

Wilson Center Comments: Central American Fiscal Policy in Times of Crisis

Aaron Schneider – 6/5/12

I want to thank Cindy and Eric for organizing this event, and Hugo Noe, Ricardo, and Maynor, for sharing their stage with me. In the interest of full disclosure, it's only fair that I mention that I'm on an advisory board for ICEFI, so I've watched this document take shape. Also, while I'll discuss a bit of my own book today, and only my name appears on the title, the host of ICEFI experts represented by these colleagues could easily have appeared as coauthors. They helped me to understand public finance in Central America, and some of the ideas we share and have developed together appear in the last chapter of their study.

I'm sure you have many of your own questions and observations, so I'll limit myself to a few points. First, I want to make the point that Central America is in crisis, but not the crisis that most people in Washington think about – the Cold War-ish lens that emphasizes drugs and security. The crisis in Central America is a crisis of political economy, and it reveals the fundamental inadequacy of the states built to deal with the challenges of global capitalism. In the last two decades, Central American governments went furthest, and signed on most enthusiastically, to a neoliberal project of economic integration with the US. Yet, this pattern of global integration has been wholly inadequate, where some wealth has certainly been created, but that wealth has been too little, concentrated in too few hands, and

not accumulated in a way that is sustainable or channeled into linkages for paths of future growth.

Second, I consider one of the main contributions of this text the explication of crisis in fiscal terms. While the narrative of South America has been a successful rebound from the 2007 downturn, the experience of Central America has been wholly distinct. Central America fits into globalized international capitalism in its own unique ways, and when the crisis hit, Central American countries fell further and rebounded less. Their fiscal experiences demonstrate that 2007 was more than a Great Recession, it was a fundamental change in the sources of dynamism, the places of production, and patterns of distribution in global capitalism. These changes to the international economy are not settled, and they present both challenges and opportunities for Central American countries and all of us.

Third, while the potentially momentous changes to international capitalism pose great challenges and opportunities, the evidence in fiscal affairs suggests that in the face of similar crisis, there are distinct responses being mapped across countries in the region. These six countries are often grouped as though they were the same, but particular combinations of social actors, institutional frameworks, and political processes produce distinct outcomes across countries.

Further, by exploring these differences we can learn quite a bit about the capacity of states to respond to shifts in global capitalism. States under

globalization are required to insert national actors in international capitalism, secure key inputs like land, labor, and capital for emerging sectors, and manage social questions of rising, falling, and excluded groups. This balancing act is expressed in fiscal terms, and changes in the fiscal basis of the state rewrite the basic relationship between the state and important social actors.

The fourth point I'll make is that the ICEFI project ends by asking what social actors might support the fiscal strategies matched to global integration, and offers the same conclusion that I offer in my book: the region has yet to see a coalition of dynamic economic elites, middle classes, and popular sectors. This is the coalition that for a brief period in the second half of the 20th century offered development and democracy to Costa Rica, and this coalition is the reason I work with ICEFI and this team – these are the democrats with a small 'd' who believe in representative government, the professionals who care about technically effective policy, and the patriots who care about the future of their countries. They are the lynchpin of the coalition that could build a modern state, and their presentation outlines a path forward that bridges the interests of economic elites and the popular sectors of their countries.

I'll say a few more words about this coalition in closing, but I want to emphasize a few aspects that also appear in my book. Integration with the global economy creates opportunities for new sectors to emerge, and the elites atop these

sectors gain in wealth and power. For them to sustain their dynamism, secure new markets, guarantee key inputs, and manage their relationships with other actors, they need certain policies and institutions from their governments. This is more than lobbying or influence, it is an act of state-building, which must occur each time shifts in international capitalism present opportunities for accumulation in new sectors and call forth elites to manage these sectors.

Yet, emerging elites do not always get the states they want, nor are they always even clear on the policies and institutions that will work. To make sense of the state-building project unfolding in each country, I look at the tax reforms that occurred from the onset of neoliberal globalization to the onset of crisis. The ICEFI project updates my framework by looking even more closely at the period since the crisis. We reach similar conclusions.

The cohesion of emerging elites and their relationship with other groups, especially declining elites and popular sectors, shapes the kinds of statebuilding that occurs. When I say cohesion, I mean the ability to unify around a coherent strategy for building state institutions and policies. By dominance I mean the ability to impose this vision, or convince others to collaborate. Where emerging elites are cohesive and dominant, as they were for almost twenty years in El Salvador, they get most of what they want in state institutions. Where emerging elites are divided and subordinate or at least balanced by traditional elites, as they

are in Guatemala, state-building projects remain frozen in time. In between El Salvador and Guatemala, the other countries of the region display intermediate patterns, which I measure by exploring changes to tax regimes, and ICEFI explores with data from tax, spending, and debt.

For both of studies, public finance is a particularly good place to look for the expression and success of state-building projects. In public finance, societies write the record of what public goods are to be provided, who benefits from collective efforts, and who pays the cost. Public finance represents in dollar values the terms of our political communities. These communities are particularly difficult to hold together under globalization, when owners of capital have an array of tools to escape taxation, can secure their own public goods in the market, and hold government hostage over debt. Still, it is precisely because public finance is so difficult under globalization that it is the site at which we can read the successes and failures of national state-building projects.

On this point I wish to return to the themes of the ICEFI study. In particular, the study explores the equity implications of tax, spending, and debt. As economists, the thinkers at ICEFI approach the concept of equity as a moral imperative; the inequalities we see in Central America, indeed in North America, are clearly unjust. They approach inequality as an economic imperative; inequality denies a large portion of society the human capital it needs to contribute

meaningfully to the economy with increases in productivity. As a political scientist, I would also add that inequality is a political imperative. Popular sectors need to be incorporated in the provision of public goods like education and health and protected from the worst vulnerabilities of economic downturn, otherwise they cannot participate meaningfully in a democratic project of state-building.

To the immediate question this statement provokes – do we want a democratic project of state-building that includes popular sectors, the answer is yes, and in my book the case of El Salvador is instructive. During the period of 1989 to 2009, El Salvador was governed by a party that effectively channeled the interests of a cohesive and dominant transnational elite. They centralized power in the executive and imposed their vision of state-building to project their interests throughout Central America. Yet, this vision of state-building was unbalanced by any attempt to incorporate popular sectors, and in many instances quite explicitly sought to exclude them. As a result, while the economic elite of El Salvador grew rich, they were far less able to take advantage of the boom years of 2005-7 and suffered the most when the crisis hit. Without the countervailing power of popular sectors and middle classes, state-building in an age of global integration is unrepresentative and inadequate.

Central America offers a lesson more generally about the politics of state-building and globalization. Fiscal policy must secure contributions from the most

dynamic sectors of society and provide social protection and incorporation for all.

If not, the opportunities of global integration will be missed and the challenges of global downturn will not be met.