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ECONOMIC STABILIZATION PROGRAMS
IN LATIN AMERICA: POLITICAL DIMENSIONS

Milton Charlton
Columbia University

Deborah Riner
Princeton University

Introduction

The problems of inflation and balance-of-payments crisis are hardly new to the Latin American scene. Nevertheless, the last decade has witnessed economic imbalances of unprecedented magnitudes in several Latin American countries. Efforts to achieve stabilization have had a marked impact on many of these nations, in economic, social, and political terms.

Under the aegis of the Latin American Program of the Woodrow Wilson International Center for Scholars, a workshop was organized to examine the political dimensions of Latin American stabilization. The workshop, co-chaired by Laurence Whitehead of Oxford University and Alejandro Foxley of CIEPLAN in Santiago, Chile, was held in Washington, D.C., June 21-23, 1979. A List of participants is appended.

The objectives and parameters of the workshop were briefly outlined by Laurence Whitehead at the opening session. The cases to be examined ranged from Mexico to Chile, at opposite poles both geographically and politically. The aim was to encourage theorizing and speculation, extending beyond economic analysis to an examination of the political elements which are both cause and effect of economic decisions. The focus, Whitehead said, would be on political questions valid in all cases, such as whether economic stabilization could have been achieved at less social and political cost.

As Whitehead pointed out, the issues examined are no longer considered only the problems of backward or mismanaged Latin American societies. The disequilibria currently being experienced by the United States and the rest of the industrialized world highlight the importance of an increased understanding of inflation and the adjustment process.

What follows is a summary record of the discussions held during the workshop. Milton Charlton was responsible for sections I, II, IV, and VI, and Deborah Riner for sections III, V, and VII. It should be noted that the formal papers presented at the workshop are being distributed by the Wilson Center as part of the Latin American Program's Working Papers series, and that the summary which follows may be most usefully read in conjunction with those papers.

I. The International Context

The international framework surrounding programs of economic stabilization was examined by Sidney Dell, who presented a paper entitled, "The International Environment for Adjustment in Developing Countries."

Defining a favorable international environment as one minimizing the disruption caused by the need for adjustment in the overall pattern of economic development, Dell identified two necessary preconditions: a buoyant world economy to absorb developing-country exports, and large flows of long-term capital to developing countries. Neither condition currently prevails. Instead there has been widespread stagnation and inflation as well as a shorage of long-term capital. Adjustment has consequently meant the lowering of imports, a contraction of economic activity, and a decline in real capital formation.

Indeed, Dell continued, there are major inconsistencies between the prevailing approach to balance-of-payments adjustment and the widely acclaimed goal of promoting development. One is the slowdown in capital formation. A second concerns the financial stresses caused by heavy reliance on short-term capital. A third stems from greater international tolerance of so-called "structural surpluses" than of deficits. The insistence on rapid elimination of deficits results in merely shifting the burden among countries rather than in the achievement of equilibrium. Fourth, the burden falls most heavily on the poorest countries having least access to short-term borrowing, with perverse effects on global income distribution. Finally, the international system tolerates increasingly restrictive trade policies among the developed countries, frustrating the efforts of developing countries to adjust by expanding exports. The efficacy of devaluation as an adjustment tool is thereby eroded.

Turning to possible solutions, Dell offered several proposals aimed at facilitating adjustment in developing countries. He mentioned the conclusion of commodity agreements, greater transfers of real resources, and increased access to developed-country markets. Much of his attention, however, was focused on the IMF, which he said should be given greater resources and the means to lengthen the period of adjustment. Over the years the conditions imposed by the IMF have hardened significantly, in part because its resources have shrunk in relation to world trade. IMF conditionality is now so severe that its effectiveness is undercut, since no country will turn to it except as a last resort.

What are the chances of meaningful reform? Dell noted that there are signs of a change in the thinking of the IMF. In a speech at UNCTAD V in Manila, IMF Managing Director Delarosière remarked that the developing countries' social and economic objectives must be taken into account, and that stabilization programs should be flexible enough with regard to the speed of adjustment to allow for needed structural changes. However, Dell said, the reaction of the developed countries indicated that the emerging IMF view is not universal, while the developing countries remain too divided to promote effectively the necessary changes.

Commentary

Four issues raised by Dell's paper and needing further discussion were identified in a commentary by William Branson. First, Branson felt, the paper displayed some ambiguity about the role of private financial markets, implying that due to a regrettable lack of public financing much of the funds must come from private sources. Yet even domestically, Branson pointed out, loan guarantees are provided only for those denied credit from private sources. Likewise internationally, the optimal solution is to let those who can borrow on private markets do so and save official funds for cases of "market failure." Why are official sources presumed preferable, and private sources taken as a last resort?

Second, Branson asked what evidence there was that the changes in the international environment since 1974 have reduced the import capacity of LDCs. Obviously some countries face foreign-exchange constraints, but he contended that this is often due more to their effort to grow too fast relative to their resource endowment than to the international environment. In aggregate terms, he added, the non-oil-exporting LDCs have actually accumulated reserves of foreign exchange. This fact, Branson said, is puzzling within the framework of Dell's analysis.

Third, Branson suggested the need for more discussion of the appropriateness of the monetarist doctrine underlying the IMF approach to stabilization. The theory assumes a flexibility in prices and wages often not obtaining in developing countries. Indeed, it is easy to construct economic models in which squeezing the money supply leads to a fall in exports and in increase in imports. Further analysis is needed of the actual causes of the economic disequilibria found in developing countries. A hasty resort to monetarist prescriptions may only aggravate the imbalance.

Finally, Branson contended that appealing for an improved international environment is not likely to be of much help. The OECD countries have shown their inability to control a situation which has also proved detrimental to their own long-term growth prospects. A better approach, he suggested, would focus on attracting long-term capital through investment incentives. In the developed countries, because of weak investment demand, there is a large surplus of savings. The capital is hence available; the problem lies in inducing it to flow from the developed to the developing countries. This raises the traditional problems of MNCs and foreign investment in general, he conceded, but therein lies the path to a solution.

Branson also raised a policy problem touching on his own recent research. If a developing country wishes to adopt a pegged exchange rate, what currency or basket of currencies should it fix against in an era of floating currencies? The choice, he noted, will have an impact on relative prices domestically.

Discussion

In the discussion which followed the workshop participants focused on four central questions:

Constraints on development. Branson's assertion that rising aggregate reserves showed that the constraints on development are not international in nature proved controversial. Charles Lipson remarked that since 1974 LDC import volumes have remained almost constant, reversing at great pain an earlier pattern of growth. He added that the current accounts of non-oil-exporting developing countries have recently begun to decay anew. Last year the aggregate deficit shot up to $35 billion. This new gap may create serious problems, he said; it is not clear that the banks will be willing and able to fill the need this time.

Since deficits have been growing, Alejandro Foxley argued, the growth in LDC reserves reflects the attempt to maintain economic growth through international borrowing. The rising debt burden threatens future growth, he warned. Branson replied that the level of debt matters little as long as the borrowed resources are productively employed. José Serra added, however, that such investments must be productive not only in the microeconomic sense, but must also generate foreign exchange with which to amortize the loan. Moreover, according to Dell, a country's debt can grow to the point where it impedes further economic growth. He cited Brazil as an example.

The reigning atmosphere of uncertainty, in the view of Adolfo Canitrot, explains the increase in reserves. They are needed as a hedge because of the instability of exchange rates, internal rates of interest, and the inflow of foreign capital. Barbara Stallings saw the growth in reserves as part of a deliberate strategy to attract new bank loans. Dell agreed, saying that the great majority of newly accumulated reserves could be traced to a few big borrowers such as Brazil and the Philippines, and to the special case of India. Apart from these countries, he maintained, reserves have either remained stable or fallen in real terms.

Dell's conclusion that the more advanced developing countries face fewer constraints in the adjustment process was challenged by Foxley. In Latin America, he said, import substitution has led to less flexibility in restraining imports since they have become industrial inputs. Dell replied that he was focusing on the potential for export expansion rather than on import contraction.

Alternative paths to adjustment. There are only two ways to adjust in the face of rising import costs for oil and other essential goods, in the view of Guido di Tella. In the absence of an unlikely increase in international transfers, a cut in internal demand is unavoidable. Branson agreed that an increase in external costs must translate into a drop in real income. The question, he said, is how that loss is to be absorbed.

Dell countered that in global terms a loss of real income is not inevitable except under conditions of full employment. Theoretically the imbalance can be righted through increased exports. However, as shown by the treatment of LDC textiles, the developed countries are unwilling to accept the products of newly industrializing nations. Lipson objected that neither was the problem of protectionism so severe nor the future so bleak as suggested by Dell. The textile industry is the worst case, he said. Many other industries are being quietly forced to accept increasing imports.

In regard to the alternative favored by Branson--i.e., attracting new foreign investments--Canitrot remarked that because of the continuing uncertainty in the world economy, holders of capital in the developed world prefer lending short-term over investing long-term. According to Dell, the proper response by the developed countries to soft demand for domestic investment would be to supplement the inadequate outflow of capital with an increase in foreign aid, thereby creating a new demand for their own exports. Unfortunately, he said, advanced countries find it politically impossible to increase aid during a time of domestic economic woes.

The alternative of enlarging the funds available through the IMF and easing its terms also elicited comment. Stallings asked whether the reforms proposed by Dell would clash with the interest of the banks in maintaining a tight IMF supervision over shaky LDC economies, and whether such a clash might not render the reforms unfeasible. Some bankers might oppose the proposed reforms for ideological reasons, Dell responded, but a more rational, long-term approach to adjustment would also serve the banks' interests. Lipson claimed that many banks would favor increased IMF resources and easier terms. Much more of bank lending would thereby be brought under the protection of IMF-supervised programs, since countries would turn to the IMF for help at an earlier stage.

The logical extreme of easing IMF conditionality, Michael Moffitt noted, would be to unify balance-of-payments assistance and development assistance as envisioned by Keynes in the 1940s. He implied that, if the political will were available, such a move could help to remove the contradiction between the goals of stabilization and development. Dell responded that, although many countries understood the original Articles of Agreement to embody Keynes' idea of automaticity, today not even the developing countries contest the principle of conditionality. The question is rather one of terms and objectives.

