Overseas Development Institute

CONDITIONALITY AND THE POLITICAL ECONOMY OF POLICY REFORM IN LATIN AMERICA

Ramani Gunatilaka

Working Paper 96

Results of ODI research presented in preliminary form for discussion and critical comment

ODI Working Papers

37: Judging Success: Evaluating NGO Income-Generating Projects, *Roger Riddell*, 1990, £3.50, ISBN 0 85003 133 8
38: ACP Export Diversification: Non-Traditional Exports from Zimbabwe, *Roger Riddell*, 1990, £3.50, ISBN 0 85003 134 6
39: Monetary Policy in Kenya, 1967–88, *Tony Killick and F.M. Mwega*, 1990, £3.50, ISBN 0 85003 135 4
41: ACP Export Diversification: The Case of Mauritius, *Matthew McQueen*, 1990, £3.50, ISBN 0 85003 137 0
42: An Econometric Study of Selected Monetary Policy Issues in Kenya, *F.M. Mwega*, 1990, £3.50, ISBN 0 85003 142 7
53: Environmental Change and Dryland Management in Machakos District, Kenya: Environmental Profile, *edited by Michael Mortimore*, 1991, £4.00, ISBN 0 85003 163 X
54: Environmental Change and Dryland Management in Machakos District, Kenya: Population Profile, *Mary Tiffen*, 1991, £4.00, ISBN 0 85003 164 8
55: Environmental Change and Dryland Management in Machakos District, Kenya: Production Profile, *edited by Mary Tiffen*, 1991, £4.00, ISBN 0 85003 166 4
56: Environmental Change and Dryland Management in Machakos District, Kenya: Conservation Profile, *F.N. Gichuki*, 1991, £4.00, ISBN 0 85003 167 2
57: Environmental Change and Dryland Management in Machakos District, Kenya: Technological Change, *edited by Michael Mortimore*, 1992, £4.00, ISBN 0 85003 174 5
58: Environmental Change and Dryland Management in Machakos District, Kenya: Land Use Profile, *R.S. Rostom and Michael Mortimore*, 1992, £4.00, ISBN 0 85003 175 3
61: The Informal Financial Sector: How Does It Operate and Who Are the Customers? *J.J. Thomas*, 1992, £4.00, ISBN 0 85003 178 8
65: The Seed Sector in Developing Countries: A Framework for Performance Analysis, *Elizabeth Cromwell, Esbern Friis-Hansen and Michael Turner*, 1992, £6.00, ISBN 0 85003 183 4
66: The Performance of the Seed Sector in Zimbabwe: An Analysis of the Influence of Organisational Structure, *Esbern Friis-Hansen*, 1992, £4.00, ISBN 0 85003 184 2
67: Political Regimes and Economic Policy Patterns in Developing Countries, 1978–88, *John Healey, Richard Ketley and Mark Robinson*, 1992, £4.00, ISBN 0 85003 185 0
68: The Impact of NGO Poverty Alleviation Projects: Results of the Case Study Evaluations, *Roger Riddell and Mark Robinson*, 1992, £4.00, ISBN 0 85003 1923
69: Continuity and Change in IMF Programme Design, 1982–92, *Tony Killick*, 1992, £4.00, ISBN 0 85003 194 X
70: IMF Lending: The Empirical Evidence, *Graham Bird*, 1993, £4.00, ISBN 0 85003 197 4
71: Issues in the Design of IMF Programmes, *Tony Killick*, 1993, £4.00, ISBN 0 85003 199 0
72: Food Aid Programmes of the European Community and its Member States: A Comparative Statistical Analysis, *Edward Clay and Charlotte Benson*, 1993, £4.00, ISBN 0 85003 200 8
73: Economic Inflexibility in Africa: Evidence and Causes, *Tony Killick*, 1993, £4.00, ISBN 0 85003 205 9
74: The Changing Role of NGOs in the Provision of Relief and Rehabilitation Assistance: Case Study 1 – Afghanistan/Pakistan, *Nigel Nicholds with John Borton*, 1994, £6.00, ISBN 0 85003 206 7
75: The Changing Role of NGOs in the Provision of Relief and Rehabilitation Assistance: Case Study 2 – Cambodia/Thailand, *Charlotte Benson*, 1993, £6.00, ISBN 0 85003 207 5

Working Paper 96

CONDITIONALITY AND THE POLITICAL ECONOMY OF POLICY REFORM IN LATIN AMERICA

Ramani Gunatilaka

March 1997

Overseas Development Institute
Portland House
Stag Place
London SW1E 5DP

ISBN 0 85003 250 4

Foreword

'Conditionality' is an ugly recent addition to the English language with which government officials in indebted countries have become all too familiar. In the context of this paper, conditionality refers to policy changes which an aid donor agency stipulates a government must undertake in order to obtain, or retain, access to the donor's financial support; it is an exchange of money for policy action. It arises most frequently in connection with the 'adjustment' programmes of the International Monetary Fund and World Bank but bilateral donors have made greater use of it in recent years.

This paper is a product of a research project under way in ODI, under my direction, which is examining the uses and limitations of donor conditionality as a way of bringing about improved economic policies in developing countries. ODI has now published three *Working Papers* as outputs of this project, in addition to the main report which we hope to bring out as a book during 1997. A parallel paper by Ana Marr dealing with Southeast Asian experiences was published as *Working Paper 94* in July 1996 and an essay on the consistency of policy conditionality with the idea of national sovereignty, by Douglas Zormelo, was published as *Working Paper 95* in November 1996.

There has during the last decade and a half been a remarkable about-turn in thinking about economic policy in many Latin American countries, particularly as it relates to macroeconomic management. In this paper Ramani Gunatilaka examines the extent to which the conditionality of the IMF, World Bank and bilateral aid donors contributed to this policy revolution, concentrating particularly at the forces that contributed to the policy turning points in each of the countries studied: Argentina, Bolivia, Chile, Colombia, Ecuador and Mexico.

The project of which this paper forms part is funded by the UK Overseas Development Administration and ODI would like to express its gratitude for this support. However, neither ODA nor any of the many people who have helped us in this project are implicated in the conclusions arrived at.

Tony Killick
March 1997

Acknowledgements

The author is a Research Economist at the Institute of Policy Studies, Colombo, Sri Lanka and previously a member of the research staff of the Overseas Development Institute. She is grateful to Chandi Chanmugam, former Executive Director, and Saman Kelegama, present Executive Director, of the Institute of Policy Studies, Colombo, for allowing her to devote time to this work.

Contents

Table

I
POLICY DIRECTIONS BEFORE THE TURNAROUND

Introduction

The response of major Latin American countries to the destabilising effects of the Mexican peso crisis of December 1994 revealed the extent to which market-oriented economic policy reforms in Latin America had taken root. No country, not even Mexico, imposed currency controls; none of them gave any serious thought to abandoning economic liberalism; and one-time profligate governments remained circumspect about foreign borrowing and public spending. In fact, several governments forged ahead with privatisation (Mexico, Brazil and Peru), and Argentina's government used the crisis to push through labour market and pension reforms previously held up in Congress (*The Economist*, 20 May 1995).

The purpose of this paper is to identify the causal factors behind the sea change in policy to assess the extent to which the conditionality attached to IFI lending may have had an impact in bringing about the changes. The analysis takes as its base the identification of a decisive turning point in the adjustment experience which made for success or failure in each of the sample countries: Argentina, Bolivia, Chile, Colombia, Ecuador and Mexico. By relating these turning points to the period of IFI involvement in policy-based lending (see Appendix Table), as well as to the historical record of adjustment in these countries, it is possible to distinguish the catalytic influences on adjustment and the role of the IFIs in the process. Part II, therefore, juxtaposes the record of IFI policy-related lending with the historical record of policy reform in each of the six countries, with particular focus on the turning points. Part III concludes by returning to the issues and hypotheses raised below and bringing together the common elements of the country experiences.

Towards the abyss

The economic policy transformations in Latin America are all the more remarkable given the extent to which the statist, inward-oriented development strategy they had been following at least since World War II had become entrenched. The theoretical foundation for the state-led import substituting industrialisation (ISI) strategy which all the major Latin American countries followed was provided by the Prebisch–Singer thesis fashionable in the 1950s.

This theory held that primary exports by developing countries faced low income and price elasticities of demand, whereas the converse was true for manufactured exports from industrial countries. Consequently, the commodity terms of trade of developing countries were believed to have a tendency to deteriorate over time vis-à-vis their imported manufactured goods. It was hence recommended that developing countries establish protective regimes and raise taxes on traditional exports, in order to re-allocate resources from the primary productive sector towards manufacturing (Prebisch, 1959: 252–57).

These measures were expected to increase export earnings in the longer run, but, as is now well-known, the anti-export bias of the resulting framework of incentives inevitably undermined the ISI growth strategy: declining export earnings were progressively less able to finance the import-substituting industries' need for imported inputs and capital equipment. Consequently, economic growth became constrained by foreign exchange bottlenecks. There was some attempt at reducing the extreme anti-export bias of the strategy after the mid-1960s in some of these countries but these attempts were thrown off course by the 'ill-fated stabilization efforts and ill-advised capital inflow during the late 1970s'. Other than in Chile, the import-substituting policy framework remained in place in the region until the 1980s (Corbo, 1994: 324).

