisdom concerning central banks has ratcheted up the debate over how governments in the region can make credible macroeconomic commitments.

The Argentine "currency board" provides one such model. The Convertibility Law of 1991 stipulates that local currency in circulation must be backed by hard currency reserves, eliminating discretion over money supply. Argentine authorities worked hard to convince financial markets that this arrangement distinguished their country from Mexico; these efforts, combined again with a massive inflow of external assistance, enabled Argentina to edge away from financial collapse in 1995 and to begin a recovery during the second half of 1996.

This experience has contributed to growing support for a "currency board" model among international creditors and in Latin American and ex-Communist countries such as Ecuador and Bulgaria. It is important to emphasize, however, that the Argentine model was established under exceptional circumstances. It was instituted in the context of severe hyperinflation, and only after decades of extreme monetary and political instability had destroyed the credibility of less drastic policy initiatives. Similar steps are not likely to be politically viable in less extreme circumstances. Especially in Mexico, it seems inconceivable that any government would accept the establishment of a dollar-based monetary system, which in effect would delegate management authority to the United States Federal Reserve.

Meanwhile, in a number of countries, there is still considerable opposition to proposals for more conventional forms of central bank independence already established in Mexico. Opponents of strong central banks argue that elected presidents and their finance ministers should not be deprived of control over a major tool of economic management. These views are strong in Brazil, for example, where both important policy-makers and influential industrialists view monetary policy as an important instrument for promoting growth.

Debate over industrial policy is likely to constitute an even more contentious issue -- again, one that has been deepened by the Mexican crisis. For the international financial community, as well as significant segments of the Latin American policy elite, the crisis has reinforced the urgency of undertaking new, politically controversial measures aimed at deepening existing market reforms and increasing domestic savings. The highest on the agenda -- and the most controversial -- are labor market deregulation, the privatization of mining and infrastructure sectors still under state control, and a revamping of pension funds.

Advocates of industrial policy do not necessarily oppose such measures, but they called for a reexamination of the assumption that trade liberalization and other market-oriented reforms are sufficient to sustain growth.[3] Alternative proposals take a wide variety of forms, from greater emphasis on government support for technological innovation and infrastructure investment, to broad financial support for exports, to more selective incentives to particular economic activities and industries.

The success of the East Asian countries, particularly Korea, has been an important point of reference in these debates. Market-oriented reformers emphasize the importance in the Asian cases of relatively cautious macroeconomic policies, realistic exchange rates, and some import liberalization for exporters. Advocates of a more active state role, on the other hand, point to the role played by a variety of targeted industrial policies: from preferential credit policies to selective protection, direct subsidies, the use of state-owned

[3] Luiz Carlos Bresser Pereira, Jose Maria Maravall, and Adam Przeworski, *Economic Reforms in New Democracies: A Social Democratic Approach* (Cambridge: Cambridge University Press, 1993).

enterprises, and government support for private sector cartels.[4] Even the World Bank has cautiously endorsed some of these components of the East Asian model, particularly active government intervention in support of exports.[5]

Conflicting lessons are also drawn in the policy debate from experiences in Latin America. Interestingly, Chile, which has generally been cited as a paradigm case of market-oriented success, provides some support for moderate industrial policy as well. Export credits and other promotional activities strengthened the position of the enterpreneurial sector after 1984 and contributed to Chile's dramatic economic recovery during the next ten years. In addition, the state-owned copper company has served as an important foundation of both fiscal stability and export performance.

Brazil is also likely to become an important regional model for an active industrial policy, if the expansion which started in 1993 is sustained. Trade liberalization initiated in the early 1990s did contribute significantly to this expansion, along with a substantial upsurge in direct foreign investment. But promotional policies have played an important role as well. The automobile industry has come in for special treatment, as it has in Mexico and other countries. In the Brazilian case, tax relief and negotiated agreements on wage and price restraints have apparently made an important contribution to the resurgence of growth within this sector.

General agreement on the importance of sustaining macroeconomic and balance of payments equilibrium can provide the basis for a vigorous and meaningful debate on these issues. But no single model is likely to evolve within

[4] The two strongest statements of this position are Robert Wade, *Governing the Market* (Princeton: Princeton University Press, 1990) and Alice Amsden, *Asia's Next Giant* (New York: Oxford University Press, 1989).

[5] See The World Bank, *The East Asian Miracle* (New York: Oxford University Press for the World Bank, 1993).

the region as a whole. In Brazil, a long history of cooperation between a dynamic private sector and the state bureaucracy could provide the foundation for the success of contemporary industrial policy initiatives. Similar possibilities exist in Colombia and, to a lesser extent, in Chile. Conversely, there is a strong rationale for less interventionist approaches in countries where state-business relations have been marked by unpredictability and antagonism -- for example, in Argentina and Peru. Policy choices, in short, can be expected to vary from country to country; and depending on their economic histories and political situations, a fairly wide variety of approaches may prove to be viable.

B. *Poverty and income inequality: social policies*

Even if Latin American governments succeed in reigniting economic growth, they also face daunting and long-standing problems of poverty and income inequality. Statistics on social conditions are poor, and should be interpreted with caution; but the available data on recent trends are far from encouraging. As Table 1 shows, poverty increased substantially throughout the region during the 1980s and 1990s, although Chile, Colombia, and Uruguay are interesting exceptions. The distribution of income, shown in Table 2, either worsened or remained at very high levels. Brazil and Mexico rank among the most unequal countries in the world, and levels of inequality are also extremely high in Bolivia, Chile and Venezuela. National income surveys are not available for Peru--the Gini coefficients are based on a survey of households in Lima--but income inequality in Lima worsened dramatically during the 1980s and levels of poverty are extremely high. Both income inequality and poverty levels also rose markedly in Argentina.

Table 1. *Percentage of the Population below the Poverty Line**

	1970s/1980s	1980s/1990s
Argentina (urban)	7.6 (1980)	28.5 (1990)
Bolivia (urban	51.1 (1986)	54.4 (1989)
Brazil (national)	34.1 (1980)	40.9 (1989)
Chile (national)	45.0 (1985)	34.8 (1990)
Colombia (urban)	13.0 (1980)	8.0 (1989)
Mexico (national)	16.6 (1984)	22.6 (1989)
Peru (Lima)	35.0 (1979)	45.0 (1986)
Uruguay (urban)	6.2 (1981)	5.3 (1989)
Venezuela (national)	4.0 (1980)	12.9 (1989)

Sources: For Argentina, Chile and Peru: Nora Lustig, *Coping With Austerity: Poverty and Inequality in Latin America* (unpublished ms., The Brookings Institution, 1994); for all other countries: The World Bank, *Latin America and the Caribbean: A Decade after the Debt Crisis* (Washington, D.C.: Latin America and the Caribbean Regional Office, September 1993), p. 122.

* Poverty is defined as an income of $60 or less per month.

It should be noted that the "popular sectors" (that is, formal-sector blue-collar workers and the lower middle-class) were hit hard during the 1980s, along with even poorer groups in the rural areas and the urban informal sector. In fact, in Chile, Mexico, Argentina and Brazil, the middle 40 percent appear to have lost disproportionately, probably as a result of reductions in public sector wages and services.[6] The deterioration in the living standards of popular sector groups is significant in a number of ways. On the one hand, the downward mobility of middle-income employees and formal-sector workers could provide an incentive for anti-reformist protest. At the same time, they are more likely under such conditions to oppose efforts to reallocate social services toward the very poor.