<u>Public versus private financing</u>. Branson had suggested in his commentary that reliance by less-poor countries on private financial markets was a near-optimal solution. Foxley objected that this view

takes no account of the effects on the internal distribution of wealth. When domestic savings are scarce, the result is a high internal rate of interest. The largest firms get immediate access to cheaper foreign funds, further increasing their competitive advantage. Very often, foreign funds do not flow in sufficient abundance to establish a single rate of interest.

Dell observed that the ratio between official and private sources for balance-of-payments support is lower now than at any time since the creation of the IMF. Less-poor countries like Brazil go to the private market not because they like it, but because the conditions imposed by the IMF have become intolerable. What is the advantage, he asked, of such a pattern? What is the purpose of an official agency if its ostensible beneficiaries don't want to use it?

Explaining the unfavorable environment. How can the persistence of conditions hindering LDC adjustment and the resumption of growth be explained? Whitehead suggested that there are three types of explanations. A first concentrates on analytical mistakes, for example by the IMF, in failing to identify and implement the best responses to the adjustment problem. A second type argues that an outcome unfavorable to the developing countries is determined by the self-interest of the stronger states which control the system. Here he noted the tendency to speak of a dichotomy between "what the IMF should do" and "what the banks want the IMF to do." A third type might focus on the growing weaknesses in the mechanisms of international decision-making. Better analysis thus might not lead to better outcomes. The discussion seemed to concentrate on the first category of explanation, Whitehead added.

Dell agreed with Branson's comment that the developed countries are not maintaining slack demand "simply to be beastly" to developing countries. He argued, however, that they know what to do to improve the situation, and that they have made a deliberate choice not to. The judgment that controlling inflation is more important than fighting stagnation and unemployment is a political one, he said, one that could be reversed.

II. A Comparative Perspective on Chile (1973-77) and Brazil (1964-68)

The first specific stabilization programs examined were those of Chile (1973-77) and Brazil (1964-68). A paper analyzing the two cases comparatively, "Inflación con recesión: las experiencias de Brasil y Chile," was presented by Alejandro Foxley. Despite obvious differences in the context surrounding these two cases--politically, economically, and internationally--Foxley defended the validity of the comparison by pointing out a basic similarity: in each case a right-wing authoritarian regime had recently replaced a government aiming at a redistribution of wealth and power. Each also adopted an orthodox approach to economic stabilization.

The goals pursued in both cases were similar, Foxley contended, and extended far beyond the stated objective of eliminating inflation and righting the balance of payments. Implicitly, the stabilization strategies aimed to establish a new social order which would exclude certain groups from positions of influence. Economically, the long-term aim was an economy open to trade and relying on the market for the allocation of resources. In the short-term, the government sought to strengthen private capital by shifting resources away from the state and wage-earners. Foxley argued that it was impossible to fully understand the use of orthodox stabilization policies without taking into account these implicit as well as explicit goals.

The result of using the limited tools of orthodox policy--wage restraint and monetary control--to pursue these various objectives was, according to Foxley, stagflation in both cases. The deflationary effects were, however, much more pronounced in Chile. Several factors helped to explain this difference, including Chile's higher initial rate of inflation and the more difficult international situation since 1973. But much of the fault, Foxley argued, lay in the shortcomings of a rigidly applied orthodoxy in Chile. It focuses on too narrow a range of policy instruments, it underplays the role of non-monetary causes of inflation, and it ignores the oligopolist-like behavior of firms under conditions of high inflation and economic uncertainty.

Were any alternative approaches available? Foxley contended that the contrast between the Brazilian and Chilean experiences indicates that the Chilean government's objectives could have been realized at less economic and social cost. He pointed to the heterodox elements in Brazilian policy, including a limited use of price controls and the use of public investment as a counter-cyclical tool. Other options, he argued, are created by the choice of timing, as for example in the dismantling of protective tariffs. Tariff reduction at the wrong moment can reinforce existing deflationary tendencies.

The stabilization policies actually followed did succeed in shifting wealth toward private capitalists, Foxley continued. The concentration of resources was achieved through a variety of mechanisms, including differential treatment of wages and prices, tax changes favoring capital, and subsidies to the financial sector. In the case of Chile, a redistribution of assets was also effected by selling off state-owned enterprises at greatly reduced rates. Not only was a factoral redistribution achieved, however; even within the Chilean private sector, government policies and the deep recession resulted in a marked concentration of industry.

Commentary

In commenting on Foxley's paper, José Serra first offered some reflections on orthodox doctrine and policy. He noted, for example, that monetarist theory assumes that policy-makers are exogenous, when they are clearly endogenous. He also questioned whether policies based on false theoretical assumptions were simply mistakes or whether they were adopted to meet other goals. He hinted that policies actually diminishing control over the money supply through the creation of money substitutes may have been intended to speed the redistribution of wealth. Similarly, orthodox policies most appropriate to demand-pull inflation have been repeatedly applied to inflation due largely to other causes. He hypothesized that monetarists may see a cut in demand as a tool even against cost-push inflation. A recession may be seen as necessary to break a cycle, correcting earlier pressures in the labor market responsible for rising costs and inflationary expectations. But the answer is not clear, he said, noting that the sectors which benefit from orthodox prescriptions are not always those which wield political power.

Turning to the specific cases of Brazil and Chile, Serra pointed out six major differences between them:

a) Politically, the threat to the existing order posed by popular forces was much greater in Chile than in Brazil and the reaction against them was consequently much stronger.

b) The initial distribution of property was vastly different. In Brazil private property remained intact, while in Chile the government had nationalized some two-thirds of the monopolies.

c) The initial rate of inflation was much higher in Chile--20 percent per month versus 80 percent per year in Brazil. Chile hence suffered a much greater distortion in relative prices.

d) Chile's trend growth rate was much lower than Brazil's, facilitating the institution of radical changes under Allende and inhibiting fundamental changes in Brazil.

e) The role of imports differed importantly between the two economies. For example, Brazil produced 98 percent of the value added in its automobile industry, while the Chilean auto industry was generally limited to assembly.

f) The aggregate social cost of applying orthodox policies was much greater in Chile, where per capita income growth was lost for 8 years and distributional effects were more severe.

Despite this catalogue of elements distinguishing the cases, Serra argued that the similarities in policy aims and results validated the comparison for the purpose of evaluating the monetarist approach to stabilization. He did, however, take issue with several points in Foxley's presentation. He objected to the implicit conclusion that Brazilian policy was in the hands of relatively "nice guys" compared to Chile, recalling again that the political context was different. He asserted that Foxley overestimated the effectiveness of the 1965 price controls in Brazil, calling them a failure and arguing that the price decreases were actually due to agricultural overproduction and falling wages. He disputed the choice of base year for the calculations showing an increase in Brazilian investment during the period of stabilization, noting that in 1965 investment was at its lowest point ever. He also objected to the base year chosen for measuring changes in the rate of unemployment.

With regard to imports, Serra stated that Brazilian policy was not, in fact, very orthodox. Tariffs were lowered only slowly. In contrast, the Chilean government attempted to use imports to keep prices down and lowered tariffs rapidly.

In Brazil's growth strategy during this period, Serra continued, export growth was not a significant component at all, accounting for only 3-4 percent of the total expansion. Moreover, the strategy pursued was not one of "balanced growth" because there was a bias against the capital-goods sector. The resulting imbalance, he said, was reponsible for the economic crisis of 1973-74.

Discussion

The discussion which followed concentrated mainly on explaining the differences in the results achieved by the Brazilian and the Chilean stabilization policies. Laurence Whitehead pointed out that two lines of explanation for Chile's poorer economic performance could be inferred from Foxley's paper: one, that Chilean policy makers were more dogmatic or less competent; or two, that the aim of social change took precedence over economic growth and that the harsh conditions suffered by the working classes were part of a deliberate strategy of intimidation.

Roberto Frenkel argued that the explanation was both social and economic. The social conditions faced by the new Chilean regime were more chaotic and the goal of social reconstruction seemed more urgent. Moreover, the higher rate of inflation inevitably meant that the adjustment process would be more costly. The plausibility of a purely economic explanation was argued by William Branson. Where high inflation had given rise to strong inflationary expectations, he suggested, policy makers could rationalize the resort to shock treatment without reference to any hidden social or political agenda.

The new Chilean regime, Foxley responded, put both the military and the technocrats into power, the former dominated by the desire to suppress the popular forces and the latter committed to monetarist economics. Chilean policies were hence fashioned by a mixture of theoretical and political considerations. He cited the example of high interest rates. The failure to achieve a low equilibrium rate created both the conviction that even more extreme policies were required and a constituency of private financial interests favoring the maintenance of high rates and capable of applying persuasive pressure. However, he expressed doubt that economic stagnation was deliberately chosen as part of a broad political strategy.

Some lessons from comparison of the two cases were suggested by Guido di Tella. First, Chile's ultimate success in bringing inflation down shows that the monetarist prescription will eventually achieve its objective, even though at heavy social cost. Second, Brazil's experience with heterodox policies that are less successful in controlling inflation but rate higher on other variables indicates that a tight control over inflation is not necessary for the achievement of other goals. Planners should be more aware of the trade-off, he said.

The input of the IMF was questioned by Barbara Stallings. She stated that although the publications emanating from that organization's research department are monetarist in orientation, many of the area specialists actually planning stabilization programs are Keynesians. Moreover, they are not as concerned about inflation as is often assumed; they can even find it beneficial. Their major concern is with removing controls of all kinds, reflecting their belief that liberal capitalism is the only road to development. It is, she said, a classical model which inspires them, but not necessarily a monetarist one.

The remainder of the discussion consisted largely of specific questions about Foxley's description of the Chilean case, including the mechanism whereby the expectation of inflation causes competitors to act like oligopolists and the reasons why the high real rate of interest failed to come down.