A key feature of the ISI strategy was that it envisaged a predominant role for the state in economic affairs, not only as protector of emerging industries and regulator of investment flows and prices, but as a direct investor in large state-owned enterprises. Thus, by the 1980s the state sectors in these countries had expanded considerably. For example, public sector outlay as a percentage of GDP was 42% in Argentina by 1981 and 48% in Mexico a year later. Between 1978 and 1980, state enterprises in these two countries were responsible for 20% and 24% respectively of gross domestic investment. In Brazil the figure was as high as 39% (Balassa et al., 1986: 126).

Public controls over the banking system – another characteristic of the dirigiste strategy – led to negative real interest rates for depositors (with nominal interest rates set below the rate of inflation). Although its objective was to induce investments in capital intensive industries – a crucial phase in the ISI process – the policy created a regime of 'financial repression'. The latter saw a segmented domestic financial market in which some favoured investors obtained (rationed) credits cheaply, while others were driven to expensive kerb markets (McKinnon, 1973). The policy also had the unintended effect of encouraging capital-intensive production methods whereas what were needed were more labour-intensive production techniques.

Although many developing countries the world over followed these policies at the time, their adoption in Latin America was particularly encouraged by the political economy of the region. As noted by Sachs (1989: 11), many of the policy actions were not 'mistakes' or technical misjudgments, but were the result of deeper political instabilities. The economies of Latin America were (and some continue to be) driven by great inequalities of income. These in turn generated fierce distributional conflicts reflected in chronically large budget deficits, as governments bought the support of various highly mobilised groups through redistributive measures and subsidies. Larrain and Selowsky, for example, show that public investment in Mexico 'followed a general upward trend conforming to the Mexican political cycle' (1991: 285). Current expenditures too were driven at various times by the political exigencies of providing long-term employment in the state sector.

Meanwhile, also for political reasons, governments were unwilling to raise taxes on economic elites in order to finance growing public expenditures. Predictably, by 1982 the public sector deficits in Argentina, Mexico and Brazil were unsustainably high at 14, 17 and 17% of GDP respectively (Balassa et al., 1986: 126). For a while deficits could be covered by resort to foreign credits, which were plentiful in the 1970s, but when the period of easy credit tapered off, countries like Mexico, Bolivia and Ecuador took to printing money to cover the deficit. Argentina had been doing this since the 1950s, at least.

Fiscal expansion and other political-economy factors also made Latin America prone to persistently high rates of inflation relative to other regions. High and volatile prices in Argentina were clearly driven by monetisation of the fiscal deficit after 1961. Between 1975 and 1991 the annual rate of inflation always exceeded 100% and Argentina ended the 1980s with hyperinflation (IMF, 1992: 107). Meanwhile, Bolivia experienced hyperinflation in 1985. This too was due to fiscal expansionism, aggravated by wage-price spirals induced by wage indexation. Chile too was a chronic-inflation country between 1950 and 1973, when the military government took over. This again was mainly due to lax fiscal policy (Little et al., 1993: 192). In contrast, Mexico was a low-inflation country, except for two populist public sector spending booms during 1973–81 which generated fiscal and balance of payments deficits. The fiscal deficits were partly monetised and the exchange rate substantially devalued, which measures fuelled inflationary pressures during Echeverria's administration (Little et al., 1993: 196).

Brazil, too, had high and variable rates of inflation for much of 1960–89, generally exceeding 20% per annum, and rising to over 100% after 1981. While Brazilian policy-makers consistently followed a demand expansionary policy, Brazilians learned to live with the consequent inflation because adverse effects were reduced by indexation. However, wage indexation in turn fed into wage-price spirals so that Brazil too ended the 1980s with hyperinflation (Little et al., 1993: 174). Only Colombia among the major Latin American countries followed a conservative approach to macroeconomic management throughout.

Wage indexation and price controls were typical of the measures adopted by Latin American countries to deal with chronic inflation. The prices of agricultural staples and energy products, for instance, were controlled in favour of the urban working class with adverse effects on rural incomes, energy efficiency and the fiscal deficit (the energy industries were invariably state monopolies). They also increasingly relied on chronically over-valued exchange rates to favour urban workers and protect manufacturing at the expense of the politically weak agricultural sector (Sachs, 1989: 15).

The potent combination of accelerating inflation, negative real interest rates and overvalued exchange rates made for capital flight on a massive scale, and this created its own constituency of vested interests. This was especially the case in countries which had no capital controls, like Argentina, where capital flight as a percentage of debt was approximately 52% in 1987, and Mexico, where the corresponding figure was 57%. Capital flight in Venezuela that year was 106% of total external debt (Pastor, 1990: 12). Since much of the reallocation of privately-held domestic assets to foreign assets took place when the exchange rate was overvalued, and hence foreign assets were cheap, this ensured the investors – invariably local elites – windfall returns in domestic currency when the inevitable devaluation eventually took place.

Such factors rendered these economies highly vulnerable to the three simultaneous external shocks of the early 1980s which heralded the debt crisis: a cut-off in access to international bank credit, a rise in world interest rates and a fall in most commodity prices. Almost immediately, governments had to start making significant net resource transfers abroad in order to service their external debts, which meant they had to slash their non-interest deficits or else find alternative methods of finance. While most governments cut public sector investment drastically, these cuts were insufficient to meet the gap. They consequently shifted to domestic borrowing with further inflationary consequences. The latter effects, coupled with rising interest rates, undermined the fiscal situation even more as economies were driven into recession. This further contracted the government's revenue base.

The turn-around in economic policy which most Latin American governments undertook in the late 1980s must, therefore, be seen in the context of the economic abyss into which they had fallen as a result of earlier policies and from which they had to claw their way out. Their reform efforts were almost invariably accompanied by credit arrangements with the IMF and World Bank (the Bank had by then moved into structural adjustment lending as a means of inducing policy reform in recipient countries) and a feature of the attendant donor–borrower relationship was that the IFIs – especially the IMF – were initially regarded with hostility by most Latin Americans, who saw them as agents of Northern industrial interests intent on perpetuating dependency in the South. Credit arrangements with the IFIs, and associated conditionalities, were seen as the instruments through which such dependency was enforced. However, following the turnaround in policy in these countries, it is clear that this hostility too has undergone a sea change.

Issues for examination

The principal objective of this paper is to assess the importance of IFI conditionality in catalysing policy change in Latin America. The definition of conditionality we use is that of the hard-core variety as set out by Killick (forthcoming). These are actions, or promises of them, which are made only at the insistence or under the coercion of the lender, and are 'measures that would not otherwise be undertaken, promised involuntarily by governments in urgent need of the financial assistance to which the measures are attached'. In the analysis to follow we distinguish between this and 'pro forma' or consensual policy conditions which governments implement voluntarily.

We also look at the other avenues through which the IFIs may have played a catalytic role, that is through policy dialogue and the provision of supporting finance. In addition to these external factors, the extent to which the debt crisis may have had a cathartic effect in jolting governments into new policy directions will also be assessed.

Since the statist, import-substituting, pro-inflation policies followed by Latin American governments earlier had been to a large extent driven by political factors, as noted above, we hypothesise that the domestic political environment was a crucial variable in the adjustment process. How important was the role played by domestic politics, especially in relation to that played by IFI conditionality? What were the political variables which went into producing an internal configuration of forces favouring reform? Among these variables, we consider the extent to which the nature of politics – whether adversarial or consensual – facilitated or frustrated reform. In this context, did democracy help or hinder? The role played by the nature of policy decision-making – whether consensual, interest-dominated or technocratic – will also be examined.

In order to assess the relative importance of each of these factors in bringing about the reorientation in policy, we consider the adjustment experience of the six Latin American countries mentioned above. The selection of the sample was, by necessity, governed by the availability of relevant published material.

II
RECORD OF POLICY REFORM IN LATIN AMERICA

1. Argentina

Before the turning point

Until Carlos Menem's election as President in 1989, successive stabilisation attempts had failed in Argentina because of the government's inability to close the fiscal gap. In its turn, the fiscal gap had been driven by Argentina's political economy, so that balancing the budget had essentially been a question of breaking the destructive dynamic between the country's politics and its economics.

The chronic violence and instability which characterised Argentine politics from 1940 until recently was explained by the inability of the country's political institutions to cope with the demands of rapid social change and the resulting rapid political mobilisation of new groups in the country. From 1912, the Argentine polity was essentially corporatist: political parties were class-based. The small, land-owning elite interests were represented by the Conservatives, the Radical Civic Union (UCR) was founded by the emerging middle class, and the Peronist Party which came to power by the middle of the century was a working class movement. However, the dramatic increase in political participation of the middle class in 1912 and the working class in 1945 were not fully accepted by the older elites (Snow and Wynia, 1990: 131).

Argentina's statist, redistributive policies post-World War II were shaped by the political-economy of the country. As each party came into power, it strengthened its alliance with respective corporatist entities through redistribution and subsidies. Losing parties in an election seldom accepted electoral defeat as definitive, knocking on the doors of the barracks for redress. Between the overthrow of Peron in 1955 and the military takeover of 1976, Argentina had experienced two minority Radical governments (1958–62 and 1963–66), two military regimes (1955–58 and 1966–73), a brief civil conflict (1962–63), and a return of the Peronists (1973–76). The military itself had been plagued by internal ideological factions which limited its ability to carry out a coherent programme, unlike in Chile.