Table 2. *Income distribution in Latin America, Korea, and Taiwan: Gini Coefficients**

	1970s/1980s	1980/1990s
Argentina (Buenos Aires)	.39	.46
Bolivia (urban)	.48	.52
Brazil	.57	.63
Chile	.53	.53
Colombia (urban)	.58	.52
Mexico	.51	.55
Peru (Lima)	.43	.44
Uruguay (urban)	.45	.42

[6] Lustig, "Coping with Austerity," p. 4-5.

Venezuela	.51	.50
Korea	.39	.34
Taiwan	.30	.33

Sources: For Chile and Mexico: Nora Lustig, *Coping With Austerity: Poverty and Inequality in Latin America* (unpublished ms., The Brookings Institution, 1994); for all other Latin American countries: The World Bank, *Latin America and the Caribbean: A Decade after the Debt Crisis* (Washington, D.C.: Latin America and the Caribbean Regional Office, September 1993), p. 120. For Taiwan: Harry Oshima, *Strategic Processes in Monsoon Asia's Economic Development* (Baltimore: Johns Hopkins University Press, 1993), pp. 201-202; for Korea: D.M. Leipziger et al, *The Distribution of Income and Wealth in Korea* (Washington, D.C.: The World Bank, 1992), p. 10.

* A gini index measures the difference between shares of national income received by individuals or households (usually ranked by deciles), and the share that each would receive if income were equally distributed. The higher the coefficient, the more unequal the distribution of income.

One of the most controversial issues of contemporary social policy debate is whether market-oriented reforms, on balance, have slowed or accelerated these trends toward a worsening of poverty levels and income distribution.[7] To assess the distributional effects of adjustment, a tricky counterfactual is required: the relevant comparison is what would have happened to real incomes under an alternative adjustment program, or under none at all.

With respect to poverty levels, it is plausible that the net effect has been positive. Some adjustment measures exacerbated the effects of the crisis in the short-run, particularly with respect to urban workers in both the formal and informal sectors; the elimination of subsidies on food, fuel and transportation had negative consequences, and expenditures on social services generally declined during the crisis.[8] But low-income groups have benefited directly from

[7] See Samuel A. Morley, "Poverty and Distribution in Latin America: Evidence from the Past, Prospects for the Future," unpublished ms., Inter-American Development Bank, April 1994; Nora Lustig, "Coping with Austerity, Poverty and Inequality in Latin America," unpublished ms., Brookings Institution, February 1994; Robert Dohner and Stephan Haggard, *The Political Feasibility of Adjustment in the Philippines* (Paris: Organisation for Economic Cooperation and Development, 1994).

[8] See Joan Nelson, "Poverty, Equity, and the Politics of Adjustment," in Stephan Haggard and Robert Kaufman, eds., *The Politics of Adjustment* (Princeton: Princeton University Press, 1992), pp. 222-231; World Bank, *World Development Report 1990: Poverty* (New York: Oxford University Press, 1990), p. 116.

the reduction of high inflation, and if the reforms succeed in promoting economic growth, poverty is likely to decline over the long-run.[9]

The long-term effects of adjustments on income distribution are less clear.[10] Economic reforms undertaken during the 1980s and 1990s reversed policies that had favored import-substituting industries and unionized workers over agriculture, labor-intensive production, and workers in the informal sector. But the actual impact of these reform efforts is likely to be strongly influenced by the prior distribution of assets, natural resources, and other structural features of the economy.

In Chile, employment and real wages began to grow rapidly in the early 1990s, partly as a consequence of the extremely rapid expansion of labor-intensive exports in agriculture, fishing and forest products. Moreover, there was evidence that poverty fell and the distribution of income began to improve.[11] Table 3 shows the shifts in the share of GDP among different sectors of the population. The share of the bottom 40 percent of Chilean families dropped significantly under Pinochet, but began to rebound somewhat during the early 1990s. On the other hand, the middle 40 percent of Chilean families fared less well. Their share dropped from about 32 percent in the 1960s and 1970s to under 29 percent during the Pinochet era -- a sharper drop in relative terms than that of the poorest sectors -- and then declined even further during the early 1990s.

Table 3. *Income distribution in Chile, 1959-1992*

	Bottom 40%	Middle 40%	Top 20%

[9] For a review of these arguments, see Stephan Haggard, "Markets, Poverty Alleviation and Income Distribution: An Assessment of Neoliberal Claims," *Ethics and International Affairs*, 5 (1991).

[10] Gary S. Fields, "Growth and Income Distribution," in George Psacharopolous, ed., *Essays in Poverty, Equity and Growth* (Oxford: Pergamon Press, 1991).

[11] Mario Marcel and Andres Solimano, "Developmentalism, Socialism and Free Market Reform: Three Decades of Income Distribution in Chile," The World Bank, Policy Research Working Paper #WPS 1188, September 1983.

Alessandri (1959-64)	10.7	32.0	57.9
Frei (1965-70)	10.3	31.1	58.6
Allende (1971-73)	10.6	34.0	55.4
Pinochet (1974-89)	9.1	28.9	62.0
Aylwin (1990-92)	10.1	28.4	61.5

Source: Mario Marcel and Andres Solimano, "Developmentalism, Socialism, and Free Market Reform: Three Decades of Income Distribution in Chile," The World Bank, Working Paper 1188, September 1993, p. 5. Data are from surveys of household income, Universidad de Chile.

Elsewhere, trends have been even less favorable. In Bolivia, unlike Chile, there are few natural resources outside the mining sector, and export-oriented policies have been far less effective in stimulating labor-intensive employment. In Mexico, agricultural liberalization will negatively affect peasant producers of corn and grain, and manufacturing exports were inhibited by exchange rate appreciation and tight money policies. In Argentina and Mexico, privatization and financial liberalization provided segments of the business elite with tremendous windfalls, while smaller businesses have been battered by the impact of trade liberalization and other market-oriented reforms.

Even under democratic governments, deeply-entrenched patterns of inequality are unlikely be be reversed quickly. Indeed, democracy is in many respects inimical to radical redistribution. But it is possible to conceive of specific policies that could have a significant effect in softening the short-term costs of adjustment and reducing inequalities over the long-run. The World Bank has for some time advocated targetted anti-poverty programs aimed at the poorest and most vulnerable sectors of the population, including subsidies for poor children and women and public employment schemes and compensations for laid-off workers.[12] Such measures were implemented by governments pursuing market-oriented reforms in Bolivia, Mexico, and Chile under both Pinochet and Alwyin.

[12] *World Development Report 1990*, p. 117-120.

Though success was uneven, these efforts have had some positive impact even in situations of recession and fiscal constraint.

Broader steps to reduce inequality are also compatible, in principle, with the market-oriented growth strategies advocated by mainstream economists. Reallocating fiscal expenditures toward basic health services and primary education occupied a prominent place in John Williamson's well-known effort to summarize the "Washington consensus" on adjustment.[13] There has also been increasing emphasis placed on the fact that education, health policy and land reform not only alleviate suffering and provide opportunities for the poor, but are determinants of growth as well.