III. Contemporary Brazil and Uruguay

Brazil. Addressing the case of contemporary Brazil, José Serra noted that that country's current inflation rate--averaging 38 percent annually between 1974 and 1978 and now hitting 50 percent--is remarkable for several reasons. It is the highest in Latin America, with the exception of Argentina and Peru. It is the highest experienced in Brazil since 1960-1964, and the rate is increasing. It is also occurring under an authoritarian regime, perceived in the 1960s as the only political system capable of solving the problems of the economy. The inflation rate is higher than the 20 percent annual rate recorded during the populist Kubitschek government, although--as Guido di Tella pointed out--when comparing inflation rates it is crucial to judge the rate of a given year in relation to the rate of inflation in the preceding years. Whether an economy is moving to a 20 percent rate from a rate of 10 percent or from 80 percent, for example, is quite important.

Moreover, Brazil's inflation is happening at a time when all the conditions said to be necessary to eliminate it obtain. Wage pressure has been contained. Real wages have fallen at a rate similar to that in Chile. The public-sector deficit has been transformed into a surplus that is used to subsidize the private sector. The coexistence of a 50 percent inflation rate with a budgetary surplus is a telling point against the monetarists for whom a public-sector deficit is a prime culprit in inflation. Neither are external bottlenecks due to foreign-exchange constraints or opposition to centralized power present to fuel inflation.

Serra discussed alternative explanations of the contemporary inflation. External price changes have played a role in inflation. The prices of oil and imports have increased, but then so have export prices: Brazil's terms of trade in 1975-1976 were the same as in 1971-1972, and were improving. Increased export prices have been translated into a rise in the domestic price level, but changes in the external environment are not primarily to blame, Serra concluded. Demand pressure does not explain the 50 percent rate either. Some demand pressure exists, but it is not general and there are idle resources.

A more important factor is land speculation, making use of a large part of the available agricultural credit, and a shift from internal consumption of food to external sales. These factors have resulted in a 4 percent per capita decline in the food supply from the mid-1960s to 1975. Production grew at historical rates, but 40 percent of the cultivatable land in Sao Paulo goes unoccupied and, as in Argentina, wage goods are now being exported. To combat inflation, an agricultural boom needs to be combined with a recession.

Another cause of the present crisis is the deceleration of growth resulting from decisions taken during the milagro. To keep the durable-goods sector growing at 25 percent annually, the demand for intermediate and capital goods was satisfied with imports. Regressions show that rapid growth is associated with low price-level increases and more rapid price increases with slow-growth periods. When the growth rate decelerated in 1973-1974, the basic imbalances in the economy inhering in the development strategy were manifested. The oil-price hike was simply the coup-de-grace. Simōn Teitel argued that reliance on imports is not necessarily disastrous: to cut imports in the long run, it is necessary to import in the short-run to build a capital-goods industry.

The most important source of inflation, Serra stated, is the financial system. The financial system's share of national income is growing rapidly--from 3.3 percent in 1959 to 7 percent in 1977. In Brazil, the financial system is a speculative one. As a result, the commercial interest rate is very high--about 25 percent a year in real terms--which makes speculation more profitable than real investment in the productive system. To counteract the appropriation of an increasing share of the economic surplus by the financial system when the rate of growth of the surplus is slowing, the government has provided subsidies so that funds are available to targeted sectors (such as agricultural and industrial exports) at negative real interest rates. However, these funds have been used to speculate with government bonds in the financial market, aggravating the high real interest rate problem.

In economic theory and in the developed countries, open-market operations are an instrument of monetary control. In Brazil, they are an instrument of speculation. Far from controlling the money supply, open-market operations have created a second system of money: there is more money in government bonds than in bank deposits, and when bonds are purchased for as little as three hours, the turnover can be imagined. Open-market operations have produced fissures within the government; the Minister of Finance opposes them while the director of the Central Bank argues that they keep bank profitability high despite the squeeze on money. That official's explanation of how the purchase and sale of government bonds did not foment speculation was so succinct that anyone who had not previously understood how the system worked did afterwards, and speculation flourished.

Confusion over the role of open-market operations arose among workshop participants. Serra stated that the government used open-market operations to sterilize foreign-capital inflows because the inflows are not entirely offset by increased imports. The increase in the money supply and resulting rise in the interest rate due to its inability to sterilize the inflows are an explanation of inflation favored by the government. However, Barbara Stallings had been told in interviews with U.S. private bank officials that the government did not use open-market operations to sterilize foreign-capital inflows, and that, instead, a system of multiple interest rates was employed, with the free-market interest rate rising to sterilize the capital inflow.

In the 1960s it was widely believed that "too much democracy" was at the root of the inflation plaguing Brazil. Authoritarian government is not the cause of inflation, Serra continued, but neither is it a guarantee against it. Expectations are crucial in combating inflation, and today the government's economic policies lack credibility. Thus, many people have concluded that only a democratic government can successfully manage the economy. Only democracy will endow anti-inflation measures with the legitimacy they need if they are to be effective.

Since 1978, the political opening has accelerated. Along with it, strikes have appeared. Although they are illegal, more strikes occurred in 1978 than any year since the early 1960s. Wage pressure is being felt again, causing a jump in inflation and a loss of credibility by the government. Workers are asking for larger increases now to compensate for future losses.

Laurence Whitehead ventured a hypothesis that the prospects for the coexistence of a stable economic environment and democracy after an authoritarian regime are bleak because the build-up of economic pressures released in the transition to a more open political system will result in an inflationary explosion, an acute macro-economic disequilibrium rectifiable only by the imposition of orthodox stabilization policies. In both Brazil and Uruguay, he argued, authoritarian governments were more concerned with adjusting relative prices than price stability. After long periods of authoritarian rule, there is still inflation but in an altered context: now there are excluded groups who have suffered grave real losses and who would want their relative income shares restored if authoritarian rule were relaxed. Neither the unfavorable international economic environment nor the political legacy of exclusion are conducive to a return to democracy and a stable economy.

Paul Drake suggested that the identification of a type of political regime with inflation depends on historical context. In the 1920s, the blame for inflation was laid on landowners and speculators. Consequently, stabilization policies gave an impetus to political reform efforts. The argument associating bureaucratic-authoritarian regimes with stabilization policies comes from a different historical period, one in which the onus for inflation was successfully put on workers. Serra agreed that the stabilization policies chosen depend on which group is blamed for inflation. In 1965, for example, the enemy in Brazil was clearly identified. Now that there are no unions or Communists to accuse, and inflation persists, there is talk of democratization.

Uruguay. Uruguay's recent experience with stabilization policies was discussed by Jorge Notaro. In 1974 the military government of Uruguay adopted a new economic strategy, one distinguished by its emphasis on controlling the money supply. Both internal and external conditions dictated this choice. Perceptions of "the enemy" and of the groups whose support was desirable and reliable led the regime to adopt policies that would gain the adherence of important sectors of local business and foreign capital. The demonstration effect of the Brazilian miracle and balance-of-payments deficits reinforced the appeal of a monetarist approach to stagflation.

Unlike Brazil, Chile, and Argentina, the Uruguayan government succeeded in controlling the money supply. Taking the liquidity coefficient as the measure of money supply, in the last two years the money supply was 20 percent below its 1974 level and 37 percent less than its 1968-1972 average. From 1973 to 1978, the money supply grew less rapidly than the cost of living. The government deficit was cut each year--in the last two years it has been 30 percent of its 1974-1975 magnitude. At the same time, public expenditures increased. To control the expansionary effect of foreign-capital inflows and external economic developments on the domestic money supply, manipulation of interest rates, open-market operations, and reserve requirements were employed. Since October 1978, use of the latter two instruments has ceased. The exchange rate has been fixed--first for three months and then for nine--at levels anticipated to equalize internal and external interest rates. This discouraged further capital inflows with their expansionary effect on the domestic money supply when the government no longer wished to build up its reserves.

The government sought to open the Uruguayan economy to market forces and the world, as well as to control the money supply. Prices were to be freed. The process, however, was gradual. In 1974, 90-95 percent of the items in the market basket were controlled; by June 1977 the proportion was 50 percent, and by December 1978 it had declined to 38 percent. Real salaries fell by 28 percent, but over a five-year period. The interest rate--the most sensitive price, as Serra had mentioned--was the object of special concern. A positive real interest rate to stimulate investment and end the "confiscatory taxation" of savings was a goal achieved. Since the end of 1977, a positive real interest rate has been paid on loans, and in the beginning of 1978--after five years of negative real rates--on deposits. As in Brazil and Argentina, stabilization policies have augmented the spread between actual and paid interest rates--in Uruguay, it has been 25 percent annually. From 1974 to 1978, credit to the private sector has expanded 64 percent in real terms and continues to grow. About one-quarter of the expansion in credit has gone to the agropecuarian sector.

As part of the opening, the exchange rate was freed and tariffs reduced. Restrictions on the purchase of foreign exchange were abolished, and after a year the Central Bank set the price of foreign exchange, eliminating the dual exchange market system. Devaluations in real terms ceased after 1976 as the increase in the internal price level was greater than subsequent devaluations. Through manipulation of the price of foreign exchange, the government skimmed the benefits of improvements in Uruguay's terms of trade for domestic use. Tariff reduction has been modest, and the expansion of manufactured products for export--such as leather--has been encouraged through subsidies averaging 20-25 percent and reaching a maximum of 45 percent. Like the decontrol of internal prices, the liberalization of external prices--the exchange rate and import prices--was more gradual than in Chile and more orthodox than in Brazil.

The announced goals of the regime were internal and external price stability with growth. The 1956-1973 growth rate that hovered around 1 percent per year was supplanted by a yearly average of 2.7 percent after the institution of the new economic policies. However, the average for other Latin American countries was 4.5 percent. Efforts at price stability were not so successful in relation to the experience of other Latin American countries during the same period (the cost of living increased 62.4 percent annually in Uruguay in 1974-1978, while the average for other countries was 49 percent) or compared with Uruguay's experience from 1968 to 1972 (a 52.6 percent average rate). The last three years did see a lower rate of increase than the 1974-1978 average, and in 1978 the cost of living rose 44.5 percent. Still, given the fall in per-capita consumption, the fall in real wages, growth of the secondary work force, and the rise in open unemployment (from 8 percent in 1968-1972, to 13 percent in 1975-1977, to 20 percent today), the price-stability record is not impressive. Neither are the results on the external side especially encouraging. While reserves have grown, so has Uruguay's external indebtedness, and it continues to show a current account deficit.