While industrialists and military nationalists generally supported the ISI model in Argentina, antagonism towards the Peronist movement frequently led these groups into political alliances with financial and agro-exporting groups which advocated more liberal strategies. Thus, during the military regime of Videla, Finance Minister Martinez de Hoz (1976–81) attempted to dismantle the regulatory apparatus of the state-led ISI model, even to the extent of lifting controls on capital movements and trade. At the same time, the government maintained an overvalued exchange rate to control inflation, and this led to serious macroeconomic imbalances as speculative dollar purchases by the private sector were financed by massive foreign borrowing by the government to cover its fiscal deficit. The foreign resource inflows thereafter haemorrhaged away in the form of capital flight by the local private sector (Kaufman, 1990: 72).

From March 1981 to December 1983, the economy faced a series of shocks: commodity prices declined sharply, international interest rates rose, devaluation fuelled inflation in the domestic economy, and the Malvinas (Falklands) conflict added to the devastation of the public finances and loss of confidence in the military regime. In October 1983 the Radical Party won open and free elections for the first time. The new president, Raul Alfonsin, inherited an extremely unstable economy: the fiscal deficit was more than 12% of GDP in December 1983 and inflation was running at a monthly rate of 20% (Erro, 1993: 136).

Corporatism had become increasingly difficult to sustain by the time Alfonsin took over because there was little surplus in the economy that the government could appropriate for redistribution. Even so, soon after the election the government implemented some populist policies. Ceilings were imposed on increases in public utility rates and an 8% wage increase was granted above the automatic indexation rate. Thereafter, Alfonsin was forced to make several stabilisation attempts (the Austral Plans of 1985 and 1986, for example), all of which failed due to his inability to implement the necessary structural correlates to the programmes. New debt was taken on to finance the budget deficit, and foreign interest payments that the government could not meet were capitalised (Erro, 1993: 146–48).

Despite poor compliance with loan conditions, at least until 1987 Argentina was successful in obtaining financial support from the Bank and the Fund on the basis of its bargaining power as Latin America's largest debtor (see Appendix Table). Three Fund stand-bys were granted to Argentina between 1983 and 1988 but tranche releases of all three were suspended due to non-compliance with loan conditionality. In the Bank's case, involvement in sectoral lending to Argentina began in 1985 with the Baker Plan, and a sectoral loan for agriculture was approved in April 1986. Here too the government did not meet the conditions for the release of the second tranche, failing to establish a federal land tax or to liberalise the import of tractors and machinery (World Bank, 1993b: vi–viii). However, as credits from international commercial banks were linked to specified levels of Bank disbursement, the Bank came under pressure from the US administration to release the tranche. Consequently, the Bank's management recommended a waiver of conditionality to the Board which the latter approved 'after much acrimonious debate' (ibid.).

By early 1988, when arrangements with the Fund fell through, James Baker, the US Treasury Secretary, pressured the Bank to lend to Argentina in order to keep alive the facade of debt repayment. As manager of Ronald Reagan's presidential campaign, Baker was particularly anxious to keep the debt problem quiescent before the elections took place. With Argentina's own presidential campaign due to start shortly, there were fears that pressures for a radical solution would force Alfonsin to adopt a more confrontational approach. The US Treasury therefore went to the extent of providing Argentina with a bridging loan, notionally made conditional on the approval of a package of sectoral and project loans by the Bank, whereas such loans were usually tied to Fund programmes (Tussie and Botzman, 1990: 397–400).

The Bank's Second Trade Policy Loan (TPL II) was not, as would normally have been the case, supported by a concurrent Fund stand-by, as agreement with the Fund on a programme proved elusive: Alfonsin found the political risk associated with a Fund stabilisation programme too high in the run up to the presidential election. With no concurrent stand-by, the Bank had to play the dual role of both catalyst to attract new loans from the commercial banks and monitor of Argentina's macroeconomic performance. The TPL II Loan therefore included, over and above sectoral conditions, a new clause making disbursements conditional on favourable macroeconomic performance. Macro-conditionality was rigorous, not only for loan effectiveness but also for tranche release. This was designed to limit the further risk of Bank exposure should the Fund be unwilling to agree a stand-by, because the financial support of other creditors and the Fund was critical to the viability of the strategy (Tussie and Botzman, 1993: 396).

In the event, a Fund stand-by indeed failed to materialise, and in its absence other creditors were unwilling to lend. So even though the government complied with, and made satisfactory progress in meeting, sectoral conditions, its failure to meet macroeconomic targets enabled the Bank to suspend disbursement of the second tranche of TPL II. Meanwhile, the US Government's attitude towards the debt crisis changed with the new Bush Administration which came to power in early 1989 and which was prepared to recognise discounts on the book value of debt. The Bank was therefore able to seize on the excuse of non-compliance on macro-conditions and make a fast exit from an adjustment programme which, being underfunded, was doomed to failure anyway. The Bank appears to have been more interested in saving itself from the consequences of the failure of a programme which it has entered into unwillingly than in ensuring the success of its sectoral programme.

Menem's U-turn in 1989

At the presidential elections in May 1989, the Radical Party candidate lost to Carlos Menem of the Peronist Party. By July the economy was in severe crisis: inflation was running at 200% per month, there was no investment and the bourgeoisie was exporting as much capital as was possible.

Menem had been elected on a very populist platform, presenting himself as Juan Peron's successor, making frequent references to 'social justice' and advocating a unilateral moratorium on foreign debt payments. Moreover, his record as governor of La Rioja was not promising, as his administration was known for an overblown and inefficient state apparatus. Menem had also been willing to sell his support to Alfonsin for federal government subsidies. Why then did Menem break with the past and choose to restructure the economy by grasping the nettle of fiscal reform?

David Erro argues that the most likely reason for this turnaround was that Menem realised that there were no other alternatives (1993: 197). Menem inherited an insolvent state to which no international financial agent (including the IFIs) was willing to lend. By 1989, total external debt amounted to a staggering US$65 billion – approximately 538% of total exports for that year (World Bank, *World Debt Tables*, 1991–92: 10); between 1989 and 1990 net long-term capital inflows had plummeted from US$4.7 billion to US$1.2 billion. Meanwhile, net long-term loans for 1991 were negative at US$1.5 billion, with Argentina paying back nearly twice as much as she received in loans (World Bank, *World Debt Tables*, 1995: 107). There were no longer any funds available to buy political support through redistribution and subsidies.

Hence, despite his populist rhetoric and working class support, Menem was forced to distance himself from the lobbying of corporatist entities, align himself with the business community and effect rational, market-based policies. Soon after his election, Menem held extensive meetings with the chief economists of the Argentine multinational Bunge y Born which was not associated with any corporatist entity. Several Bunge y Born economists and executives were appointed to the Ministry of Economics. The president simultaneously severed ties with the various factions of the Peronist Party and no leading Peronist was included in the new cabinet (Erro, 1993: 197–99).

In stipulating the economic plan by law (the Law for the Reform of the State and the Law Regarding the Economic Emergency), the president gained clear and strong powers to implement economic policy and legally bound the government to implement a comprehensive programme of structural reforms. Within three months of assuming office, he announced plans for the privatisation of the Aerolineas Argentinas and Entel – the best known state enterprises. Subsequently the government down-sized its services across the board and halved military expenditures. Rationalisation of the state sector made 120,000 workers redundant. Tax revenue was increased, especially through the implementation of an 18% VAT. Foreign trade was completely deregulated and all regulatory boards in the agricultural sector were abolished (Erro, 1993: 218–20).

Initial attempts at stabilisation were unsuccessful, however. In fact, it was after the

Bunge y Born Plan that inflation began to accelerate. When the stabilisation efforts ran into difficulties Menem invariably made scapegoats of his ministers of finance. The structural adjustment programme, however, marched relentlessly on (Erro, 1993: 206). Efforts at stabilisation began to bear fruit only after Plan Bonex. In January 1990, *plaza fijos* – certificates of deposit with astronomical interest rates which were fuelling hyperinflation and inflating public debt – were nationalised and transformed into ten-year, dollar-denominated bonds. Simultaneously the government eliminated almost all its short-term debt and replaced it with long-term bonds carrying far lower obligations. Consequently M2 was slashed by 60% and the government kept its promise not to print money to finance the deficit.

In 1991, under Finance Minister Cavallo's Convertibility Plan, a fixed exchange rate in the context of an open economy forced local manufacturers to control costs in order to compete with imports. It also forced the government to continue with restructuring and to live up to its commitments with respect to controlling the fiscal deficit (Erro, 1993: 215–17).

In Argentina's case, it seems likely that it was the lack of financial assistance from donors rather than donor support and conditionality which forced Menem's government to undertake reform. As noted above, no creditor was willing to lend to Argentina at the time of Menem's accession. Donor influence over policy reform (inadvertently or otherwise) resulted from the withholding of financial relief until there was in place a government convinced of the need for reform and committed to programme implementation. If donors and creditors had provided credit to Argentina at the time of Menem's assumption of the presidency (and had not been frightened away by his talk of declaring a unilateral moratorium on debt repayments), it is likely that the soft budget constraint thus provided would have enabled him to keep the populist promises of his manifesto, and further postponed reform.

Developments from 1991

After Menem had convincingly demonstrated that his government was committed to reform, the IFIs were willing to resume operations and provide financial support for further policy adjustments. By mid-1991 the government had signed up for two sectoral loans, the Public Enterprise Reform Adjustment Credit and the Public Sector Reform Loan, totalling US$625 million. At the same time a Fund stand-by for SDR780 million came into operation but was subsequently cancelled and a three-year Extended Facility (EFF) credit for SDR2,149 million granted instead. In the pipeline in 1993 were fiscal, administrative and social security reforms and reform of intergovernmental fiscal relations.