The politics of such policies, however, are likely to be quite complex. As I will discuss below, building the state's capacity to deliver social services implies major economic and political challenges, ones that are compounded by the still fragile economic circumstances that continue to exist in many of the countries we have examined. Even with substantial external financial assistance, enlarging the scope of public services to a broad range of low- and middle-income groups would involve either the construction of a more comprehensive and progressive tax system or a reversion to the macroeconomic populism that has been so costly in the past.

Politically, there is no doubt that progressive tax reforms would encounter strong opposition from upper-income groups and would be difficult to enforce. And even if public revenues can be expanded, administrative reorganization of health and education services is likely to involve sharp conflicts *within* coalitions that favor such measures, especially between potential low-income consumers of social services and public sector unions and other professional groups that have benefited from existing arrangments.[14]

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[13] John Williamson, ed., *Latin American Adjustment*, pp. 10-12.

[14] Ricardo Hausmann, "Sustaining Reform: What Role for Social Policy?" in *Redefining the*

II. Problems of State Reform

No policies can be successful without competent state bureaucracies to implement them. Market-oriented strategies, no less than more activist industrial policies, depend on the public adminstrations that can provide collective goods and cooperate with private business without being captured by particular firms or sectors. Privatization of banks, transport, and public utilities, for example, has implied the need for governments to undertake additional responsibilities for the regulation of private monopolies. Similarly, the establishment of effective social safety-nets implies bureaucracies that can deliver core public services and/or ensure the accountability of private providers.

The capacity of Latin American states to perform such functions has never been high, but their overextended bureaucracies were devastated by the fiscal crises that exploded in the early 1980s. The collapse of external financing and hyperinflation had disastrous consequences for public revenues; in extreme cases such as Bolivia and Peru, revenues fell to as low as 3 percent and 7 percent of GDP during the hyperinflations of the 1980s. In these countries and most others, such pressures in turn forced crippling cutbacks in public wages, investments, and social services.

Though the fiscal retrenchments and market-oriented adjustments which followed these crises were sometimes viewed as attacks on government, they were in many respects necessary first steps toward the strengthening of the state. Reducing fiscal deficits and establishing sustainable macroeconomic equilibria provided conditions that were essential for a more effective state. In reducing the responsibilities undertaken by the public sector, moreover, the adjustments of the 1980s opened opportunities for governments to focus more selectively and efficiently on the provision of public goods.

State in Latin America, edited by Colin I. Bradford. (Paris: Organization for Economic Cooperation and Development, 1994), pp. 173-195.

The economic reforms of the last decade, however, paid little attention to issues of administrative reform and did little to halt the deterioration of human resources within the public sector. On the contrary, in many parts of the region, morale collapsed within essential public agencies, often leading to the exit of the most capable civil servants. Thus daunting challenges of state reform have persisted into the 1990s.

1. *Tax administration.* The most serious weaknesses lie on the revenue side. Although most countries were forced to squeeze down public expenditures during the crisis of the 1980s, their capacity to establish an effective tax base remains precarious at best. Moises Naim notes that for the region as a whole, revenues averaged around 14 percent of GDP during the early 1990s. This was five points below the average for all middle-income developing countries and nine points below that of the industrialized countries.[15] Revenue constraints have not only placed limits on non-inflationary expenditures; they have also reduced opportunities for public savings (the difference between revenues and current expenditures), which is important for increasing the meager domestic savings rate in the region.

By the early 1990s, a number of Latin American countries had attempted to address this issue. One step has been to institute simpler and more broadly-based value-added taxes. Although these have regressive features, they are relatively easy to monitor and collect and for this reason have been widely favored throughout the region. In Bolivia, Peru and Argentina -- all countries which had experienced hyperinflation -- governments have also taken steps to improve the efficiency of tax offices by increasing compensation and training for personnel, augmenting the ratio of tax auditors to administrative personnel, and publicizing enforcement of tax collection. While these efforts appear to have

[15] Moises Naim, "Latin America: The Second Stage of Reform," in *Journal of Democracy* Vol. 5, No. 4., October 1994, p. 40.

produced improved tax yields, it is unclear whether they will be sufficient to sustain public finances as opportunities to earn revenues from privatization decline.

2. *Overstaffing.* For political reasons, most governments have found it easier to reduce their public wage bill by cutting salaries and compressing salary scales, rather than by downsizing the public workforce and establishing priorities among programs. Again, of course, there are important exceptions; between 1989 and 1992, Argentina's civil service reform eliminated an estimated 86,000 public sector positions, about 16 percent of the federal government, and transferred another 210,000 personnel to provincial jurisdictions.[16] In the majority of countries, however, patronage pressures and strong public-sector unions impede substantial downsizing. Indeed, in a number of cases, public employment has actually increased in spite of the fiscal crisis. In Brazil, employment grew by about 65 percent during the 1980s, with a heavy concentration of patronage appointments at the municipal level.[17] Prior to the cutback in Argentina, overall public-sector employment increased by about almost 24 percent between 1983 and 1989, while salaries declined by 34 percent.[18]

Tough job security laws compound these problems. Competitive, merit-based recruitment is prohibited in many countries at all but entry-level and top management positions. Promotions are based on seniority, and performance reviews rarely discriminate among employees. Tenure protection makes it difficult to hold workers accountable, and dismissal for incompetence is all but impossible.

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[16] Pablo Antonio Fontevila, "Downsizing the State: The Argentine Experience," in Shahid Amjad Chaudhry, Gary James Reid, and Waleed Haider Malik, eds., *Civil Service Reform in Latin America and the Caribbean: Proceedings of a Conference* (Washington, D.C.: World Bank Technical Paper Number 259, 1994), p. 114.

[17] Helio Zylberstajn, "Pay and Employment Issues in the Brazilian Civil Service," in Chaudhry et al, eds., *Civil Service Reform in Latin America*, p. 128.

[18] Pablo Antonio Fontdevila, "Downsizing the State: The Argentine Experience," p. 111.

3. *Weakness of senior management*. At the senior management level, the compression of salary scales has serious consequences for the recruitment and retention of qualified personnel. There is little consistency between salaries and skills in the public and private sectors, and discrepancies are particularly large at upper management levels. In Uruguay, a division director in the public sector earns only about 37.5 percent of what a manager earns in the private sector; in Argentina, the figures are between 24 and 51 percent, and in Venezuela, between 16 and 67 percent. Even in Chile, where the quality of senior management is reputed to be somewhat better, top-level public sector managers earn between 63 and 70 percent of the average for their counterparts in the private sector.[19] Advancement based on seniority or political patronage offers little reward for merit.

4. *Ineffective delivery of social services*. Social services in Latin America were hit very hard by the debt crisis of the 1980s. In per capita terms, social spending within the region declined by 18 percent between 1980 and 1985. Even more significant, social spending lost ground as a component of overall public spending; its share of non-interest expenditures declined by 16 percent.[20] At a time of extraordinary hardship, priorities shifted away from social services.