The military regime's failure to achieve price stability cannot be attributed to external shocks. The oil-price hike and decline in the terms of trade aggravated an already serious situation, but easy access to external financing mitigated the balance-of-payments difficulties while the slowness of exchange-rate adjustments and the fall in real salaries offset their inflationary impact.

Price stability was an important but secondary goal of the government. Its true priority was the transformation of relative prices and the reassignment of resources to promote a new form of insertion into the international economy. The March IMF Bulletin stated that because inflation in Uruguay was a more difficult problem than it had appeared, the liberalization of external relations would be a weightier determinant of Uruguay's access to the Fund than the attainment of price goals. The mode and implementation of pricing, exchange rate, tariff, and credit policies testify to the priority of real factors over monetary variables. Inflation is the forum of the conflict over relative prices. The hostility between workers and the military that was sharpened by the coup and intensified by relative price adjustments precludes a social-contract solution to the problems of the Uruguayan economy.

Uruguay's experience with stabilization policies offers three lessons to monetarists, Notaro concluded. One is that inflation can increase even when the money supply is controlled. The second is that price instability does not necessarily prevent growth of GNP, savings, or investment. The third is that a fall in the purchasing power of foreign exchange does not prevent an important net capital inflow.

IV. Mexico

Laurence Whitehead's paper "Mexico from Bust to Boom: A Political Evaluation of the 1976-79 Stabilization Program" was the background for a discussion of Mexico's recent experience with stabilization.

In presenting his findings, Whitehead briefly traced the factors leading to the Mexican crisis of 1976. In the face of several adverse long-term trends, the Echeverría administration had attempted to maintain a high rate of growth through increased public spending, much of it financed through foreign borrowing. In 1976 this strategy finally collapsed, resulting in two massive devaluations of the peso. Although stressing the impact of the 1971 and 1975 recessions in the United States, Whitehead nevertheless concluded that less than half of the disequilibrium in the Mexican economy in 1976 could be attributed to shocks from abroad.

Whitehead characterized the performance of the Mexican system in responding to the crisis as "pretty good," from both an economic and a political perspective. The exchange rate has been stabilized, the balance-of-payments deficit has been reduced, and the growth rate has risen--all without resort to the political repression characteristic of stabilization programs elsewhere in Latin America.

The key to this relative success, in Whitehead's analysis, has been the renewed confidence of domestic and foreign investors. Three factors, in turn, were mentioned as reponsible for this development: the IMF standby agreement, growing oil resources, and the techniques of political management typical of the Mexican political system. The most important of these three, in Whitehead's view, is the last. He specifically cited the importance of collaboration between the outgoing and the incoming administrations, the relative unity of the political elite, and the willingness of organized labor to accept short-term losses in order to preserve its role in the political system.

Commentary

Porfirio Muñoz Ledo offered a commentary on Whitehead's paper, raising four main points. First, he sought to place the crisis of 1976 in context. It was, he said, merely a financial crisis, a manifestation of an underlying economic crisis that has been brewing for more than a decade. As an illustration of the underlying problem, he pointed to the level of employment, which has been growing at a decelerating rate with each successive decade despite a 7 percent average annual growth in GNP. Since the late 1960s, the growing imbalances in every sector of the Mexican economy have thrown into question both the viability of the Mexican model of development and the continued legitimacy of the political system. Despite the recent return to a high rate of economic growth, this underlying crisis remains unresolved.

Second, Muñoz stressed the structural element in the economic dislocations of 1976. Inadequate internal demand, he said, necessitates reform of the entire structure of Mexican industry, a structure built up during the period of growth through import-substitution. Further, the neglect long suffered by the agricultural sector has created a crisis of food supply. He contended that without structural reform--broadening of the industrial base and solving the problem of the countryside--there can never be a lasting solution to the problem of inflation.

Third, Muñoz pointed to the political as well as the directly economic impact of developments abroad, using as an illustration the less receptive attitude of Mexico's private sector toward reformist policies after the fall of Allende in Chile.

Finally, he indicated greater pessimism than that implicit in Whitehead's paper about the capacity of the Mexican political system to manage the economic situation. The crises of 1968 and 1976 both resulted from the government's failure to maintain a productive dialogue with important interest groups. The question now is whether the present stabilization policies will augment the government's capacity for fruitful dialogue, permitting it to tackle the fundamental structural problems plaguing the economy. Continuing inflation, he hinted, may deprive the government of the alliances that so far have kept the system open and reasonably democratic.

Discussion

The ensuing discussion centered around two main themes: the definition of stabilization and of success in achieving it; and the primary factors to which Mexico's relative success should be attributed.

Questions of definition. Several speakers noted the growing difficulty of measuring the success of stabilization. Under the rules of the Bretton Woods system in the 1950s and 1960s, as Pedro Malan pointed out, the standard was clear: price stability and balance-of-payments equilibrium. What does stabilization now mean, he asked, in a world of the "dirty float" and global price instability? Economic definitions often seem to imply keeping inflation under control at a social cost which may be politically intolerable. Paul Drake offered as an alternative a political definition of a successful program: one that reduces economic disequilibria without resort to political repression.

Thomas Skidmore pointed out that, from an international perspective, stabilization really refers to achieving equilibrium in the balance of payments, not to controlling inflation. Only payments problems force governments to turn to the IMF. In post-1967 Brazil, the policies dubbed "successful" actually institutionalized inflation while nevertheless maintaining large reserves of foreign exchange. However, Charles Lipson noted that Iran illustrates the political hazards of inflation even in the absence of balance-of-payments difficulties--an inflation which may indeed be propelled by an influx of foreign exchange. Mexico, with its oil bonanza, may soon face such a situation.

The definition of success implicit in the Whitehead paper, according to Olga Pellicer de Brody, concerns the restoration of investor confidence rather than the control of inflation or the reduction of the external deficit. The linkage between confidence and external balance, however, was stressed by Alexander Nowicki, who emphasized the porousness of the U.S.-Mexico border and the sensitivity of Mexican and U.S. capital to changes in the relative rates of return of the two countries. Renewed investor confidence hence has played an important role in stabilizing Mexico's exchange rate despite a continuing price inflation far exceeding that of the United States.

Whitehead indicated that the standard of success he was using was a comparative one. He contrasted the Mexican experience with other, obviously less successful cases (in both political and economic terms) as well as with what in 1976 could reasonably have been feared would occur in Mexico itself.

Questions of cause. Opinions differed as well concerning the factors primarily responsible for Mexico's relative success with stabilization. In contrast with Whitehead's emphasis on the inherent strengths of the Mexican political system, Pellicer de Brody argued that a major part of Mexico's success in restoring confidence without repression is due to the *reforma política*. In her view, however, the most important factor was the increase in Mexico's estimated crude oil reserves and its growing oil exports. Had the oil factor been removed, she contended, investor confidence might not have returned, economic growth would not have regained its momentum, and foreign bankers would have been much more reticent about extending loans.

Muñoz added that oil could also be held largely responsible for Mexico's improved external accounts. He observed that the increase in oil exports since 1975 is greater than the reduction in the balance-of-payments deficit over the same period. In contrast, he argued, the so-called stabilization program contributed only marginally to Mexico's improved economic performance, by convincing investors that reformist policies would not be renewed. It has not, he stressed, had a major impact either on inflation, which remains high, or on the public-sector deficit, which normally contracts at the beginning of a new governmental cycle.

Whitehead acknowledged the important role of oil, but argued the difficulty of assigning priority between economic and political factors. Since Mexico's resource endowment was already becoming recognized by 1974, he asserted, the new administration's different approach to the political manipulation of oil has had a greater impact than has the continuing expansion in estimated reserves. In analyzing the part played by oil, therefore, the counter-hypothesis should not be "What if there had been no oil?" but rather "What if oil had not been found in such spectacular amounts?" Indeed, he suggested that the rapid expansion of estimated oil reserves has been of doubtful net benefit for economic and political stability.

William Branson pointed out that a simple Keynesian economic model might seem adequate to explain the evolution of Mexico's economic aggregates since 1975, without resort either to political variables or to an emphasis on oil. It could appear that economic policies, including demand management and exchange-rate adjustment, simply succeeded in producing some of the desired results. Whitehead countered that the situation described by the aggregate figures looks very different in hindsight. In 1976 policy makers saw good reason to fear that a loss of control over the exchange rate would lead to massive new wage demands, a South-American-style wage-price spiral, and continuing capital flight, eventuating in a deep recession, growing social struggle, and perhaps a repressive authoritarian response. Against this background, economic factors alone cannot suffice to explain the "better-than-feared" outcome. Explanation must also turn on the strengths of the Mexican political system. Nevertheless, several speakers indicated that a major test of the strength of that system remains ahead in the struggle over the distribution of the new oil wealth.

Other points raised in the discussion included a suggestion by Rosario Green that Whitehead make more explicit his analysis of the Mexican political system and of the social relationships which sustain it; and a call by Rosemary Thorp for care in distinguishing between "confidence" and "expectations," since investor confidence may be unrelated to inflationary expectations.

V. Argentina

Guido di Tella began a panel discussion of the Argentine case with an analysis of the 1973-1976 stabilization program. What distinguished the program from earlier ones, he suggested, was not its economic components, but the exceptional degree of political-economic intermixing and the "oddity" of political developments. The populist alliance which controlled the government first pursued a leftist course. A more normal populist program and problem--trying to do too many things for too many sectors--not surprisingly supplanted the twist to the left after 60 days. July 1974 saw a policy twist to the right, as had happened in the Frondizi period, leading to a collision between the president and the erstwhile labor base of her government. The consequent price outburst and the *rodrigazo* returned the moderates to the government for a brief while. The military, skeptical of Isabelita and the once again dominant right, took power in March 1976.