The extent to which lobbying by class-based interest groups had broken down and adjustment policies had been consolidated was evident in the aftermath of the collapse of the Mexican peso in December 1994. Despite being only months away from the presidential election in which he was seeking re-election, Menem chose to deflate the economy to raise productivity and badly-needed export earnings rather than devalue the currency. He also used the crisis to push through labour market and pension reforms previously held up in Congress (*The Economist*, 20 May 1995). In May 1995, Argentines re-elected Menem to office, showing that the electorate had matured to the extent that it was prepared to accept hard measures in return for political and economic stability. It is also significant that Menem's nearest rival in the election, Jose Octavio Borden, challenged the methods and results of reform, but not the principle (ibid.).

In Argentina's case, the most important contribution made by the IFIs towards bringing about economic policy reform in that country seems to have been, ironically, to withhold financial assistance at the crucial point. The fact that no international financial agent, not even the IFIs, were willing to lend in 1989, and the fact that the government had been driven to bankruptcy by years of distributional conflict, meant that there were no longer any resources available to sustain the old system of buying political support through redistribution and subsidies. Consequently, Carlos Menem, notwithstanding the populist rhetoric which brought him into power, was forced to deal with new economic realities. Once convinced that policy reform was the only way out, Menem implemented structural reforms with surprising single-mindedness. The Bank and the Fund's loan conditionality had little role to play in this policy transformation, although their subsequent financial support helped thereafter to sustain the program.

2. Bolivia

The 1952 revolution and policies to 1985

Sachs and Morales observe that Bolivia's economic recovery since 1985 was as extraordinary as its economic crisis during the first half of the decade (1988: 9). Perhaps one of the most remarkable features of this transformation was that it involved a reversal of the 1952 revolution by the very man who had led workers, peasants and displaced middle classes in revolt against an oligarchic elite thirty-three years earlier.

The 1952 revolution was a culmination of the political uncertainty and unrest stemming from the collapse of tin prices at the beginning of the Great Depression. Bolivia had been heavily dependent on the export of tin ever since the fall of silver prices and depletion of deposits in the nineteenth century. The country's mono-commodity export structure was a direct result of its geographic features: a very large, sparsely populated, land-locked country with a forbidding terrain like Bolivia can viably export only those products for which a high value per unit weight can overcome high transport costs (Sachs and Morales, 1988: 13). This resulted in a highly skewed and dependent economic structure, and a political order where landholding and exporting elites monopolised key resources, such as land and capital.

In the 1930s, the collapse of tin prices and the disastrous Chaco War with Paraguay undermined the economy, made chaos of public finance and debilitated the oligarchic political system. The latter had been controlled by La Rosca, the three tin magnates who controlled 80% of tin production, and who had extended their control into banking, commerce and transport. The economic crisis laid the foundation for sectors of the middle class to unite with the working class to form a broad revolutionary movement which was led by the Movimento Nacionalista Revolucionario (MNR) (Gamarra and Malloy, 1990: 365–66).

The 1952 Revolution saw the setting up of an economic structure governed by 'state capitalism'. The largest tin mines were nationalised and transferred to a new state mining corporation, COMIBOL. An effective land reform destroyed the old hacienda system, and the public sector was assigned the responsibility for capital formation in both manufacturing and infrastructure. The statist model was expected to provide a political answer to Bolivia's highly unequal income distribution and the concomitantly skewed distribution of political power.

Nevertheless, the concept of more equitable growth through a large state sector became a natural prey to the distributional conflict among various sectors of Bolivian society, each of which looked to the central government to satisfy its particular distributional agenda. Thus, leftist or populist leaders repeatedly turned to inflationary finance, foreign aid or foreign borrowing to permit higher wages and increased employment in the state sector. Governments on the right, in contrast, bolstered segments of the private sector through subsidies, financed not by higher taxes but by reducing public sector wages and through foreign borrowing. Occasionally, military leaders intervened, sometimes to forestall redistributionist actions by destroying unions and leftist politicians (the administrations of General Barrientos (1964–69) and Colonel Banzer (1976–78) for example), and sometimes to indulge in populism themselves (Alfredo Orando (1969–1970) and Juan Jose Torres (1970–71)).

Sachs and Morales point out the far-reaching consequences which the distributional conflict and the statist development model had on economic policy and performance (1988: 19). Foremost among these effects was fiscal indiscipline in the face of a growing public sector coupled with the weak capacity of the state to overcome opposition from high income groups and institute necessary tax rises. This was accompanied by the deep politicisation of almost all instruments of economic policy because of their potential distributional uses. Problems were deepened by uncertainty among private investors created by the alternate swings from leftist to rightist regimes with widely different agendas. To cap it all, successive governments began to regard the public purse as a private slush fund to which they could help themselves for personal gain and political patronage.

Bolivia's rapid accumulation of external debt in the 1970s reflected increasing dependence on 'borrowed money and borrowed time' as a quick fix to the internal distributional conflict. The overvalued exchange rate maintained through foreign borrowing also created its own constituency as it became a one-way bet for flight capital. Consequently, Bolivia's debt problems assumed crisis proportions before the international crisis of August 1982. By 1981, Bolivia had already been forced to reorganise its foreign liabilities, as fresh foreign credits began to dry up. Unwilling or unable to raise taxes or contract expenditure, successive governments (there were nine heads of state during a chronically unstable period between 1978 and 1982) resorted to seigniorage financing to bridge the fiscal deficit. In 1981 the economy was rocked by the commodity price slide and the steep rise in international interest rates. Real GDP declined by 0.9% in 1981 and by 8.7% in 1982. Price levels rose by 308% during the same period (Sachs and Morales, 1988: 22).

Siles Zuazo's government which came to power in October 1982 inherited this economic mess. His administration was the first elected government in 18 years and was comprised of a coalition of the left-wing faction of the MNR and a number of leftist parties. As such, the new government was extremely vulnerable to populist pressures. Siles sought to deal with the crisis by at least five stabilisation attempts designed to satisfy the IMF and the private sector. Each of these was sabotaged either by his opponents or his so-called allies in Congress. While Siles's coalition partners could never agree on policies to reduce expenditure, his government's right-wing opponents in Congress rejected all proposals to broaden or stabilise the tax base (Sachs and Morales, 1986: 28). Meanwhile, the major labour federation, the Central Obrero Boliviano (COB), staged strikes and demonstrations in protest at the austerity measures. Inevitably the government modified the package to the point of undermining its effectiveness, thereby provoking the exasperation of the IMF and the emergent private sector (Gamarra and Malloy, 1990: 371).

The Bolivian hyperinflation of 1984–85 was clearly the most dramatic symptom of the crisis, rocketing from annual rates of several hundred percent in 1982 and 1983 to 25,000% per annum by 1985 (Sachs and Morales, 1988: 9). It was not only the deficit dynamic which drove inflation, with the government unable to cut back public spending in the face of falling foreign credits, declining tax revenues and increasing debt service payments. As pointed out by Pastor, the Bolivian hyperinflation also reflected a wage-price spiral which careered out of control due to the 'political and policy paralysis' of the Siles administration (1991: 214). For example, one of the government's early measures included a 100% indexation of the minimum wage. By April 1984, the government promulgated a policy of 100% indexation for all wages. Also in April 1984, the major labour federation, the COB, staged a national strike to protest against a new stabilisation package following a visit to La Paz of an IMF mission. The strike forced the government to meet the COB's demand to stop servicing external debt.

The turning point in 1985

In December 1984, Siles was pressured into relinquishing power a year earlier than expected owing to the crisis situation. The 1985 elections failed to give any candidate a clear majority. Former dictator Hugo Banzer polled the highest percentage of votes but did not control a Congress dominated by the centre-left parties, which decided to ally themselves with the MNR. Thus, Congress elected Victor Paz Estenssoro of the MNR for his fourth term in the Presidency on 6 August 1985.

Clearly, the new administration's first priority was to resolve the economic crisis. The 'New Economic Policy' (NEP) was unveiled only three weeks after the government came into power on 29 August 1985. Undoubtedly, the programme came as a surprise for the MNR and the leftist groups which had supported Paz's election, as it represented a dramatic dismantling of the state capitalist development strategy established by Paz and the MNR after the revolution, and reinforced by subsequent regimes. It was, moreover, an orthodox stabilisation attempt at a time when neighbours such as Mexico, Argentina and Brazil were following heterodox approaches to resolve their macroeconomic crises. The NEP encompassed not only plans for macroeconomic stabilisation but also for trade liberalisation, administrative and tax reform, and deregulation and privatisation in the domestic economy.

The fiscal part of the programme was to embrace a five-point strategy which included:

(1) a stable and unified exchange rate backed by tight fiscal and monetary policies;

(2) increased public sector revenues, via tax reform and improved public sector prices;

(3) a reduced public sector wage bill, through reductions of employment in state enterprises (particularly COMIBOL) and reduced real rates of compensation;

(4) an effective elimination of external debt servicing, through a combination of rescheduling with official creditors and a unilateral suspension of payments to foreign private creditors until a more fundamental debt settlement could be arranged; and

(5) a resumption of concessional foreign financial assistance from foreign

governments and the IFIs (Sachs and Morales, 1988: 28).