Social expenditures have not only been too low, however, but also seriously misallocated: education outlays flow disproportionately to universities, rather than to primary schools; support for healthcare goes to hospitals, rather than to measures for prevention of basic disease. Pension systems and other social safety-nets have limited coverage and rest on precarious financial foundations. Delivery systems are typically controlled by overcentralized bureaucratic organizations that place a heavy burden on fiscal resources. Within

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[19] Gary J. Reid and Graham Scott, "Public Sector Human Resource Management in Latin America and the Caribbean," in Chaudhry et al, *Civil Service Reform in Latin America*, p. 48.

[20] World Bank, *World Development Report 1990: Poverty* (Published for the World Bank by Oxford University Press, 1990), p.116.

such organizations, obtaining necessary information from lower-level units is also a serious problem. As one study suggests, top officials are often unable to "ascertain the quantity of resources [their subordinates] are using, and what they are accomplishing."[21]

Reforms in social-service systems are possible in principle, but face a myriad of organizational and political obstacles. The privatization and decentralization of health, education, and pension systems may, as many have argued, eventually improve the quality and efficiency of such services while making them more responsive to the needs of local beneficiaries. Even so, the difficulties of making such a transition should not be underestimated. At present, most state and municipal governments lack the personnel and facilities required to assume new responsibilities, and central governments are often unequipped to regulate and oversee the effectiveness of private providers. As I shall discuss more below, moreover, organizational reforms and the reallocation of expenditures both face opposition from unionized providers of services and from existing beneficiaries.

5. *Decline of law and order*. Severe deterioration in the capacity to guarantee basic law and order, finally, constitutes the most alarming trend of the past decade. Drug mafias have become deeply entrenched in the Andean countries, Mexico, and some parts of the Caribbean. Economic crisis and the dislocations of adjustment efforts have led to an upsurge of violent crime and to the increasing privatization of police functions in most wealthy neighborhoods. Perceptions of corruption are widespread, and have emerged as major political issues in Brazil, Argentina, Mexico, Colombia and Venezuela. Weak judiciaries and poorly-trained police forces have been overwhelmed by such problems. The judiciary is underfunded and overloaded with cases. Judges frequently depend on the goodwill of their political patrons for tenure in office, and court systems

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[21] Gary J. Reid and Graham Scott, "Public Sector Human Resource Management in Latin America and the Caribbean," in Chaudhry et al, *Civil Service Reform in Latin America*, p. 61.

have been subjected to wholesale political purges in a number of countries -- most recently in Peru and Argentina. Needless to say, the judiciary is typically held in very low esteem by the general public. In a poll of Buenos Aires residents in 1992, for example, almost 70 percent of the respondents felt that corruption was widespread within the judicial system.[22]

Police forces are also in severe disarray. Underpaid and undertrained, they operate in many countries as predators, rather than as protectors of citizens' rights. A few comparative statistics from Sao Paulo, Brazil, underline this point quite dramatically.[23] In 1992, almost 1500 people were killed in Sao Paulo during confrontations with police, as compared with approximately 25 in Los Angeles and New York. In New York and Los Angeles, between two and three civilians are wounded for every one who is killed by the police, whereas in Sao Paulo, the "kill ratio" goes in the opposite direction: approximately five people die for every one who is wounded, a strong indication of police executions rather than lawful arrests. Civilian courts lack jurisdiction over such behavior by virtue of legislation passed during the military regime; consequently, official criminality typically goes unpunished.

Basic law-and-order problems are particularly severe where mafias and police have become closely interpenetrated. In Colombia, Peru, Mexico and Brazil, vicious circles of police corruption and citizen mistrust have reached a point where reversal is quite difficult. This process is much less advanced, on the other hand, in the southern cone countries, and it may be possible to upgrade the professional competence of police forces before the problems get out of hand.

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[22] Hugo Fruhling, "Judicial Reform and Democratization in Latin America." Prepared for *Fault Lines of Democratic Governance in the Americas*, North-South Center, University of Miami, May 4-6, 1995, p. 24.

[23] Data are from Teres P.R. Caldeira and James Holston, "Citizenship, Justice, Law: Limits and Prospects of Democratization in Brazil." Prepared for *Fault Lines of Democratic Governance in the Americas*, North-South Center, University of Miami, May 4-6, 1995, p. 17.

THE POLITICS OF REFORMING THE STATE

Sectors of the international financial community have recognized for some time that these problems must be addressed if the process of economic reform is to be consolidated and deepened. Institutions such as the World Bank and the Inter-American Development Bank have begun to pay increasing attention to problems of governance and state reform, with specific emphasis on ways to make public-sector organization more efficient, transparent and accountable. Much of the debate centers on the creation of a more meritocratic civil service, establishment of performance-related incentives, and the devolution of some service functions to territorially-decentralized units of government.

Reform of the state, however, is not simply a matter of calling on political leaders to summon the "political will" to put the "correct" institutional formulas into place. Like economic reforms themselves, the transformation of the state is inevitably a *political* process; it will involve conflict and bargaining among politicians, bureaucrats, and interest groups -- many of whom have important stakes in existing arrangements. Outcomes are likely to vary widely within the region, depending on the relative strength of such groups and the incentives which they face. Nevertheless, it is possible to provide a stylized sketch of some of the principal players, and the interests they might be expected to pursue.[24]

1. *Presidents*. In systems with presidential constitutions, presidents and their inner-circle of advisors are key actors in the initiation of reform. Though proposals for reform may come from professional groups, NGOs, or international financial groups, presidents are essential to set them in motion within the political system. Of course, like other politicians, presidents depend on patronage and other special benefits that cut against more general efforts to

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[24] The following paragraphs draw heavily on a recent paper by Stephan Haggard, "The Reform of the State in Latin America" (unpublished, 1995).

increase the coherence of state organization. Compared to most legislators, however, they also appeal to broad national constituencies that encompass a wide range of interests, and they thus tend to have a greater stake in creating state organizations capable of promoting aggregate economic welfare.[25]

This stake provides an incentive for presidents to take the leadership in state reform efforts. In Brazil, Argentina and Mexico, presidential backing has generally been instrumental, for example, in strengthening the administrative capacity of elite decision-making units such as finance ministries, central banks, and specialized development agencies. Large-scale line agencies, however, tend to be far more resistant to presidential initiatives, and elite agencies themselves are highly vulnerable as long as they continue to depend solely on the support and political resources of particular presidential incumbents. Without support from other social and political groups, presidential backing alone does not constitute a dependable foundation for large-scale and lasting bureaucratic reform.[26]

2. *Party leaders and legislators.* Legislators and party leaders may also have collective stakes in broad welfare-enhancing policies, but as individual politicians, their opportunities for reelection often depend on the capacity to distribute patronage and pork to relatively limited constituencies. Legislative politicians often oppose civil service reforms because they limit access to such resources. Effective and sustained rationalization of the public bureaucracy depends on finding ways to reduce this opposition and gain the support -- or at least the acquiescence -- of congressional majorities.

Though we still know little about the circumstances in which this might be most likely, it is possible to specify a number of political and institutional

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[25] See Barbara Geddes, *Politician's Dilemma: Building State Capacity in Latin America* (Berkeley, Los Angeles, and London: University of California Press, 1994), pp. 131-134.