Launched as a structural reform program, the stabilization effort of the *peronistas* was based on a social pact. By early 1975, a crisis in the external sector loomed on the horizon. Rather than renegotiate the social pact, the government implemented anti-labor policies. Political measures included the destruction of union autonomy and of the left in universities, as well as the use of para-military groups to control subversion, and unsuccessful wooing of the military. On the economic front, there was the rodrigazo.

Striking economic features of the period were: (1) the recurrent stop-go sequence of stabilization programs; (2) the question of antagonism between investment and distribution (while investment fell slightly under the populist regime, its composition altered significantly, with government investment reaching 11 percent and private investment falling from 13-14 percent to 8 percent; (3) the success of industrial exports with an overvalued exchange rate; and (4) the high correlation of price oscillation and inflation with the intensity of oligopolistic fights between sectors. Di Tella concluded that the reformist strategy failed for structural reasons. The likelihood of re-creating the populist alliance, in his assessment, is poor.

That economic policies since 1976 have failed to propel the economy towards growth or stability did not surprise Adolfo Canitrot since, in his view, these are secondary objectives of the present government. Its fundamental goal is political: to avoid the rebirth of the populist alliance by removing its economic base through structural transformations. According to the liberal diagnosis of Argentina's economic maladies, the inevitable consequence of the internal market-oriented industrialization strategy pursued by all governments for the 30 years prior to 1976 was a crisis every three or four years. Because it was premised on relative pricing policies that used the agricultural surplus to finance the expansion of urban demand, wage increases were the model's "motor of growth." Growth, however, was accompanied by excess demand, inflation, and external disequilibrium, requiring stabilization programs and provoking recession. The policies pursued under Martínez de Hoz were explicitly designed to avoid this sequence. Opening the economy was to eliminate the negative impact of unions on costs, permitting businesses to price competitively. The state should no longer have to avert stagnation by deficit financing and granting special privileges to capital to encourage inflows.

Within the governing alliance's consensus on the bankruptcy of the old model and the need for and contours of the new, there are differences dividing the military and the liberal fraction of the bourgeoisie. Argentina's role in Latin American geopolitics is one such issue. More important issues are the size of the state and unemployment. No growth translates into high unemployment, and that seems to be undesired by the military; the number of state employees has risen but the increase has occurred primarily in the states and regions, under governments run by the military.

Roberto Frenkel analyzed the instruments employed to transform the economy. Since the rodrigazo inaugurated hyper-inflation, and the development of a speculative, short-term financial market introduced new, distinct, and much more complex adjustment mechanisms, the economy has entered a qualitatively different phase. Five years of stagnation and high inflation have seen four major policy changes, but in no case was the goal of liberating the automatic regulating mechanisms of the economy abandoned. The first phase of economic policy he labelled "orthodox traditional." Inflation was attributed to excess demand. The remedy--manipulation of relative prices and deflation as preached by the IMF--was clear. By the beginning of 1977, it was equally clear to the government that the skyrocketing price level did not signal the move to a new equilibrium.

Retaining the excess-demand analysis of inflation, the government initiated the "orthodox monetarist" phase of its economic management. The reforma financiera of May 1977 was a crucial element of the new approach--as well as providing the Central Bank with sorely needed additional instruments to control the money supply, it advanced the long-term goal of freeing markets. The reform integrated banks into the short-term capital market, freed the interest rate, and forced decentralized public enterprises into the new capital market for financing. It also precipitated a "boom" in the interest rate, inflation, and speculation. Investment fell and the economy entered a deep recession.

By May 1978 the coexistence of hyper-stagflation and large reserves prompted the inauguration of the third phase of anti-inflationary policies, "desindexación." The excess-demand interpretation of inflation that undergirded the first two phases of policy was replaced by an analysis emphasizing the roles of costs and expectations. Founded on the belief that a deceleration of the rate of increase of food prices and production costs would eventually be reproduced in the rate of private price increases, desindexación was supplemented in December 1978 by a fourth policy phase, "futuro pautado." Periodic adjustments of the exchange rate, public prices, and salaries are announced in advance. The new policies have not achieved price stability, and the social tensions created by the redistribution arising from relative price changes grow.

The stabilization programs implemented in Argentina and Chile differ from the experiences of other Latin American countries in two fundamental respects, Frenkel stated. The first is the extent to which long-term political goals dominate the short-term interests of fractions of the bourgeoisie in economic policy-making. The second is the rapidity and violence of the redistribution caused by the realignment of relative prices. The violence of the adjustment process he attributed to the initial conditions of the economies. In both countries, unsuccessful "shock" policies accelerated the wage-price spiral six to twelve months before the imposition of military rule and stabilization programs.

Two facts about price behavior require explanation, Frenkel said. How was it that during the initial policy phase unprecedented price mark-ups of 50 percent were sustained while real wages fell, both costs and profits soared, and the economy was in recession? Why, in mid-1976, did inflation stabilize with price mark-ups 50 percent higher than the norm of the pre-Peronist period? In answer to these questions, Frenkel advanced a model of businesses' pricing behavior in conditions of high uncertainty and hyper-inflation. It is an ex-post explanation of behavior, lacking scientific proofs in the sense that it is not based on regressions or random samples, he acknowledged. Rosemary Thorp felt that even though there are limits to testing the model empirically, it is probably very central to understanding economic developments.

In the model, the business's pricing decision exposes it to two types of loss. The first is the risk of losing income due to excess stocks and overproduction. The second risk arises from underestimating future costs. The model optimizes the business's position by minimizing loss from both kinds of risk. A policy of risk-minimization leads businesses to set prices a little above the expected inflation rate for the period. In an economy such as Argentina's, where the expectations of businesses revolve around variables managed by the public sector (the exchange and interest rates, public-sector prices, salaries), this pricing behavior ensures that any attempt to modify relative prices will be answered with inflationary price increases by businesses. Gross industrial profits from 1976 on could be 20 percent higher than the pre-Peronist norm because in this economy the freezing of nominal wages guarantees climbing profits when demand falls. This is a recession induced by the mark-up push of pricing behavior. It is not mark-up push in quite di Tella's sense--this behavior is manifested in very competitive markets as well as oligopolistic ones. It is a problem of uncertainty and information.

In reply to Alejandro Foxley, Frenkel observed that the mark-up model can explain the continuation of the inflationary process. Because price-setting on the basis of expectations about the most visible parameters of the economy proved successful in the past, businessmen continue responding to changes in the exchange rate and public prices by raising their prices. The audience asked how the model was affected by inter- and intra-sectoral differences in profits; mark-up pricing was not uniformly successful. Frenkel responded that the sectors most dependent on the demand of salaried workers experienced the greatest fall in sales, and mark-ups were probably not as successful as in industries such as automobiles where the loss of sales was not so large. Nonetheless, there was not the succession of bankruptcies or crises that one would expect from a strong contraction of demand. Businesses survive a 50 percent contraction of demand if their salary costs fall by 40 percent, though at a lower profit rate.

Thorp asked if there are not limits to this pricing behavior set by demand elasticities or tariff reductions. She also wondered why Chilean efforts, unlike those of Argentina, have not been undermined by expectations. She suggested as possible reasons: (1) this is Chile's first effort and, if unsuccessful this time, will not work a second time; (2) there is a clearly defined enemy in Chile; (3) tariffs.

Discussion

Themes running through the discussion were: the elements of a successful stabilization program; the viability of alternative development models; the social basis of the state; and the causes of the economic impasse.

Elements of success. Thorp began by emphasizing Canitrot's point that regardless of its connotations, contemporary usage of "stabilization" in Argentina does not mean a return to normality despite the resemblance of the present impasse to that of the 1950s. Then, as now, relative prices and expectations were crucial in prompting greater agricultural production, she said. Citing di Tella, Foxley argued that a successful stabilization program meets a political-structural criterion--who has access to and control over resources. Frenkel noted that the current government, unlike Argentina's previous authoritarian regime, employed such a criterion. Elaborating on this, he said that the achievements of 1966-1969--decreasing the inflation rate and maintaining industrial profits with a relatively insignificant effect on real salaries--are subordinate to the long-term goal of transformation of the economy. Canitrot stressed that it is a general political climate which the government seeks to create. Whitehead observed that the goal of stabilization programs in both Argentina and Chile was claimed to be the prevention of a resurgent populist alliance, and that Canitrot had presented Argentina as a case in which economic policies were deduced from long-term political goals while Foxley had argued that the internal logic of the economists' model determined Chilean policy. Are these two different cases?

Teitel strongly disagreed that the primary goal of the regime's economic program is to avoid repetition of the populist experiment. If this were the objective, he argued, keeping salaries at very low real levels is counterproductive. Similarly, we would not see efforts to achieve full employment, since it is more difficult for unions' pretensions to be maintained when open unemployment is 20 percent than when it is 2 percent. The same problem was raised by Foxley's remark that the best manner of preventing an alliance of workers and the local industrial bourgeoisie was unemployment. Canitrot replied that unemployment is only one of many policies, all with internal contradictions, that are useful from the government's perspective. The near-absence of unemployment prompted questions by Whitehead and Foxley. The former asked why high unemployment accompanied the fall in real wages in Chile but not in Argentina. The latter wondered how such high employment could be achieved and how it affected the money supply.

Participants agreed that there had not been a "true test" of monetarist policies, although their reasons differed. Di Tella believed that the social dynamics of Argentina cause the military to change its policies when unemployment appears. Thus, the failure to stabilize in even the restricted sense of decreasing inflation was not a failure of monetarist policy. Foxley argued that because there had been an aggregate supply shift rather than a fall in aggregate demand, monetarist policies were not tested. Frenkel conceded to the monetarists that their prescriptions could control inflation: by having an inflation rate more or less equal to the inflation rate of its imports, a country such as Panama purchases "control" of inflation at the cost of totally modifying its social and economic structures. This alternative was selected by Chile and, to a lesser extent, by Brazil and Uruguay.

It was clear to Frenkel that in Argentina the objective of controlling the money supply is in frank contradiction with that of opening the financial market. When public enterprises were forced into private capital markets, and banks became efficient financial intermediaries, international capital flows responded very quickly to any changes in the interest rate. In this context, the Central Bank can only control the money supply indirectly through its exchange- and interest-rate policies.