Who designed the NEP? The official position was that the stabilisation measures were drafted by a group of Bolivian technocrats led by the US-educated Gonzalo Sanchez de Lozada (Cariaga, 1990: 42). However, Jeffrey Sachs of Harvard University was involved in preparing the document that served as the basis for the early stabilisation policies of the newly-elected Paz Estenssoro government. Sachs later became a day-to-day adviser on the implementation of the programme over a two-year period (Harberger, 1988: 4).

There is also evidence that the technocratic group maintained a continuous dialogue with the IFIs, particularly with the Fund. But neither the IMF nor the US Agency for International Development took seriously the decision by the government to carry out a drastic adjustment programme. The Inter-American Development Bank and the Andean Development Corporation provided only limited financing to Bolivia, although they showed great interest in the outcomes of the programme. The World Bank announced its full support but a year elapsed before its first loan was disbursed (Cariaga, 1990: 42). Bolivia had lost its credibility abroad to such an extent that the IFIs were understandably wary of extending further credit.

Even though the Bolivians maintained a dialogue with the IMF, it was clear that, at a crunch, the team followed Sachs's advice rather than the Fund's. For example, while IMF officials argued for wage adjustments and further depreciation of the exchange rate, Jeffrey Sachs argued that stabilising the exchange rate was the key to eliminating the vestiges of hyperinflation. The government followed Sachs and drew down international reserves (Pastor, 1991: 225). The break in hyperinflation began more than a week after the inception of the programme, when inflation fell from a rate of more than 50% per month to zero almost immediately. Bolivian policy-makers thereafter followed the principle that the key to price stability was a stable unified exchange rate protected by tight fiscal and monetary policies (Sachs and Morales, 1988: 29).

Given the volatility of Bolivian politics, the fundamental question is how and why Paz Estenssoro pushed through the orthodox shock of the NEP. Although the programme was considered by many as Paz's treason to the revolution, it represented a new pragmatism on the part of the veteran political leader, necessary to deal with the hyperinflation, which virtually destroyed the functioning of the economy, and the collapse of a state mining system constructed on the basis of a tin industry rapidly going out of existence. Traditional positions were abandoned, radical reforms accepted and Paz pursued the NEP outside, even against, the old party structure, supported young technocrats against old party bosses (Gamarra and Malloy, 1990: 373).

Implementation of the NEP depended on two key political factors: the ability of the government to control labour and its ability to push reforms through Congress. Paz

Estenssoro struck a political truce with the major right-wing opposition party, the Accion Democratica Y Nacionalista (ADN) of Hugo Banzer. The Pacto por la Democracia between the MNR and Banzer's ADN was signed on 17 October 1985. The pact did not establish a governing alliance but an agreement through which the two parties agreed to cooperate in Congress to push through the Decree Law 21060 enacting the NEP and related legislation.

The pact enabled the government to impose two congressionally-sanctioned states of siege aimed at organised labour. Paz's strategy to control labour was drastic. When the government's freeze of public sector wages and elimination of wage indexation produced labour protest, the government detained 30 union leaders and confined 145 others to remote river ports. As the programme progressed, it sacked many tin miners, thereby effectively destroying the country's most powerful labour union (Pastor, 1991: 226). Paz also used the pact to pass a far-reaching tax reform programme, three budgets and a new electoral law through Congress. As Gamarra and Malloy put it, 'the pact resolved the structural impasse between executive and legislative authorities that had plagued the Siles government and ended the thirty-year threat of the COB to incumbent governments' (1990: 373).

The Bolivian stabilisation process was highly 'orthodox', eschewing all wage and price controls. The currency was devalued; a new and free-floating exchange rate established; all price and wage controls eliminated; and public sector prices substantially raised. The latter included the elimination of all government subsidies, including those on bread and other foodstuffs, and subsidised rates and fares charged by public services and utilities were also abolished (Sachs and Morales, 1988: 37). Government expenditures were severely restricted and the real wages of government employees were reduced. Along with the fiscal shock, the government implemented major tax reforms, including the imposition of a VAT system which went back to many of the recommendations of the 1970s Harvard tax advisory group known as the Musgrave Commission. Paz Estenssoro also undertook a systematic attack on the state bureaucracy by dismantling the COMIBOL that was fiercely supported by the mineworkers' union. Between 1985 and 1987, COMIBOL's workforce was reduced from 30,000 to only 7,000 (Klein, 1992: 275).

The stabilisation programme was successful despite large adverse shocks that hit the economy. In October 1985, the International Tin Council, an organisation of 32 nations which purchased tin for support purposes, went bankrupt and the international tin market collapsed. While this may have helped the government in its conflict with the miners, as Klein suggests (1992: 276), the terms of trade deterioration further squeezed real incomes. Nevertheless, the rise of an illegal and parallel coca economy to some extent helped Bolivia to absorb the balance-of-payments effects of the tin market collapse and provide alternative employment for displaced workers. However, even the price of coca plummeted from late 1985. Moreover, depressed oil prices and the failure of Argentina to keep current on its payments for gas imported from Bolivia forced the government to transfer funds to the oil company and regional governments. The combined losses from these shocks exceeded US$150 million in 1987.

Nevertheless, credibility at home, boosted by the stabilisation measures, led to the repatriation of more than US$260 million in flight capital and the government used these inflows to offset the effects of external shocks (Cariaga, 1990: 45). This repatriation of capital helped ensure the success of the programme until credibility was restored with international lending organisations.

It is clear that IFI conditionality did not play a catalytic role in Bolivia's turning point. The IFIs did not take the government's assured intentions of undertaking reforms seriously, and therefore there were no credit arrangements with either of the two institutions in operation at the crucial stage of reform (see Appendix Table) although the Bolivians did maintain a useful policy dialogue with the IFIs throughout.

Developments after 1985

Paz's government was fortunate to inherit from the previous regime the total suspension of interest payments on its external commercial debt pending a longer-term settlement. At the time of its election, total external debt was 130% of GDP and commercial bank interest arrears alone amounted to more than 10% of GDP. In contrast, the government was collecting less than 2% of GDP in revenues (Sachs and Morales, 1988: 36).

The political and economic challenge facing the government was to cut the budget deficit and obtain the support of international creditors, especially the IFIs. However, the fact that budget austerity was linked to an IMF programme made it politically impossible for the government to be seen to be cutting the budget in order to pay off foreign debt, without which international credit would not be forthcoming. A primary objective of the harsh stabilisation measures was to obtain foreign debt relief through the Baker Plan. However, the Bolivian government was turned down for assistance under the Plan on the grounds that the foreign commercial banks were not prepared to resume lending to the country (Cariaga, 1990: 50). The IMF and the US government attempted to pressure the Bolivian government at the beginning of the stabilisation programme to resume normal interest payments to the banks but the government insisted that it could not and would not undertake stabilisation coupled with debt servicing (Sachs, 1994: 514).

Finally, in 1986, the IMF accepted the Bolivian government's argument and the Bolivians were able to engineer a 'consensual default': the Fund awarded Bolivia a stabilisation programme despite the unilateral suspension of commercial bank payments. This enabled the government to 'take harsh adjustment measures without facing the charge of being the servants of foreign creditors' (Sachs and Morales, 1988: 36–37).

The agreement with the IMF enabled Bolivia to get new IMF credits, to refinance past loans coming due, and to arrange for new financing from the Bank. Bolivia was also able to negotiate a Paris Club rescheduling with official bilateral creditors, allowing it to refinance 100% of all interest and principal coming due on bilateral loans during the consolidation period of the Paris Club agreement. After 1985, Bolivia became one of the few debtor counties in the world to achieve a net inward transfer of resources. In 1987 the IMF became the sponsor of Bolivia's debt buyback operation with the commercial banks (Sachs and Morales, 1988: 37).

The NEP managed to lower inflation dramatically: by 1987 the annual rate was around 11%. GDP was stagnant between 1984 and 1985, contracted by nearly 3% in 1986 and recovered to grow at 2.6% per annum in 1987–88 (Pastor, 1991: 227; Cariaga, 1990: 53). By mid-1987 frustration with the continuing stagnation of the economy gave rise to political pressure which forced the government towards reactivation of the economy. Also, by 1988 the strategy of fighting inflation by supporting the peso had resulted in an over-valuation of the exchange rate by at least 10 to 20%. By this time, government finance was also a source of concern: the overall deficit for the consolidated public sector had risen from 4% of GDP in 1986 to nearly 10% by 1987 (Pastor, 1991: 227, 232). The government's desire to increase public investment and raise growth in the run-up to presidential elections in 1989 met with the sharp disapproval of the IMF. The Fund prevailed, the government scaling back its plans and reducing the deficit to around 6% of GDP in 1988 (Pastor, 1991: 232).

The MNR selected Sanchez de Lozada as presidential candidate for the May 1989 election on account of his growing popularity. The tensions of the electoral campaign, however, broke the Pact for Democracy between the MNR and Banzer's ADN. Gonzales Sanchez captured a plurality but the MNR was unable to form a government as Banzer's ADN and the Revolutionary Left Movement (MIR) established a coalition which provided political support in Congress, just as the Pact for Democracy had five years earlier (Gamarra and Malloy, 1990: 374; Klein, 1992: 283).

The most important factor of the 1989 election was that it amounted to a plebiscite on the stabilisation measures. None of the three leading parties challenged the NEP and the dismantling of the state capitalist system, and they won 65.4% of the vote (Cariaga, 1990: 53).