[26] A well-researched example of this vulnerability during the pre-debt crisis era was the rise and decline of the Brazilian Development Bank (BNDE).

factors that might affect the importance of pork-barrel benefits in the electoral process -- and thus, the inclination for politicians to accept or resist bureaucratic reform. For example, the importance of pork and other particularistic benefits tends to be strongest in small constituencies, where a relatively limited number of votes can tip the outcome. Pork and patronage are also important where party organizations are weak and decentralized and where voters are not strongly attached to party labels; in such circumstances politicians must rely more heavily on personal appeals to win party nominations or general elections. Conversely, incentives for pork tend to diminish where politicians represent large electoral districts and/or where presidents or the leaders of broadly-based national parties control opportunities for nomination and election.

Although it is beyond the scope of this paper to explore the implications of such hypotheses in detail, they offer some intriguing clues for thinking about different national opportunities for bureaucratic reform. Relatively strong and disciplined parties in Chile, for example, have contributed significantly to the maintenance of a comparatively effective civil service in the post-Pinochet era. Although parties in Argentina are more weakly institutionalized, the Peronist party's deep roots in the electorate and its majority in Congress has probably helped to diminish opposition to civil service reforms initiated under Menem. Important opportunities for bureaucratic reform may also have opened up in Colombia, where recent constitutional changes have enlarged electoral districts and strengthened control of the national leadership of the ruling Liberal party over the rank-and-file.

Where party systems are fragmented and unstable, as is currently the case in Brazil, Ecuador and Venezuela, the prospects for bureaucratic reform appear much more limited. If the PRI splinters, new conflicts between the president and congress and the increasing independence of local political bosses from federal control may also diminish opportunities for comprehensive administrative reform in Mexico.

Brazil's current president, Fernando Henrique Cardoso, has promised a thoroughgoing downsizing and reform of the state bureaucracy. But like his immediate predecessors, Cardoso faces enormous obstacles in the Congress. Parties are both highly fragmented and internally undisciplined, and unlike in Argentina, Chile, or Colombia, party labels have little significance within the electorate. The president's own party, the PSDB, occupies only 70 of the 531 seats in the lower chamber; and legislators, who are nominated by notables at the state or municipal level, have little incentive to support deals forged by the heads of their parties.

Patronage is the lifeblood of such a system, and to govern, Cardoso must either rely on decree powers or "buy" legislative support through bargains struck with individual legislators. These constraints, as suggested above, do not necessarily preclude presidential initiatives that upgrade specific agencies. But more comphrensive reforms are likely to be contingent on changes in electoral laws and the party system.

3. *Bureaucrats and clients*. Bureaucrats and their clients are also major actors in the politics of state reform. Service-providers within the state bureaucracy -- health workers, teachers, and other civil servants -- are highly unionized and are among the region's strongest interest groups. Since the bargaining power of such groups often rests on administrative centralization and extensive tenure protection, they have generally opposed moves toward decentralization and "flexibilization."

Although these groups remain important, however, their capacity to block reforms appears to be diminishing. In part, this seems attributable to the steady erosion of their economic base caused by inflation and unemployment, and in part by the growth of broad public demand for a more honest and competent public bureaucracy. The weakening of civil service unions in Argentina, for example, undoubtedly facilitated civil service reforms under Menem; also important was the fact that little opportunity existed for the unions to exert leverage outside the framework of Menem's Peronist party.

Public-sector union opposition has been stronger in Brazil, where urban unemployment rates were lower during the 1980s.[27] Even there, however, the evolution of public support for market-reforms and bureaucratic rationalization has tended to isolate unions politically. This was evident in 1995 during a long strike in the state-owned petroleum sector, undertaken both to demand large wage adjustments and to protest projected plans for privatization. Striking workers were able to seriously disrupt fuel supplies to the major cities, but they received little backing from the general public or from congressional politicians. Eventually, with the government standing firm, workers began to filter back to their jobs and the strike was broken.

Well-organized and influential beneficiaries of state services may prove to be more persistent and powerful opponents of welfare reform. As Joan Nelson has argued, conflicts over the distribution of benefits is typically an important factor in the politics of social welfare reform.[28] The political incentives to target anti-poverty programs are limited by the fact that the poor are generally among the least organized sectors of the population. Conversely, middle-sector groups, university students, and pensioners are generally powerful opponents of efforts to reallocate health and educational exenditures toward services aimed at low-income sectors. Thus, notwithstanding the weakening of public sector unions, a more effective and equitable restructuring of these services remains a serious challenge.

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[27] World Bank, *Latin America and the Caribbean: A Decade after the Debt Crisis* (Washington, D.C.: Latin America and the Caribbean Region of the World Bank, 1993), p. 123.

[28] Joan Nelson, "Poverty, Equity, and the Politics of Adjustment," in Haggard and Kaufman, eds., *The Politics of Adjustment*.

4. *Civic associations and social movements*. In the long-run, making government accountable may depend as much on the strength of "civil society" as on the structure of public institutions themselves. Civic associations can have a direct impact on the quality of public services as watchdogs and monitors of governmental performance. They can also contribute indirectly, as Robert Putnam has suggested, by encouraging norms of reciprocity and mutual trust essential to collaboration in both the public and private sectors. In societies with strong associational infrastructures, Putnam argues, citizens "expect better government and (in part through their own efforts), they get it. They demand more effective public service, and they are prepared to act collectively to achieve their shared goals."[29] This insight -- that the quality of political life depends on a dense associational infrastructure -- is at least as old as Tocqueville's classic writing on democracy in America.[30] It seems especially relevant to some of the basic problems of governance in Latin America, particularly to the fundamental challenge of making police and courts more effective and accountable. As suggested above, vicious circles of citizen mistrust and official corruption have reached crisis proportions in many countries of the region. If these patterns are to be reversed, strong civil societies are likely to play a pivotal role. In communities that lack a strong tradition of civic association, individual citizens are isolated and therefore vulnerable both to police predation and to risks of reprisals for collaborating with public authorities. In societies where participation in civic life has encouraged traditions of mutual assistance and social responsibility, these risks diminish. Citizens who "come forward" -- whether to collaborate with police or to demand accountability -- are more likely to expect and receive the support of their neighbors. Strong civic associations and strong states thus go together.

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[29] Robert D. Putnam, *Making Democracy Work: Civic Traditions in Modern Italy* (Princeton: Princeton University Press, 1993), p. 182.

[30] Alexis de Tocqueville, *Democracy in America*, edited by J.P. Mayer (Garden City, N.Y.: Anchor Books, 1969).

What are the chances for the strengthening of associational life in Latin America? In fact, we know little about how traditions of associability develop or how they can be fostered by international financial institutions or local policy-makers. It is important to note, however, that community organizations and civic movements have mushroomed throughout the region, particularly in poor urban neighborhoods. Organizations range from food cooperatives and neighborhood improvement associations, to groups organized around ethnic, gender, or religious identities. Despite widespread poverty and inequality, they appear to have become important and irreversible new facts of social life. The long-term impact of such associations may not be known for decades. But if Putnam (and Tocqueville) are correct, they may prove to be fundamentally important assets in the political and economic modernization of Latin America -- even, or perhaps especially, in Mexico, Colombia, Peru, Brazil, and other societies in which the maintenance of law-and-order seems deeply problematic.