Alternative development models. The question of opening the economies aroused controversy. Although the benefits of an export-led growth strategy are not so great as before, di Tella still advocated opening the economy because of the diminishing returns to import-substituting industrialization (ISI). Canitrot agreed that reducing the level of protection to attain competitive national industries is valid, but only in micro terms; and that what is surprising about the effective protection rate of industries, excluding steel and paper, is their low level. He vehemently rejected the proposition that ISI can no longer be the economy's motor for growth. In support of his assertion, he cited a Development article of several months ago showing a considerable number of important investments in petrochemicals, fish, steel, communications, transportation, soy, and paper. Additionally, balance-of-payments constraints have been resolved--a smaller proportion of workers' consumption is spent on agropecuarian products, and industrial exports have risen. Since ISI still has fuel to propel the economy, the reason for abandoning the model must be to repress salaries.

Teitel protested the asymmetrical treatment of the factors of production in Canitrot's analysis, and suggested that opening the economy will equalize the internal and international returns to all factors, not just labor. Canitrot replied that in Argentina there are "special devices" to ensure that the internal rate of profit will be higher than equilibrium. "Protectionism, the theory of inefficient local capitalism," di Tella interjected. "That's something else," Teitel responded. Canitrot refused to accept an explanation founded on the ineptness of local producers. That the policy of opening is the restrictive one of lowering tariff barriers rather than an expansive one of export promotion leads him to conclude that the fundamental priority of the new model is political control; concern with growth and inflation is contingent upon the attainment of control.

Thorp asked what the logic of the government's model dictates as the new motor of growth. She observed that the government can borrow easily in the very liquid financial markets, but it hesitates to use its resources to expand demand and spur growth because of the high inflation rate and its ideological commitment to a smaller role for the state. Thus, the government accumulates rather than invests resources. In the new model, the economic surplus is to be transferred privately through the financial market. Yet, the private sector is not investing either--perhaps, she suggested, due to its lack of understanding of the new model.

Thorp assumed that the government must see traditional and non-traditional exports replacing an expanding internal market and rising wages as the impetus behind growth. Canitrot and di Tella, however, agreed that the government is not doing all that it could to encourage exports. Di Tella allowed that his assessment of the policy of promoting industrial exports with an overvalued exchange rate as "idiotic" is contentious. Branson observed that what is now the conventional wisdom of economics, the overshooting hypothesis, can explain the overvaluation of the exchange rate in terms of a long-run purchasing power-parity calculation. The shift to a substantially tighter monetary policy raises the domestic interest rate resulting in an inflow of capital and an overvalued exchange rate.

What are the prospects for the new model? Development models do break down but they can also last 40 years, Drake observed. He listed four causes of their duration. First, because their goals are political, models' successes do not depend solely on economic achievements. Second, the larger the country, the greater the number of people comprising the tiny minority benefiting from the model. Third, the external environment facilitates or impedes the application of models. Fourth, the longevity of the government implanting the model matters. In the narrower context of stabilization policies, Branson and Whitehead emphasized the role of expectations in determining success and failure--a history of sharp institutional and policy reversals leads to perceptions that neither the stabilization program nor the regime will last.

<u>The role of the state</u>. Foxley said that his paper had shown a high correspondence between "good economic theory" and the beneficiaries of a development strategy. A technical project is thus a <u>class</u> project. For the military, the problem is simple and the diagnosis, shared by the technocrats, is political: exclude labor from power. Canitrot described the government's decision to destroy the populist alliance, the root of subversion, as founded in the primary and fundamental interest of the business class in self-preservation. Frenkel warned that a mechanistic vision of economic policies as determined by classes and interests--short- or long-term--will result in a faulty analysis of this government's orientation. The Soviet Union in 1919 is the analog of Chile and Argentina today. Their governing groups do not represent the class interest of <u>a</u> sector, but are <u>partidos</u> whose projects are reconstruction of the social relations of production. Analysis must accord politics the autonomy it acquires in periods of intense social conflict.

Thorp argued that there must be enormous, new, and strong vested interests in inflation developing in Argentina. Their origin might lie, as Whitehead's paper suggested, in the attack on labor. These groups' political role in inhibiting stabilization deserves investigation, she concluded. Di Tella cautioned that there is no necessary connection between an export-led growth strategy and restrictive social policies. The decline in the popular sectors' power that has resulted is not entirely negative. In his opinion, it satisfies a pre-condition of reopening the political system--in the future the populist alliance will be the opposition party, while in addition unions did not fare so badly as a pressure group in the Onganía period. The key question, Whitehead suggested, was: how solid is the social basis of the government? In Spain, Portugal, and Brazil, repressive states could not be sustained indefinitely, and, even if they could be, he asked, are they any less costly in economic terms than a reformist strategy?

Causes of the impasse. Whitehead summed up the discussion on the causes of the Argentine impasse with the observation that while Argentina was the third country to go through this kind of stabilization program, its experience was shaped by internal traditions. Some participants felt that insufficient concern had been shown for external causes. Rosario Green and Olga Pellicer de Brody argued that the ways in which stabilization policies had modified Argentina's insertion into the international capitalist system and the dynamics of capitalist development, especially trade liberalization policies, merited attention. Branson was surprised at the emphasis placed on the internal origins of disturbances, observing that a workshop on the OECD countries would have focussed on international events.

VI. Peru

Just as Mexico's experience with stabilization differed significantly from the pattern set by the Southern Cone countries, so also did that of Peru--but in the opposite sense. The Peruvian experience has been shaped not by competent and sophisticated policy making, but by its absence; not by relative autonomy in economic management but by near-total submission to outside pressures. These were among the conclusions highlighted by Rosemary Thorp in her paper "Structural Reform, Economic Crisis, and the Return to Orthodoxy: Peru in the 1970s."

The Peruvian crisis, like Mexico's, was caused mainly by balance-of-payments disequilibrium. The economic and political failures of democratic governments in the 1960s led the military regime of General Velasco to attempt a far-reaching restructuring of the Peruvian economy, greatly increasing the role of the state. The resulting public-sector deficits were supported by foreign borrowing, the availability of which increased dramatically in the early 1970s. Both the deficits and the loans were predicated in part on the expected discovery of vast new oil reserves which never materialized. By 1975, under the impact of global recession and falling commodity prices, Peru was faced with a massive deficit in its external accounts and a 30 percent annual rate of inflation.

Under the prodding of the IMF and private international banks, Peru attempted to meet the crisis through orthodox policies of demand contraction and monetary control. Thorp stressed, however, that it was not a simple case of policies being imposed by outside pressure against local desires. There were no rejected Peruvian alternatives; Peruvian officials apparently acquiesced almost unquestioningly in the orthodox prescriptions. The only debate concerned the speed of adjustment.

Between 1975 and 1978, little improvement in the economic situation occurred. Orthodox measures proved ineffective in Peru, in Thorp's analysis, for three reasons. The first was the absence of necessary political preconditions. She cited specifically the government's political inability to cut public spending. Stabilization policies were strongly backed only by the Finance Ministry, while other ministries maneuvered to keep spending high, and the public agitated for the maintenance of government subsidies. Secondly, orthodox policies were inherently unsuited to Peru's economy because both export supplies and import volumes were little affected by internal demand contraction. Moreover, that contraction was rendered difficult to achieve by the existence of large subsistence and informal sectors which expanded while the modern sector contracted. Thirdly, it was difficult to sustain the harsh stabilization measures over time because, though ineffective, they were extremely costly, resulting in recession, concentration of industry, and a rapid fall in real wages.

Did there exist a feasible alternative path to stabilization? Thorp contended that an economic case could be built in favor of more flexible, heterodox policies. In practice, however, the government's lack of coherence gave the IMF reason to fear that Peru would take advantage of more flexible policies to further expand public and defense spending.

Turning to the political outcome, Thorp suggested three reasons why Peru's costly and ineffective pursuit of orthodox policies between 1975 and 1978 did not lead to the radicalization of the populace or to the repression typical of the Southern Cone: the economic cushion provided by the informal and subsistence sectors; the overall weakness of the militant left; and the fact that the government was not seen as pursuing an extremely liberal vision of society, but rather as simply responding to outside pressures in an emergency.

Commentary

In her commentary on the Thorp paper, Barbara Stallings interpreted the Peruvian experience somewhat differently. Regarding the causes of the crisis, she put more emphasis on the bad luck of timing and less on poor policy making and governmental incompetence. She noted that several developments straining the balance of payments appeared at the same time: oil reserves were determined to be negligible, Peru's development strategy arrived at a stage calling for major imports of capital goods, and international prices for those goods began to rise dramatically.

Concerning the options available for dealing with a balance-of-payments crisis, Stallings pointed out that in general the alternatives are three: deflation, devaluation, and direct controls. Peruvian policy makers quickly ruled out the imposition of new taxes and direct controls, while devaluation is relatively ineffective in the Peruvian economic context. Demand contraction was thus the only live option. She contended, however, that direct controls ought not to have been dismissed so easily. Within the framework of a long-term development strategy, controls can be useful, although in the absence of a plan aiming at their eventual removal the result will likely be increasingly inefficient industries.

In subsequent discussion, Thorp pointed out that Peru had had an unhappy experience with direct controls in 1945-48, leading policy makers to vow "Never again!" Another reason for the failure to consider controls, Stallings said, was the opposition of the IMF. Nevertheless, she stressed that the IMF did not impose an orthodox approach on Peru. It merely collaborated with those internal groups who already wanted to move toward more conservative and orthodox policies. This, she argued, is one among three major functions performed by the IMF: reinforcing certain internal factions, serving as a scapegoat for difficult and unpopular actions, and providing emergency financing.

Finally, turning to political dimensions, Stallings argued that Peru only appears to deviate from the Southern Cone pattern by simultaneously pursuing stabilization and political liberalization. In reality the goals sought differ widely. Peru has never aimed to use stabilization as a vehicle for social reconstruction as in Chile. Its half-hearted attempts to balance its external accounts were salvaged only by rising copper prices. The real question is whether Peru's redemocratization could have survived a further decline in the copper price. Moreover, Stallings found unconvincing the argument that the absence of repression was made possible by the country's low level of political mobilization. That may have been the case several years ago, she said, but no more.