As far as Bolivia's stabilisation experience is concerned, the IFIs' role was supportive, and that mainly in a financial sense, rather than decisive or catalytic in terms of bringing about policy reform. Loan conditionality was generally of the pro forma type and did not push Bolivia in any direction in which the country's political leaders did not want to go. It can be argued that the hyperinflation was the key factor triggering the adjustment effort, causing the general populace to tolerate the general austerity and regressive distribution of the programme. Hyperinflation also illustrated vividly the financial limits of state capitalism and forced Paz Estenssoro's government into a new pragmatism. The latter in turn led to the cooperative agreement between the MNR and Banzer's ADN which enabled the programme to be pushed through Congress. Once the government had established its credibility in implementing harsh stabilisation measures, however, the financial support and cooperation of the IFIs strengthened its hand in sustaining the reform effort as in the Argentinian case.

3. Chile

Of the six Latin American countries studied here, Chile has been the most successful in implementing adjustment reforms. Moreover, it is in Chile that the reforms appear most consolidated, in the sense that major policy reversals in the future seem a very remote possibility.

Politics and policies before 1974

Like most of the region, Chile had followed an ISI since the 1930s. By the early 1950s, however, the growth dynamic of the ISI strategy had exhausted itself. Moreover, the middle-class political coalition that had governed during this period could no longer command the political support that they once had. The turn to economic orthodoxy came with the election of a political alliance led by Jorge Alessandri (1958–64), whose government was based on a coalition of rightist political parties. The new government gave extensive privileges to the private sector and allowed it to dominate the economy. At the same time the government encouraged foreign investment and restrained wages and consumption. The state's main function was to regulate the economy and assist the private sector (Stallings, 1990: 117).

Nevertheless, in the years that followed (1958–73), political coalitions and economic strategies in Chile moved increasingly leftward, towards greater state intervention and a more closed economy. Although fears of a victory by a leftist alliance caused the right-wing political parties to support the centrist Christian-Democratic candidate in the 1964 presidential elections, during Eduardo Frei's administration (1964–70) the state assumed an even more important role, while still relying on the production and investment capacity of the private sector. For example, foreign capital was sought but its operations were controlled by government guidelines. The government also instituted an agrarian reform and brought the key copper industry under state ownership. Many of Frei's reformist policies, however, cost him the support of the right (ibid.; Sigmund, 1990: 208).

The 1970 election was won by Salvador Allende, the candidate of the Popular Unity alliance of Socialist and Communist parties. The new government was bent on paving the way for a transition to socialism. Allende thus expanded agrarian reform and increased state control of foreign capital. Certain strategic enterprises were taken over (US-owned copper mines were nationalised in 1971), others were increasingly regulated. Government incurred higher public expenditure for both consumption and investment. By 1972 Chile's economy was hobbled by severe macroeconomic imbalances, with runaway inflation, and acute fiscal and balance of payments crises. Economic collapse was accompanied by a political crisis as leftist groups began to seize landholdings, while the populist government encouraged increased class polarisation. Extremists from both sides of the political spectrum soon created a state of total anarchy (Sigmund, 1990: 209).

The leftward shift in economic policy had occurred within a liberal democracy system; until the 1973 coup, Chile was one of the oldest constitutional democracies in the world. Since 1833, with only two interruptions – a short but bloody civil war in 1891 and a period of military intervention in 1925–32 – the country's political system had followed regular constitutional procedures, with extensive civil liberties and political participation. The military was seen as professional and apolitical (the army having been professionalised along Prussian lines following the end of the War of the Pacific in 1883) (Stallings, 1990: 124; Sigmund, 1990: 206).

It was only when it became clear that civilian politicians were incapable of maintaining a constitutional consensus, to re-establish the rule of law and arrest economic decline, that the military broke with their tradition of non-intervention. An added factor was that the 'military monopoly on the instruments of coercion was being threatened by armed groups' (Sigmund, 1990: 210). Military intervention was seen as justifiable when the bases for civilian administration – a functioning economy, the maintenance of law and order, and adherence to legality and constitutionalism – no longer prevailed. On 11 September 1973, therefore, the three forces and the police overthrew the Allende government in a one-day coup that included the bombing of the presidential palace.

The coup of September 1973 was a watershed in Chilean history. The military project which emerged subsequently has to be seen as 'a reaction against the heightened level of class conflict during the Allende government, against the existence of a Marxist left in general, and specifically, against the Allende government's efforts to use the state as an agent for social transformation' (Oppenheim, 1993: 117). In essence, the armed forces planned a complete transformation of Chilean politics and society. The military project was two-phased. In the first phase, the military aimed to depoliticise the country by attacking and eliminating leftist political groups and old institutions and practices. Then the military aimed to replace these elements with new political and economic institutions and cultural values (ibid.: 118). The extreme free market economic strategy which the military leaders were to follow needs to be seen as the reaction of the military regime to Allende's socialist interventionism, as an attempt to reverse the dirigiste trend of the last decade. In a short while, the military government degenerated into the personal dictatorship of General Augusto Pinochet (Sigmund, 1990: 213).

The IFIs played a minimal role in Chile's affairs during the Allende years, there were no Fund stand-bys operational during the period. The Bank entered project loan agreements with the Chilean government in the areas of education (1970) and roads (1970). However, these loans are likely to have offered little leverage for influencing government macroeconomic policy (see note to Appendix Table).

The turning point, 1974–76

At the time of the 1973 coup, the armed forces knew little of economic matters. Since many of the military leaders distrusted civilians, they held virtually all ministerial posts during the first year of their rule. At the same time, there were other groups who had the ear of military men, among them two contending groups – the *duros* (hardliners) and the *blandos* (moderates). The former maintained a strident nationalistic position plus a belief in strong authoritarian government. The latter, in contrast, were not committed to long-term military rule and did not necessarily see the need for a strong, authoritarian state.

The 'Chicago Boys' formed part of the latter group. Economists by profession, most of them had been trained at the University of Chicago as a result of an exchange programme set up with the Catholic University in 1956. Besides a common educational experience, members of this group shared social and cohort ties. The world-view taught by the Chicago school was dominated by the thinking of Milton Friedman and Arnold Harberger. But Oppenheim argues that it is probably Frederick Hayek 'who stands as the true intellectual father of the Chicago Boys' (1993: 148–49). Hence, the world-view to which this group subscribed accepted that private property was sacrosanct; and that the state was to be non-interventionist, allowing market forces to operate as freely as possible with minimum government regulation and maximal privatisation. As such, they rejected the Allende model completely.

The Chicago Boys had already prepared an economic plan by the time of the coup, based on the view that Chile's economic ills stemmed from a closed and highly protected economy and excessive government intervention (Pinera, 1994: 227). When the military junta came to hear of it and realised it contained the antithesis of Allende's Marxist model, they saw the plan as the means to eradicate the 'cancer of Marxism' from Chilean politics and economics. The fact that the Chicago Boys were technocrats rather than politicians, whose first loyalty was to their profession rather than to any political party, made them doubly attractive to the military as a group which could be put in charge of implementing the plan (Oppenheim, 1993:

149). So, when Fernando Leniz was named Minister of the Economy as early as October 1973, he appointed one of the Chicago Boys, Sergio de Castro, as his adviser. Other Chicago Boys were also placed in positions within the government (Oppenheim, 1993: 150).

At first, the liberalisation programme was adopted gradually. The pace of implementation accelerated in April 1975 following a visit to Chile by Milton Friedman. By that time, the most pressing problem facing the military junta was rampant inflation, which by official statistics reached 505% in 1974. During his visit, Friedman fervently advised strict adherence to a free market model and on 24 April the Pinochet government announced an economic recovery programme that consisted of a set of extremely strict monetarist prescriptions along the lines Friedman had recommended. The programme came to be popularly known as the 'shock treatment', and its successful application ensured the dominance of the Chicago Boys' paradigm (Oppenheim, 1993: 127–28, 150).

From 1976 onwards, the free market ideas of the young technocrats were applied 'in almost textbook fashion' to 'detoxify a state-hobbled economy' (Stallings, 1990: 118; Pinera, 1994: 228). By this time, the Chicago Boys held virtually all the important economic posts, while Sergio de Castro, as Minister of Economy and then Finance, played a pivotal role for the group (Oppenheim, 1993: 150). Government expenditure was ruthlessly pruned back and the fiscal deficit eliminated. Many public firms were returned to their previous owners or sold at knock-down prices. Tariffs were lowered from an average of 100% to a uniform 10%, and the capital markets deregulated (Stallings, 1990: 119). The problem of inflation was tackled first by controlling monetary expansion and the government deficit. When this failed to yield positive results, the exchange rate became the main stabilisation tool and was pegged to the dollar from mid-1979 (Moran, 1989: 492–93).

There were two Fund stand-bys operational in Chile from January 1974 to March 1976. The agreements with the Fund reinforced support for demand-reduction policies (Stallings, 1990: 122), as they included the standard measures of public expenditure restraint, limits on credit expansion, and exchange rate reforms, among other stabilisation measures. However, it is unlikely that the conditionalities attached brought about the complete sea change in economic policy-making that was occurring in Chile. The conditions, being consistent with the general re-orientation in economic policy, were of the pro forma rather than the hard core variety, and did not push the military government in any policy direction in which it did not want to go itself.