III. The Institutionalization of Democracy

During the 1980s, the political frameworks in which Latin American societies faced these challenges underwent dramatic transformations from military dictatorships toward electoral democracies. By the 1990s, with the glaring exception of Cuba and the more ambiguous exception of Mexico, this transformation was largely complete. Contrary to the fears expressed by many observers at the onset of the transformation, most of these new democracies have proved remarkably durable. With the exception of Peru under Fujimori, constitutional governments survived extraordinarily severe economic crises. Also contrary to expectations, a significant number have managed to initiate wide-ranging market-reforms.

In hindsight, it seems clear that a variety of international and domestic factors have contributed to this resilience. Perhaps the most important single factor has been the decline in ideological polarization that has resulted from the winding down of the Cold War. The weakening and collapse of the Soviet Union has both deprived revolutionary groups of their primary international patron and eliminated the credibility of right-wing alarms against alleged communist threats. As a consequence, the United States government and conservative groups in Latin America have been much less inclined than in the past to back anti-communist military dictatorships.

The economic failures of most military dictatorships also contributed in many countries to a widespread rejection of authoritarian alternatives. While numerous opinion surveys show widespread dissatisfaction with the economic performance of democratic governments, they also indicate very limited backing for military rule. Table 4 shows survey results that are especially encouraging for Chile, Uruguay, Venezuela and Colombia. In these countries, support for democracy is comparable to European levels. Data for Ecuador, Peru and Brazil are more disturbing: in all three countries, support for democracy fell below 70 percent, and in the run-up to Fujimori's coup, almost 30 percent of the Peruvian sample expressed support for the military. Even in those cases, however, both international conditions and preferences of the domestic population make a sustained return to military dictatorship unlikely.

While there are frequent discrepancies between institutional norms and political realities, the establishment of formal democracy in Latin America is a major accomplishment. A number of the rapidly-growing Asian countries -- Singapore, Malaysia and Indonesia -- lag well behind in this respect, and it remains to be demonstrated that the roots of new democracies in Korea, Taiwan or Thailand are as firm as those in Colombia, Venezuela, Costa Rica, the southern cone of South America, or even in Brazil. On the other hand, it is clear that the stability of Latin American democracies varies considerably across cases, and that the region as a whole continues to face serious challenges of institutional consolidation.

In this connection, it is important to emphasize that economic prosperity alone does not necessarily guarantee consolidation. Well-organized channels of representation and accountability are also important, and in this area, Latin American democracies face two interrelated problems. The first is the tendency for presidents to govern through plebiscitary appeals to the population at large, rather than through legislatures, courts, and other institutions of representative democracy. The second is the evident weakness of political parties -- the most critical links between citizens and their governments.

Table 4. *Attitudes toward Democracy (Percentages of survey sample)*

	Democracy best for country (a)	Prefer military (b)	Radical change is needed (c)
Bolivia			
(7/91)	74	11	34
(10/92)	77	11	
Colombia			
(7/91)	84	8	43
(11/92)	72	16	
Ecuador			
(7/91)	63	25	42
(11/92)	66	26	
Peru			
(7/91)	59	28	61
(11/92)	77	10	
Venezuela			
(1/92)	76	na	
Uruguay			
(1991)	73	10	
Chile			
(1992)	79		
Brazil			
(1992)	42	22	
Spain			
(1985)	70		10
Portugal			
(1985)	61	9	
Greece			
(1985)	87	5	

Notes: (a). For Bolivia, Ecuador, Peru, Columbia and Venezuela, response to question: "In your opinion, which type of government is best for (survey country)--a democratically-elected government, a military government or a revolutionary government?" Percent responding "democratically-elected government." For Uruguay, Chile, Brazil, Spain, Portugal and Greece, percent agreeing with the statement "Democracy is best for a country like ours."

(b). For Bolivia, Ecuador, Peru, Columbia and Venezuela, response to question: "In your opinion, which type of government is best for (country in question)--a democratically-elected government, a military government or a revolutionary government?" Percent responding "military government." For Brazil, Uruguay, Spain, Portugal and Greece, response to statement: "In some cases, a non-democratic government could be preferable to a democracy." Percent agreeing.

(c). Response to question: "Thinking for a moment about (survey country) as a whole, which of the following comes closest to your opinion: our society should be radically changed from the way it is now; our society is basically OK, but widespread reforms are required; our society is fine and neither revolutionary changes nor widespread reforms are necessary." Percent agreeing with statement that radical change is necessary.

Sources: Juan J. Linz and Alfred Stepan, *Problems of Democratic Transition and Consolidation: Southern Europe, South America and Eastern Europe*, unpublished ms.; United States Information Agency, "Andeans Favor Democracy Despite Dissatisfaction with Current Conditions," Research Memorandum, Feb. 7, 1992; "Fujimori and His Actions Are Widely Endorsed, but Peruvians Ultimately Want Democracy," Research Memorandum April 27, 1992; Opinion Research Memorandum, March 19, 1993; "Andean Publics Prefer Democracy," Opinion Research Memorandum, April 8, 1993.

1. *Presidential personalism.* Traditions of personalist leadership are deeply-rooted in Latin American history, and this style has reemerged with a vengeance in a number of contemporary democratic settings. Carlos Saul Menem, Alberto Fujimori, Carlos Andres Perez and Fernando Collor all shared in common an inclination to seek broad popular mandates through media appeals and personalist movements, rather than relying on institutionalized consultation with legislators and interest groups.

This pattern of personalistic leadership reflects a number of deeply-rooted factors, not the least of which may be the historical attachment which most Latin American societies have to presidential constitutions. Unlike in parliamentary governments, presidents and legislators have independent electoral mandates. Presidents cannot, like prime ministers, be routinely replaced when they lose the support of legislative majorities; on the other hand, they also lack the authority to dissolve parliament and call new elections. In the absence of clear constitutional rules for resolving legislative deadlocks, presidents face greater temptations than prime ministers to govern without congressional consent. A growing number of scholars have argued that long-standing patterns of democratic instability in Latin America can be traced in part to problems of divided government.[31]

In recent decades, these institutional and historical factors have been reinforced by the conditions of macroeconomic crisis in which many contemporary Latin American democracies were reestablished. The demands for rapid responses to these crises and the disorganization of opposition induced many presidents to initiate reforms by decree, or to ram emergency laws through acquiescent legislatures. In some instances -- for example, during the

[31] Juan J. Linz and Arturo Valenzuela, eds., *The Failure of Presidential Democracy* (Baltimore: Johns Hopkins University Press, 1994)

hyperinflations in Bolivia, Argentina or Peru -- it can be argued that failure to have responded decisively to deteriorating conditions would have posed even greater threats to democracy. Whatever their objectives, however, autocratic personal leaders pose important dangers for democratic societies.