Discussion

The ensuing discussion centered around various explanations of the policy outcomes and the broader political outcomes analyzed by Thorp and Stallings.

Explaining policy outcomes. One major area of differing views concerned the role of the IMF, and of international forces in general, in determining the stabilization policies pursued by Peru. Sidney Dell challenged Stallings' presumed conclusion that because certain domestic groups ally with the IMF the policies it favors cannot be said to be imposed from outside. The Fund's primary interest is the protection of the global monetary system, he pointed out, not helping individual countries achieve their particular social and economic goals. But balance-of-payments equilibrium should not be the only goal. In the case of Peru, he argued, the program prescribed was too drastic and too sudden for its fragile economy.

Stallings objected that the domestic groups favoring orthodox policies cannot be treated as mere puppets controlled by international forces; their interests at times converge but they are autonomous. Dell rejoined that he did not intend to suggest that domestic forces are puppets, but only that the forces most influential in shaping the policy outcome are international rather than national when a country finds itself dependent on IMF help.

Another participant challenged the alleged ineffectiveness of orthodox policies, citing a study showing that devaluation and demand constraint in Peru did lead to a significant reduction of imports. He asked whether Thorp's analysis was empirically based or relied on a stylized analysis of Peru's type of economy. Moreover, he asked, were there any practical alternatives, given the constraint of limited external financing? Thorp acknowledged the lack of alternatives, as long as Peru stayed in the game whose rules were set by the IMF. If that game had been rejected altogether, however, she felt that other options would have appeared.

Dell came to the defense of Peruvian policy makers, contesting the implication that they were unusually inefficient and citing the case of the United Kingdom. He noted moreover that international agencies had approved the general outline of the Peruvian policies which eventuated in the crisis. Thorp nevertheless maintained that a lack of competence was evident in the failure to consider a more unorthodox approach to stabilization and to integrate it into a national development plan.

The general tendency, in Peru as elsewhere, has been to subordinate development planning to the immediate goal of stabilization. Alexander Nowicki asserted that the experience of Peru has put an end to this tendency, both among governments and in international organizations. He noted that since mid-1978 Peru has been working on an investment strategy that has World Bank support.

A final question concerned the relationship between the decision to end the military's effort at structural reform and the institution of orthodox stabilization measures. Did the leadership seize the external imbalance as an opportunity to dismantle the socialist experiment? Stallings felt that the experiment's demise could be dated even before Velasco's fall in 1975, long before the economic crisis appeared. Thorp disagreed, contending that more than a facade of radical policies remained in place until the crisis rendered them untenable.

<u>Explaining political outcomes</u>. The second major theme running through the discussions concerned possible explanations for the relatively open political atmosphere maintained in Peru despite the application of stringent stabilization policies. Thorp's assertion that this outcome was due in part to a low level of political mobilization proved controversial. Cynthia McClintock argued that the society is mobilized but not radicalized. The military, like the IMF, serves as a scape-goat, a focus for economic and political discontent. Hugh O'Shaughnessy contended that mobilization is low, taking as his standard the level of militancy. He pointed to APRA in particular, and noted that even militant elements in Peru accept a parliamentary approach to social and political change. Stallings countered that, in the last five years, mobilization has occurred outside APRA among various leftist groups and peasant organizations. Moreover, she said, acceptance of parliamentary methods is no evidence against either mobilization or radicalism; Chile's leftists, though in the

late 1960s unquestionably mobilized, also accepted parliamentarian methods. O'Shaughnessy suggested that the relative frequency of political assassination might usefully serve as a rough index of mobilization.

Discussion also centered on the role of the informal sector in heading off political discontent. McClintock asserted that as Peru modernizes, the informal sector is declining, and that consequently stabilization did seriously hurt the country's poor. Nowicki disagreed, stating that the informal sector has been expanding, in Lima even replacing the modern sector. Stabilization policies primarily affect the modern economy, while the informal sector does not really suffer. He said that more research is needed on the impact of conventional policies on such dual economies.

Finally, the relationship between stabilization and redemocratization was discussed. Paul Drake suggested that redemocratization can be seen as a causal factor as well as a result, both in Peru and in neighboring Bolivia. He hypothesized that the government's promise of elections drained off resistance to the harsh stabilization measures among many who feared that opposition could endanger the cherished goal of civilian government. Thorp agreed that the military regime used the promise of elections both domestically and internationally to seek support, although the promise did not rest on such calculations alone. The move toward democracy was due primarily to divisions within the military and a growing desire to wash their hands of the entire mess.

VII. A Comparative Perspective

The concluding session of the workshop began with a comparative analysis by Samuel Lichtensztejn. Comparison of the impact of anti-inflation stabilization programs, he suggested, is valuable for two reasons. First, comparisons illuminate the discrepancy between governments' declared objectives and the political goals they actually pursue. Secondly, the similarity of political outcomes is a strong argument for the causal influence of international processes rather than domestic "peculiarities" in determining outcomes. The experiences of Argentina, Brazil, Chile, and Uruguay are useful to compare because: (1) industrialization is more advanced in these countries; (2) an entire generation has experience with inflation and IMF stabilization programs; and (3) the political results have been similar.

Twenty-five years of experience with stabilization programs should permit observations on the long-term, Lichtensztejn noted. Stabilization policies have not been homogeneous, but rather have evolved in three phases: opening the economies (1954-1962); concentration and denationalization (1963-1966); and authoritarian governments favoring internationally oriented industrial, financial, and export interests with an ideological base in the identification of inflation as the enemy of all sectors of society (late 1960s-1970s). Each cycle results in a crisis at a new level. All share a primary concern: the distribution and concentration of capital, income, and power.

According to Lichtensztejn, the roots of inflation are economic, but the crucial problem is under what conditions the transformation of the economic crisis into a political crisis occurs. The transition from an economic crisis to a political crisis depends on the correlation of social forces and the capacity for political control. The quantity of inflation does not produce incompatibilities with a given political regime.

Anti-inflation policies, formulated in the developed countries and applied in the developing countries, have succeeded only in institutionalizing inflation. This is because there does not exist within capitalism a political formula capable of ending inflation. Stabilization programs should not be evaluated in terms of economic variables. To do so is all right at this juncture because authoritarian regimes' lack of success in controlling inflation can be used against them. However, recession is not a necessary outcome of stabilization even in Chile and Uruguay, countries with strong tendencies to stagnate.

A second presentation, by Thomas Skidmore, began by listing issues meriting further discussion that had emerged from the workshop. These included: Latin America's experience with inflation in a range previously believed unsustainable; the region's experience--the most extensive in the world (excepting that of Israel)--with indexation as a way to counteract the distortions caused by inflation; variance in the degree of social conflict that results in economic and financial crisis and political conflict; social learning processes; the use of other countries as models; and the reluctance of direct foreign investment to re-enter during stabilization programs (suggesting that businesses are more concerned with growth than orthodoxy).

In Skidmore's view, current stabilization programs differ from past ones. Current programs are distinguished by their goal of constructing a new social order, by the resources at the disposal of the state, and by the international environment. The uncertainty over the rules of the international economic game in the 1960s gave developing countries more room for maneuver.

Two research foci will be particularly rewarding, Skidmore suggested. One is the labor-relations system. The second is the external sector. Important features of the former are the organization of labor and labor scarcity or abundance. Useful information would result from addressing the question of why the labor-relations system broke down in Argentina in the face of the cordobazo, but not in the face of similar unrest in Brazil. It would be helpful to know the implications of rolling back labor relations to their pre-Perón state in Argentina or to the pre-1924 condition in Chile. Research on the external sector, especially exports, could examine the strong ECLA influence on the Southern Cone countries and the politics of export promotion. The effects of export products becoming major consumption goods and of exporters being foreigners deserve study.

Finally, Barbara Stallings presented the preliminary findings of her work with Cheryl Payer comparing IMF stabilization programs in Europe and Latin America. The question they seek to answer is whether the Europeans were able to translate their greater political clout into less stringent conditions in dealing with the IMF. Before the institution of stabilization programs, the Latin American performance with respect to inflation, government deficit, and the balance-of-payments current-account deficit as a percentage of GDP was worse than Europe's. Letters of intent were obtained for the European cases--Great Britain, Italy, and Portugal--but not for all Latin American cases. The letters show that the stabilization programs had identical forms. The same performance criteria--public-sector deficit, balance of payments, and credit expansion--were employed in all cases. Great Britain, with the least serious economic problems, had the most stringent conditions.

Stallings discussed political and economic aspects of the European experience with IMF stabilization programs. The IMF supported domestic political factions, although the alliances formed varied between countries and issues. In Italy, the government and the IMF joined forces against the unions to jettison the scala mobile. That this alliance came apart over the issue of the public-sector deficit is not surprising since the public sector is an important source of patronage for the Christian Democrats. In Great Britain, the IMF sided with a faction of the cabinet and civil service. Portugal manifested a third pattern: in public, the government and the Fund were opponents; in private, they were allied against other political parties displeased with Soares' insistence on a single-party government.

U.S. pressure on reluctant European governments to go to the IMF took different forms. The Comptroller of the Currency's remark implying that U.S. private bank loans to Italy were risky precipitated a run on the lira and to the IMF. In Great Britain and Portugal, Secretary of the Treasury William Simon and Assistant Secretary Ed Yo promoted G-10 and IMF coordination. Britain had to promise that if its G-10 loan was not repaid in six months it would go to the Fund, and Portugal's G-10 loan was contingent upon negotiation of an IMF stabilization program. The piggy-backing arrangement that banks now use was employed because of the Fund's refusal to directly administer the loan, the original intention of the U.S. All three countries complained to the United States and Germany that the strictness of the Fund's conditions endangered democracy. Important concessions were granted Italy and Portugal, probably because their Communist parties pose a more credible threat than the left wing of Britain's Labour Party.