Moreover, a Fund programme of that era is unlikely to have envisaged the range of intense structural reforms which Chile actually undertook, such as liberalising capital markets. Even developed countries like Britain and the United States liberalised their capital markets only in the 1980s. Chilean economic policy-making at the time was essentially a laboratory experiment in economic orthodoxy. Moreover, the government's strong commitment to reform was even more evident in its continued application of free-market principles throughout the rest of the decade when no Fund programmes were in operation. Liberalising the economy culminated in the unprecedented privatisation of social security in 1981.

It is even less likely that conditionality attached to the World Bank's project loans operational during that time had much influence on the turnaround in macroeconomic policy. During the period of upheaval, the Bank entered loan agreements with respect to highways (1974), agriculture (1975, 1976), industry (1976), and water supply and sewerage (1980). However, the sector-specific nature of these projects preclude the possibility that Bank conditionality wielded an economy-wide influence.

Developments after the turnaround, 1976–89

Ironically, the textbook application of extreme free-market policies made Chile vulnerable to the external shocks which tipped the economy into crisis in 1982 (in contrast, the other countries in the sample followed statist policies in the period preceding the crisis). Simultaneous adoption of a fixed exchange rate and a wage indexation formula led to a drastic appreciation of the peso during 1979–81. Privatisation had concentrated assets in industrial and financial conglomerates with weak capital bases, making them highly vulnerable to financial collapse. Also, financial liberalisation with excessively permissive banking legislation permitted continued bank lending to risky projects and to insolvent firms associated with the same groups that owned the banks (Moran, 1991: 471–72). Although Chile's debt/GNP ratio in 1982 was relatively low at 77.2%, the major part of it belonged to the private sector which was cause for concern (World Bank, *World Debt Tables*, 1987–88: 73).

The economic crisis constituted a setback for the Chicago Boys. De Castro was dismissed, eventually to be replaced in 1985 by another Chicago-educated, albeit more pragmatic, technocrat, Hernan Buchi. A period of adjustment of the neo-liberal model followed in which tariffs were raised to 35% and the peso devalued. The endangered banking system was taken over by the government, and the government also assumed the loans of liquidated private banks (Oppenheim, 1993: 150). Then in February 1985 a structural adjustment programme coupled with an orthodox stabilisation programme was launched. The programme focused on export incentives and the balance of payments, domestic resource mobilisation and the rehabilitation of the financial and corporate sectors. The programme was supported by a three-year IMF EFF credit and three consecutive SALs from the World Bank. Both financial packages shared the goals of a more efficient public sector, better budgetary and institutional controls, an open and export-oriented economy and a revitalised financial sector.

Stabilisation measures resulted in a devaluation of the real exchange rate by approximately 90% between 1982 and 1988. Austere fiscal and monetary policies reduced the overall non-financial public sector deficit, especially by containing wage expenditures. Limits on the Central Bank's creation of credit were established to conform to specific Fund targets. Export promotion measures included the lowering of tariffs from 35 to 30% in March 1985, to 15% by January 1988, and the elimination of stamp tax on export activities and of the VAT on investment for export promotion (Moran, 1991: 474).

To rehabilitate the financial and corporate sectors, the government created special commissions to manage the firms which it had had to rescue earlier, and to define financial programmes for their re-privatisation. Re-capitalisation of banks and firms through the provision of heavy subsidies followed. The Banking Law of 1987 strengthened the supervisory and legal framework of the Superintendency of Banks. The corporate sector was re-capitalised through Central Bank-financed debt reschedulings. As soon as viable firms regained financial strength the government began to re-privatise them.

In Chile, the provision of substantial external financial assistance by the IFIs and their role in negotiating a debt rescheduling strategy, provided the government with breathing space during which it could successfully undertake reform (Moran, 1991: 487). The Bank's three SALs in operation between November 1985 and June 1989 provided Chile with US$750 million in financial assistance, while the Fund's programmes in operation between January 1983 and November 1990 made available SDR1,389 million to the Chilean government. Approval of SAL I and the partial Bank guarantee of a US$300 million loan with co-financing, along with participation in the IMF programme, enabled Chile to reach two new debt-rescheduling agreements. Maturities amounting to US$5.7 billion due in 1985–87 were restructured, and in 1987 Chile reached a new agreement with commercial creditors to postpone payments for US$12.4 billion of maturities falling due in 1988–91. In addition, external debt instruments were converted into domestic debt certificates that could be sold on the domestic capital market, while debt-equity swaps eliminated a further US$4 billion of debt (Moran, 1991: 474–75).

Although the government has claimed that its policies represented its own ideas, the opposition points to the Fund, the Bank and private banks as the source of many of the policies. Nevertheless, even if the IFIs did assist in designing the programme, Chilean 'ownership' of it was considerable, and the high level of commitment to reform on the part of the government is seen by Bank sources as a crucial factor in programme success (Moran, 1991: 487). Moreover, the post-1985 programme saw a continuation of economic policy along the lines of the neo-liberal model pursued since the mid-1970s, albeit with some readjustment. For instance, the chief architect of the 1985 programme on the Chilean side, Hernan Buchi, was a more 'pragmatic' and 'flexible' version of the 'Chicago Boys', maintaining extremely cordial relations with business leaders, the IFIs and private banks. An additional factor making for success was that major microeconomic distortions had been eliminated and the economy reoriented towards the free market at least ten years earlier. The crucial reforms had therefore already taken place and been consolidated (Stallings, 1990: 139–40).

As a result of high government 'ownership' of the programme, conditionality attached to Bank SALs was mainly consensual. Policy implementation in export development and public finance, in particular, was so successful that the government exceeded the conditions it had agreed to in these areas; implementation of financial sector reforms were also comprehensive and successful (Moran, 1991: 486). When transgressions of conditions did occur they were not punished by the Bank. In one instance, the government seems to have backed away from its commitment to end generalised subsidies, because, in early 1988, it provided a new subsidy to allow banks to reschedule housing loans. The government also used the Copper Stabilization Fund established under the SAL programme to smooth out government revenues and to finance expansive economic policies to win votes in a 1988 plebiscite and a 1989 presidential election (Mellor, 1991: 1551). There is no evidence of the Bank withholding the release of loan tranches as punishment for non-compliance with these issues.

Nor were the modalities of Bank conditionality conducive to implementation by a reluctant government, if that had been necessary. For instance, loan conditionality was expressed in vague terms: conditions in SAL I and II merely called for a 'review of progress' in the bank re-capitalisation programme or 'satisfactory progress' on particular studies. That eventual implementation of conditions by the government was highly satisfactory implies that despite the ambiguity of loan conditionality, and the opportunity it might have afforded the government for fudging, the government itself was committed towards implementing reforms.

It seems clear, then, that while financing provided to Chile by the IFIs through the 1970s and 1980s was certainly useful and an important factor in ensuring successful programme implementation and outcomes, loan conditionality was never a decisive factor in bringing about policy reform. As we saw, the military adopted the neo-liberal model in the mid-1970s as a reaction against the Marxist-oriented policies of Allende, as part of the military government's project for transforming Chilean politics and society. Although the crisis of the early 1980s was precipitated by taking the model to its extremes, the structural adjustment which followed, with the backing of the IFIs, was a continuation of that model, albeit with some pragmatic modifications.

4. Colombia

Consensual politics and policy conservatism before 1989

The most striking characteristic which distinguishes Colombia from her one-time profligate neighbours is the traditionally conservative policy stance followed by the country's governing elites. Against this hide-bound policy-making backdrop, the structural reforms of the late 1980s and early 1990s have been nothing short of revolutionary.

In a way, Colombian conservatism in policy-making has been the outcome of the country's peculiar political system, which, 'whether by design or accident, . . . has favoured non-decisions' (Kline, 1990: 256). The system has been described as being 'quasi-democratic' and follows from the National Front of 1958–74, 'the most dramatic bipartisan coalition government in Colombian history' (ibid.: 240). Under the terms of the National Front, the two historic political parties, the Liberals and the Conservatives, agreed 'to share power rather than fight over it' (there had been six civil wars between the two parties since the 1850s) (Stallings, 1990: 150). Consequently, from 1958 to 1974, the presidency was alternated every four years between the two parties and all executive, legislative and judiciary branches were elected or appointed according to party parity.

After 1974, competitive elections were re-established, but parity in the appointment of executive and administrative positions not part of the civil service was maintained (Kline, 1990: 241). The oligarchic political structure was mirrored in the merging of public and private elites. Private sector groups were included in official organs of the state, and individuals alternated between positions in the state itself and business associations (Thorp and Ross, 1991: 2, 18; Stallings, 1990: 150).

The balance of power in Colombia's national government also militates against policy experiments. The government consists of three branches, with separation of powers and checks and balances. But even though the executive is the most powerful branch of government, projects initiated by the executive are often changed, or blocked altogether, by Congress. Kline notes that in Latin America, only the congresses of Venezuela and Costa Rica have more power than Colombia's (1990: 251). Thus, the system severely limits the type of economic policies that can be followed as any change 'would require the approval of all participant political and economic groups' (Stallings, 1990: 151).

Prior to reform in the late 1980s, one plank of Colombia's conservatism was its protectionist tariff structure, following from the ISI strategy followed before the coffee and oil bonanzas of the 1970s. In 1975, a decision to liberalise trade came to nought due to the vehement opposition from the National Association of Industries and, in particular, from the industrialists of Medellin. The government responded by liberalising imports of irrelevant items and by maintaining non-tariff barriers when local industrialists complained (Urrutia, 1994: 290). This was a ruse which Colombian technocrats were to resort to more than once. For example, in 1980, when another attempt at liberalisation was opposed by the private sector, the government liberalised only what did not create undue competition for national producers.