In the first place, policies imposed outside of normal channels of consultation and accountability may be wrong. Unchecked exercise of executive authority cuts decision-makers off from information that may be necessary for correcting mistakes, and can thus lead to costly policy errors. The disastrous "tablita" experiments undertaken by military dictatorships in Argentina and Uruguay provide one set of examples from the late 1970s.[32] More recently, erratic and inconsistent decision-making in Brazil under Collor, or in Mexico during the last year of the Salinas administration, can also be attributed to personalist and unaccountable decision-making processes.

Policies made without consultation and oversight may also be politically unsustainable. In Venezuela, reforms initiated by President Carlos Andres Perez in 1989 were imposed over the heads of congressional and party leaders. But a strong backlash against the reforms led eventually to the removal of the president and reversal of the reforms.

Finally, even where the reform initiatives of personalist presidents yield positive economic results, there is substantial risk of a slide into a kind of "soft authoritarianism" in which economic success is used by the ruler to chip away at constitutional limits on his power. Experiences under Fujimori and Menem are emblematic of these possibilities. While Menem succeeded in ending the severe economic and political crisis faced by Argentine during the early 1990s, his personal popularity also allowed him to undermine the institutional limits on his authority. He has relied heavily on decree powers of dubious constitutionality,

[32] Tablitas were pre-announced schedules of minidevaluations which were aimed at reducing inflationary expectations. Inflation continued to outpace the rate of devaluation, however, leading to exchange rate overvaluation and financial crisis.

packed the Supreme Court to forestall legal challenges, and intimidated the press. Most recently, of course, he engineered constitutional changes that allowed him to bid for reelection and to continue in office beyond the conventional one-term limit. In Peru, emergency powers claimed by Fujimori after his election in 1990 provided important entry points for his decision in April 1992 to dissolve congress and rule by decree.

2. *Party systems*. Poorly-institutionalized party systems are both a cause and a consequence of this form of personal leadership. Presidents such as Fujimori who campaign "above parties" obviously undermine the role and importance of party organization; on the other hand, fragmentation and indiscipline within party systems increase the difficulty of arriving at stable compromises within the legislature and among interest groups. Immobilism in turn increases the temptation for presidents to engage in plebiscitory appeals and autocratic personal leadership.

Parties in most Latin American countries have long been characterized by vague programs, extensive reliance on patronage, and unstable electoral bases and political organizations. These problems appear, however, to have grown worse during the 1980s and 1990s. Economic crisis and market-oriented reforms have weakened voter attachments to historic parties, without as yet having produced stable new partisan identifications. As in the United States and other advanced industrial countries, moreover, the growing importance of television in political campaigning has weakened the role that party organizations have traditionally played in educating voters about candidates and policies. The result is an increase in the flux and uncertainty of democratic politics.

Table 5 displays some summary measures of two frequently-used indicators of party system stability: the extent to which these systems are fragmented into a very large *number* of competing parties, and the *volatility* of electoral support for the parties, using data from the 1970s into the early 1990s.

The measures are somewhat arbitrary, both because it is not always easy to decide whether a particular organization, coalition, or movement should be counted as a "party," and because time periods vary from country to country. Nevertheless, the data provide a useful overview of patterns within the region.

Table 5. *Electoral volatility and effective number of parties in selected Latin American countries.*

	Volatility	Effective Number of Parties
Uruguay	9.1 (1971-89)	3.2
Colombia	9.7 (1970-90)	2.1
Costa Rica	16.3 (1970-90)	2.4
Chile	16.5 (1973-93)	2.3
Venezuela	18.8 (1973-93)	2.6
Argentina	20.0 (1982-93)	2.9
Bolivia	36.1 (1979-93)	4.4
Ecuador	37.9 (1978-92)	5.8
Peru	54.2 (1978-90)	3.9
Brazil	70.0 (1982-90)	5.5

Sources: For volatility: Scott Mainwaring and Timothy Scully, eds., "Introduction," *Building Democratic Institutions: Party Systems in Latin America* (Stanford: Stanford University Press, 1995). For number of parties: Stephan Haggard and Robert R. Kaufman, *The Political Economy of Democratic Transitions* (Princeton: Princeton University Press, 1995)

Volatility is calculated by adding the net change in legislative seats between elections, and dividing by two. Effective number of parties is calculated as the inverse of the sum of the squares of percentage of legislative seats going to each party.

As the table suggests, party systems differ considerably from one country to the next. The systems of Colombia and Uruguay show considerable stability;

and those in Costa Rica, Chile, and even Argentina and Venezuela, have been much more stable and less fragmented than those in Brazil, Peru and Ecuador.

It should be noted that signs of strain are evident even in the relatively durable systems. Argentina's volatility score, for example, implies a swing of about 20 percent among the parties in a given election -- a big change in the balance of power. During the mid-1990s, moreover, a major third-party movement, the Wide Front, made important inroads among supporters of the Peronist and Radical parties. Similarly, the data on Venezuela do not reflect the virtual collapse of the two major parties during the early 1990s. Only in Chile has the trend been toward greater consolidation, with the formation of a strong center-left coalition between Christian Democrats and Socialists.

Party system instability is clearly most extreme, however, in Ecuador, Peru and Brazil. In Brazil and Peru, the average swing of votes between winning and losing parties has ranged between 54 and 70 percent; in other words, parties which have dominated in one election -- such as the PMDB in Brazil, or the Popular Action and Aprista parties in Peru -- have come close to disappearing in the next. Extreme party fragmentation also constitutes a serious problem. A two-party system may not the best means of representing the multiplicity of interests demanding to be heard in Latin America. But where five or six unstable parties compete for power -- as is the case in Brazil, Ecuador and Peru -- the consequences are likely to be confusion and apathy within the electorate, unstable legislative coalitions, and significant difficulties in modernizing the state bureaucracy. It is perhaps no accident that support for military alternatives was relatively high in each of these societies (see Table 4).

Party system instability stems from a number of social and cultural factors that are beyond the control of political leaders; for example, rapid transformations in communications and social structure. As suggested in an earlier section, however, electoral laws and systems of representation can have an important impact on the incentives facing politicians and thus on the structure of parties. Raising the minimum threshold of votes needed for representation in the legislature, for example, can have a major effect on the number of effective parties; similarly, centralizing nominating procedures and enlarging electoral districts may affect party discipline and programatic orientation.

Societies can, of course, muddle through regardless of weak party systems: Brazil, with its huge markets and dynamic export sector, is perhaps the best example. Given the centrality of parties to democratic governance, however, a high priority for the immediate future is to find ways to establish stable forms of party competition.

IV. Concluding perspectives

What are the long-term prospects for economic development in Latin America? Which societies are most likely to experience sustained growth over the next decade, and what are the chances that such growth will occur within a context of stable, democratic institutions? In this paper, I have attempted to identify a number of factors relevant to such outcomes, but there is no simple formula for determining the relative weights of these factors, or the way they combine in a given country. In the absence of more in-depth studies, an attempt to evaluate the prospects of specific countries inevitably rises only a short distance above pure guesswork.