Thorp's point about Peru also holds for Europe, Stallings said. In economic terms, what success the stabilization programs enjoyed is due to factors extrinsic to the programs. In Great Britain appreciation of the pound, the incomes policy instituted before the IMF stabilization measures, and oil account for the decline of inflation. In Italy, the IMF itself attributes the economy's improved performance to a favorable turn in the terms of trade. Since the stabilization program was never followed--the money was not really needed--interpretation of the negotiations with the Fund as a politically feasible way of eliminating the scala mobile gains credence. The outcome in Portugal is uncertain: this year a high government deficit and inflation rate are coupled with an improvement in the balance of payments. Negotiations continue. The redistributive effects in Europe are the same as those described by Foxley in Chile and Brazil.

In theory, the Fund's version of stabilization fits the European economies better than the Latin American. Capital inflows in Europe, especially Great Britain, are more senstiive to changes in the interest and exchange rates. The response of exports to IMF stabilization programs should be better in Europe because: (1) manufactured exports are much more responsive to devaluation than primary commodity exports; (2) when wage goods are exported, deflation will affect the supply of exports and, in Europe, these are manufactured consumer goods; and (3) theoretically, manufactured goods offer greater possibilities for import substitution. In spite of the theoretically better fit, there is still a heated debate, at least in Great Britain, over the merits of devaluation, advocated by Oxford, and of the more selective approach afforded by controls, the Cambridge position.

Discussion

Di Tella remarked that inflation is one of Latin America's more interesting exports. It would be wise to begin basing stabilization policies on knowledge of what high inflation is, rather than on fantasy. Economists' analyses of inflation, Lichtensztejn noted, should not overlook Argentina's contribution: institutionalized inflation. Considering high inflation, low investment, and the failure IMF stabilization programs, di Tella concluded, concluded, alternative stabilization models are necessary. O'Shaughnessy questioned whether the prestige of orthodox stabilization policies and the role of the IMF as guardian of the international monetary system might not be restored as the world moves into rough times.

To di Tella, it is clear that stabilization policies must be accompanied by structural change--though of a different sort than that which the current Argentine government seeks--which calls for difficult decisions. The basic question, Canitrot thought, is how to increase real salaries and attack the problem of distribution. Mark-ups apparently preclude addressing the issue through the labor market. It is a dilemma analogous to correcting an overvalued exchange rate: if the exchange rate rises less rapidly than the internal price level, there is a shift to dollars and a large, very rapid loss of reserves, but to devalue using the shock treatment causes prices to climb at once.

Serra pointed out that unless internal and external prices can be disconnected, inflation will cause the terms of trade to deteriorate. If all the necessary and sufficient requisites for overcoming disequilibrium are met, if exports are increased, still disequilibrium returns. The cause is not an ECLA bias, but is structural: a characteristic of dynamic domestic industries is that their propensity to import grows faster than exports. Whether the balance of

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Di Tella and Canitrot discussed what they believed were necessary elements of successful stabilization programs. Di Tella had three minimum conditions. Most crucial is balance-of-payments equilibrium. It is also important to avoid drastic oscillations of the inflation rate because these create greater future intersectorial tensions. Like Frenkel, di Tella believed that the level of the inflation rate matters. Higher rates exacerbate intersectorial conflicts, and it is more than twice as difficult to avoid oscillations with a 150 percent rate as with a 75 percent rate. The importance he attaches to minimizing oscillation as the defining characteristic of an acceptable inflation rate is illustrated by his primary aspiration--that in ten years inflation in Argentina be 150 percent. Finally, indexation is a minimum condition of a stabilization policy. Because it is symptomatic of battles over relative distribution, it is a solution compatible with Latin American reality.

Canitrot's solution begins with a return to a mechanism now disgraced: price control. The Argentine experience suggests that, regardless of one's perspective, industrial prices escape control. Martínez de Hoz tried policies based on a "demand con inflation" analysis. When they failed, he switched to a focus on costs. It also failed. Control of prices and salaries implies three requisites: (1) negotiation with unions <u>and</u> bourgeoisie; (2) a correctly valued exchange rate, an accomplishment of Krieger Vasena; and (3) an open economy, imports being the only effective method of policing prices. The other element of Canitrot's solution is controlling the growth of the public sector, which, together with inflation, is a central problem of the economy. The proportion of GNP in public-sector expenditures, as well as their absolute level, is similar to the European countries, but its distribution is quite different. In Argentina, expenditures are for public enterprises, not social welfare. The growth and distribution of public-sector expenditures, as well as control of prices, are embedded in politics. The consequences of the experience with <u>peronismo</u> were terrible. If there is to be a democratic solution for Argentina, a way to manage the workers and the bourgeoisie must be found. A political party that can control the workers, one like the Communist Party of Italy, is needed.

Jorge Notaro also emphasized that governments preoccupied with relative prices must create a milieu supportive of political moderation. The problem faced by authoritarian regimes is to persuade sectors of society that agreements holding the promise of future gains can be negotiated within the limits of the regimes' stabilization programs. It is paradoxical, Serra said, that democracy is now seen as necessary to resolve the conflict over price adjustments. The political battle over economic adjustments is waged between the workers and bourgeoisie, the public sector and financial interests, even within the government. It is a <u>political</u> problem, he continued, one that in Argentina and Brazil is called "populism" and in the U.S., "big government."

The political purpose of stabilization programs is affirmed by the similar responses made to the distinctive conditions of each country. To illustrate this contention, Muñoz discussed the interrelationship of politics and economics in Mexico. Reducing salaries has caused only a very slight reduction of inflation in Mexico, the opposite of the effect expected by orthodox economists. It is evident that the inflation rate will never fall below 15 percent. Mexico prefers to recognize structural inflation and openly institutionalize a reasonable rate by indexing salaries. In contrast, authoritarian regimes' stabilization programs clandestinely institutionalize inflation. The only outcome this implies is a fall in real salaries. Without salary increases, the social pact cementing a democratic regime will dissolve. That the same ideological justifications and anti-populist slogans are employed in Mexico, where inflation is 20 percent, as in Chile and Argentina, is thus not so peculiar.

Charles Lipson commented that growth, political stability, and predictability are relevant to foreigners' decisions to make direct investments. Political considerations also affect countries' access to international capital markets. The congruence of development plans with stabilization programs and the pace of adjustment is important. Direct violence can be viewed as strengthening the government's credibility as a debtor, or its access could be enhanced by a lengthier, more moderate, less repressive adjustment.

Frenkel warned that concentrating on the political objectives of stabilization programs underestimates the magnitude of the problem of success or failure. In Argentina, the long-term goal of the government is altering the power of distinct fractions of society, a process for which all pay. But attainment of this political goal is not sufficient for success, because behind it is another, more fundamental, objective: capital accumulation. It is also a question of politics, but whatever the new type of social relations produced by the change of political system, the process of accumulating capital must continue. The essential inference to be drawn from Argentina, Brazil, and Chile is that if limiting real wages does not spur growth and increase profits, social and legal changes must be made. Inflation, Frenkel said, can succeed in changing the power of social factions, and it is an important instrument of redistribution and concentration, as Lichtensztejn pointed out. But, in the last instance, its most fundamental goal is reconstituting the accumulation of capital.

Frenkel also argued that the <u>level</u> of inflation is as important as the capacity of the system to attenuate the harm relative price movements inflict on various social groups. The absolute level of inflation matters because of its effect on the functioning of economic agents and financial markets. Economic agents' behavior is conditioned by the normal level of inflation. Drastic changes in the level disrupt normal profit and risk calculations. Investment levels are not optimal when inflation is 150 percent. Confidence is based on the short-term credibility of an economy as well as on political stability, and higher inflation means greater uncertainty. The financial market adjusts more rapidly than any other market to changes in the price level. The greater the inflation rate, the more destabilizing is its very rapid adjustment. The financial market is an important destabilizing factor in Brazil and Argentina. Most important, a high inflation rate impedes capital accumulation.

At what level inflation is stabilized depends on what rate is compatible with the normal functioning of capitalism and what level people will accept, according to Serra. Because inflation eases acceptance of real losses and spurs growth, some inflation should be expected. Lipson suggested that it is best to pose the question of why hyper-inflation has stabilized in terms of why people begin using goods instead of money as a store of value.

Lichtensztejn ended the conference by raising the neglected issue of food policy. In an open economy, he said, policies to guarantee the provision of basic foodstuffs are normally not considered. Yet, in Brazil and Mexico, the countries in which the process of capital accumulation is most intense and sustained, a central preoccupation of the government is a food policy tied to the most needy sectors of the population. Such policies, especially if they require importing food with their predictable adverse effect on the current account, are undeniably inflationary. Still, it is indisputable that today agropecuarian policy in Mexico is an integral element of the social pact. Lichtensztejn believes that food policies integrate the workers and popular sector with the project of the government. Any policy touted as one of national or social integration must consider food, he concluded.

"Economic Stabilization Programs in Latin America: Political Dimensions"
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Participants

William Branson
Princeton University

Adolfo Canitrot
CEDES, Buenos Aires

William Cline
Brookings Institution

Sidney Dell
UNDP, New York

Guido di Tella
Instituto di Tella, Buenos Aires

Paul Drake
The Wilson Center

Richard Feinberg
Department of State

Alejandro Foxley
CIEPLAN, Santiago

Roberto Frenkel
CEDES, Buenos Aires

Rosario Green
El Colegio de México

Samuel Lichtensztejn
CIDE, Mexico City

Charles Lipson
University of Chicago

Abraham Lowenthal
The Wilson Center

Pedro Malán
IPEA, Rio de Janeiro

Michael Moffitt
Institute for Policy Studies

Cecilio Morales
Inter-American Development Bank

Porfirio Muñoz Ledo
El Colegio de México

Jorge Notaro
CINVE, Montevideo

Alexander Nowicki
World Bank

Hugh O'Shaughnessy
The Financial Times

Olga Pellicer de Brody
El Colegio de México

José Serra
CEBRAP, Sao Paulo

Thomas Skidmore
University of Wisconsin

Barbara Stallings
University of Wisconsin

Simón Teitel
Inter-American Development Bank

Rosemary Thorp
Oxford University

Alexander Wilde
The Wilson Center

Sidney Weintraub
Brookings Institution

Laurence Whitehead
Oxford University