For purposes of discussion, however, I make just such an attempt, ranking the larger countries of the region in terms of the chances that they will achieve moderate to high growth rates over the next decade. I assume that such prospects will depend in part on some of the issues discussed in the preceding sections: whether governments can implement coherent growth policies that sustain macroeconomic equilibria and provide some relief for poverty and inequality; whether they can establish a relatively competent state bureaucracy; and whether they can develop more institutionalized forms of democratic accountability. Countries are grouped into four categories: those in which chances for growth are excellent; those in which the odds for sustained growth are favorable, but which nevertheless face serious problems; countries facing more serious risks; and those in which the possibilities for growth are most likely to be interrupted or delayed by political or economic crisis in the medium-run.

Excellent growth prospects: Chile. Chile stands virtually alone among the larger Latin American countries. "Asian-level" domestic savings rates have helped to insulate it from the volatility of international financial markets; there is a strong political consensus on overall macroeconomic policy; and there are encouraging signs of progress on equity issues. Chile also has solid political institutions. It has a comparatively strong civil service, an honest judiciary, and a comparatively stable party system. Authoritarian legacies from the Pinochet era remain to be overcome, including legislators and judges appointed under the dictatorship and a military establishment that operates outside the orbit of civilian control. While these challenges are important, however, they do not appear likely to affect a strong growth trajectory.

A good bet, but with significant risks: Brazil. Notwithstanding severe political and social problems, Brazil seems to be a reasonable bet to continue moderately high growth into the twenty-first century. It has unique underlying advantages, including a huge domestic economy, a dynamic export sector, and a large inflow of direct foreign investment which will begin to pay off in coming years. In addition, President Fernando Henrique Cardoso has assembled a highly skilled team of economic decision-makers.

On the other hand, Brazil's unstable and fragmented party system will make it difficult for its political leaders to address a number of pressing issues discussed in the preceding sections, including poverty reduction, and the modernization of the state bureaucracy. For similar reasons, deep fiscal adjustments may also be difficult to implement. For the next few years, a failure of fiscal adjustment can be offset by revenues from privatization; in the longer run, however, it can imperil both financial stability and the general recovery. If Brazil grows, it will be in spite of its political system, rather than because of it.

Fair prospects for growth over the long run, but with greater vulnerability to economic crisis: Argentina, Uruguay, Bolivia. The most important strengths of Argentine and Uruguayan societies lie in their human capital: notwithstanding a dramatic deterioration in social welfare during the past decade, problems of poverty and inequality are still less severe than in Brazil, Peru, or Mexico, and in both countries there is still a skilled and literate workforce. Moreover, while both countries face important uncertainties related to the rise of new parties and the decline of traditional political forces, the leaders of the major parties are moderate and committed to macroeconomic stability.

For Argentina, the principal question marks lie in difficulties exposed by the fallout from the peso crisis and by continuing problems of political institutionalization. The Mexican crisis has highlighted the country's excessive dependence on external finance capital, and has exacerbated major structural weaknesses in the banking system; both problems pose serious threats to macroeconomic policy. Moreover, despite Menem's broad initiatives to reform the civil service, his reelection is at best a mixed blessing which can have serious consequences for the consolidation of the rule of law.

Uruguay's democratic system is more institutionalized than Argentina's, but it has moved toward market reforms much more slowly. Like Argentina, Uruguay stands to gain from participation in the Mercosur, the regional trading bloc formed in 1991 by Uruguay, Argentina, Brazil, and Paraguay. But Uruguay also faces a long agenda of issues related to privatization, trade liberalization, and pension reform.

Bolivia is placed in this problematic category for entirely different reasons. In contrast to both Argentina and Uruguay, it was one of the first countries in the region to liberalize its economy in the years following the debt crisis; and despite sluggish private investment, the country began to experience moderate growth rates by the late 1980s. The most significant constraints on Bolivia's future long-term growth lie less in its politics or its economic policies than in its relatively limited natural resources outside the mining sector and in the extraordinary poverty of its population. Sustainable growth may depend most of all on efforts to upgrade the basic skills and health of its population.

Countries with the greatest vulnerability to economic crisis: Mexico, Peru and Venezuela. Countries in this category continue to have significant long-term potential, but each remains highly vulnerable to political and economic challenges that can delay or disrupt a sustained economic recovery.

Mexico's macroeconomic difficulties are well-known and need not be discussed at length; if its stabilization program holds, it may well continue its rebound from the crisis of 1994-1995. The longer-term problems lie in the social and political realm, where recovery is threatened by deepening poverty, widespread alienation, drug mafias and corruption. Mexico's political system, to be sure, is rapidly becoming more pluralistic; and close links with the United States and Canada provide the country's leaders with strong incentives for further political reforms. But Mexico is still the only large country besides Cuba not to have made a full transition to electoral democracy, and there is great uncertainty about how politics will evolve over the next five years. I am fairly hopeful about the long-run chances for democracy, but the prospects for an orderly transition are clouded by pervasive distrust between the government and the opposition, and by bitter conflicts within the ruling party itself. As suggested above, a deepening of the strong centrifugal forces within the PRI could lead to unprecedented tensions between the president and congress and between the federal government and local officials.

The Peruvian economy has been transformed by the reforms imposed under Fujimori, and experienced extraordinarily high rates of growth from 1993 through 1995. Notwithstanding the dramatic Tupac Amaru takeover of the Japanese Embassy, moreover, there has also been a significant decline in guerilla terrorism. Although these achievements are significant, however, the country continues to face daunting political and economic challenges. The recent economic boom was slowed after 1995 by macroeconomic difficulties similar to Mexico's, including a large trade deficit and an appreciated currency. A huge and impoverished indigenous population remains excluded from effective citizenship, and the gap between rich and poor is among the widest in the region. These conditions provide continuing opportunities for a renewal of terrorism as well as for the continued influence of the drug mafia. Even more than in Argentina, finally, Fujimori's personalist style of political leadership threatens to undermine norms of political compromise, legality, and accountability that are crucial for the institutionalization of Peruvian democracy.

Venezuela, finally, has only begun to emerge from its worst political and economic crisis since its successful transition to democratic rule in the late 1950s. In the backlash against economic reform initiatives of the late 1980s, the major parties which once dominated the political center have suffered crushing defeats. This in turn has widened opportunities for plebiscitary appeals and erratic personalist leadership. The current president, Rafael Caldera, has recently taken some moderate steps toward economic reform, but he began his term with costly reversals of the market-oriented measures undertaken by his predecessor.

He has also governed with much the same autocratic style, and has gone so far as to suspend important constitutional guarantees. An important check on such tendencies is provided by the discrediting of military coup attempts and continuing popular commitments to democratic rule. As has been the case in other Latin American countries, moreover, support for market-oriented reforms has grown somewhat as the negative consequences of current policies become more apparent. Nevertheless, prospects for reform continue to be diminished by unrealistic expectations that stem from a long history of petroleum wealth and public welfare. These expectations are unlikely to fade quickly, and for this reason, the economic and political reconstruction of the system will probably take some time.

Careful distinctions among the countries of Latin America are essential if business leaders and members of the Washington policy community are to make intelligent decisions about how they might encourage economic and political development and pursue their own interests within the region. Region-wide trends, to be sure, provide an essential context for country-by-country analysis; in one way or another, each nation must deal with the challenges of state reform and democratic consolidation, and with the policy issues discussed above. National responses to these challenges, however, are likely to vary substantially. Over the coming years, this can lead to a wide diversity of political and economic institutions.