The 1980s attempt at liberalisation was also derailed by the economic crisis of 1980–81, triggered by a collapse in world coffee prices by 46% from the 1977 level (coffee accounted for more than 50% of goods exports). The worsening trade balance was partly compensated for by illegal coca dollars but the coffee price collapse was followed by the rise in international interest rates. Then devaluation of the bolivar destroyed Colombia's market in Venezuela and this was followed by a 64% fall in the price of coca between 1982 and 1983. By this time, the contagion effect of the external debt crisis of her neighbours closed Colombia's access to external credit, even though Colombia had not been a heavy borrower (Thorp and Ross, 1991: 4–6).

Betancur's administration (1982–86) first sought a heterodox solution to the crisis, which included foreign exchange controls and the reintroduction of import controls. But the programme was inadequate to cope with the growing fiscal deficit, capital flight, and the impact on non-traditional exports of an overvalued peso and low productivity. Meanwhile, external agencies insisted on adjustment as a necessary precondition for further loans (Thorp and Ross, 1991: 9; Stallings, 1990: 156).

A more orthodox stabilisation attempt followed in 1984, after the appointment of Roberto Junguito as Minister of Economy. The new strategy was shaped by the need to manage the crisis without recourse to an IMF stand-by; a Fund credit was politically unacceptable after an IMF-sponsored stabilisation effort of 1967 had led President Lleras Restrapo to break off negotiations with the Fund in acrimonious circumstances (Stallings, 1990: 151). Also, Junguito was convinced that the prospect of the kind of devaluation that the Fund was likely to have insisted on would have worsened the flight of capital.

It should be noted that the economic team did not see the economy as being in need of any major restructuring, only a need for 'a set of short-term measures to tide over the external and internal disequilibria' (Stallings, 1990: 159–60). Consequently, the government opted for an orthodox stabilisation strategy which combined a real devaluation, involving a depreciation of the crawling peg without an acceleration of inflation; a loan agreement with private international banks without formal IMF participation; and fiscal austerity to achieve these two objectives (Thorp and Ross, 1991: 9–11).

The principal difficulty in obtaining the needed US$1 billion credit line from the private banks was that they insisted on the IMF monitoring Colombia's macroeconomy while the Bank monitored the government's undertaking of certain structural reforms. Eventually, under heavy pressure from the US Government, the Fund agreed to monitor the economy without a formal stand-by in place. This was backed by a government statement of intention to proceed to a stand-by should the necessity arise (Schloss and Thomas, 1986: 12). Pressure from the US came from Paul Volcker of the Federal Reserve, who saw the Colombians' proposal as a model for other third world countries, while George Schultz and President Reagan supported the proposal in return for increased cooperation with US Central American drugs policy (Stallings, 1990: 158). The World Bank, with whom Colombia had good relations, granted a Trade Policy and Export Diversification Loan and a Trade and Agricultural Policy Loan, conditional on moves towards foreign trade liberalisation. These SECALs plus the monitoring arrangement with the IMF catalysed a 'jumbo' (US$1bn) credit line from the private banks.

But by the time the credit line came through it was of little relevance to the balance of payments, however, as the coffee price began to rise in October 1985 (Thorp and Ross, 1991: 14). Nevertheless, the government was still supposed to implement the conditionalities attached to the Bank's SECALs. To get round this, its officials resorted to their old tricks; Luis Jorge Garay, adviser to the Minister of Finance and trade negotiator, transferred to the free import list a large portion of the items on the restricted trade list but was careful not to liberalise imports of items that were produced locally (Urrutia, 1994: 292). The deception was successful in the short term; Colombian 'ownership' of the two Trade Policy loans was rated by the Bank as 'high' and 'very high' respectively (Johnson and Wasty, 1990: 18).

Trade liberalisation, 1989–90[1]

The turning point occurred during the last two years of the Barco government (1989–90) and took place primarily in the area of trade liberalisation. A combination of forces pushed the government towards this: pressure from the Bank in the context of reduced export earnings; pressure from exporters; the imperative to accelerate economic growth; the difficulties in enforcing protection; and the need to prevent a revaluation of the currency due to the build up of international reserves.

By 1988 the Colombian economy was again in difficulties, mainly due to exogenous shocks. From this year onwards growth of exports declined to only 1%, principally due to adverse weather conditions, a fall in the world price of petrol, guerilla attacks on oil pipelines and greater protectionism in the USA. The rise in real interest rates during this period saw a real reduction of credit to the private

[1] Much of what follows is based on Urrutia (1994).

sector. Food prices rose due to poor weather. Real wages and informal sector incomes fell. Then in 1989 the coffee pact broke down and the war against drugs reduced income from the cocaine trade (Thorp and Ross, 1991: 30–31).

By this time, Bank staff had discovered the truth about the earlier bogus 'liberalisation' and relations with Colombian technocrats had seriously deteriorated. In early 1989, the Bank made clear that its future loan programme with Colombia depended on genuine progress with trade liberalisation. Although Colombia was the only major country in the region which continued to service its debt, it was also the 'only country that was not even rhetorically supporting the conditionality of the "Washington consensus"' (Urrutia, 1994: 292). Strained relations with the Bank had become particularly awkward in a situation where Colombia was dependent on Bank loans and on favourable IFI reports to commercial banks in order that it would retain its creditworthiness.

However, by the late 1980s exporters had become a strong group lobbying for liberalisation. These included industrialists producing textiles, leather products, shoes and cement, members of the landed gentry who exported horticultural products, and agribusinesses exporting bananas and shrimps. A further incentive was the promise of important benefits for exports to the US under the Andean Trade Initiative, which were to some extent dependent on a measure of trade liberalisation.

Correspondingly, although the Medellin chapter of the National Association of Industrialists remained protectionist, the Bogota and Cali chapters had a majority of members who were for economic liberalisation in general. The slow growth of the economy during the 1980s had convinced many industrialists that the internal market was no longer a source of dynamic growth. They had also realised that the need to produce a diverse range of products, including inputs for the production of final consumer goods within a protected trade environment, raised short-term costs significantly. The fact that, by 1990, many private sector enterprises were managed by a new generation of economists, engineers and MBAs with foreign postgraduate degrees, also helped to re-orientate attitudes in private industry.

In any case, traditional protection had lost much of its effectiveness; the illegal drug trade of the 1980s had fuelled a growing trade in contraband as a way to launder cocaine dollars. For example, Urrutia estimated that, in 1982, at least 61% of all colour television sets in the country had been imported illegally (1994: 293). Furthermore, 'as society came to place increasing weight on minimizing illegal activity' (of which the drug trade was a part), eliminating the controls and regulations which had fuelled such activity made more sense (Urrutia, *Discussion* in Williamson, 1994: 326). Given the above factors, the government was encouraged to implement a gradual reduction in tariff and non-tariff barriers. Liberalisation was accompanied by a devaluation via a crawling peg in 1989–90.

During the 1990 presidential campaign, candidate Cesar Gaviria agreed to deepen the liberalisation, albeit gradually. However, this cautious approach had to be abandoned hurriedly within a year. In January 1991, the Monetary Board adopted a tight credit policy in order to control an inflation rate of more than 30% per annum. This, in turn, accelerated an inflow of foreign capital which contributed to a build-up of foreign reserves. By mid-1991 reserves covered 17 months of imports and the economic team was desperate to prevent a further increase so that a revaluation of the peso could be avoided; since the government was convinced of the need to promote nontraditional exports, floating the exchange rate, and the revaluation it would have involved, was out of the question.

The only alternative was to accelerate the trade opening, especially given the need to control inflation. 'After a night of consultations, the economic team agreed to bring forward all the tariff reductions planned for 1991–94' (Urrutia, 1994: 296–97). Consequently, tariffs plus paratariffs, which averaged 83% in 1985 – the highest level of protection in the region – were brought down to below 7% by 1992. During the same period, the coverage of non-tariff barriers dropped from 73% to 1%.

Significantly, the liberalising reforms were 'led by government officials who were professional economists and were convinced that such reforms would be necessary if the country were to resume rapid economic growth' (Urrutia, 1994: 304). By 1989 there were few economists left in government who had studied development economics at a time when planning and state-led growth were fashionable. Instead, most of them had been trained in North American universities and were well versed in free market economics. The political leadership was also biased towards economic orthodoxy. President Virgilio Barco was an engineer with a degree from the Massachusetts Institute of Technology. He was also aware of the growing international consensus on the advantages of market-based policies and free trade, having served as the Colombian Executive Director on the World Bank's Board. President Gaviria, an economics graduate, was personally convinced of the need for liberalisation.

Continuing reforms after 1990

After the government had successfully grasped the nettle of trade liberalisation, meeting with less political resistance than it had expected, it developed a surprising appetite for further contentious reforms, starting with tax reforms. In a way, these were necessitated by the trade liberalisation. In 1989, import taxes accounted for as much as 25% of total central government revenues. Liberalising imports thus had the potential to reduce government revenues substantially. In 1990, Congress passed its first tax reform legislation. The value-added tax rate was increased from 10 to 12% and its coverage extended to services. However, the government was unable to prevent Congress from increasing taxes on oil exports, nor did Congress decrease the dividend remittance tax for foreign companies, as the government wished.

The tax reform generated strong and vocal opposition from the private sector. The political skills of President Gaviria and his Minister of Finance managed to push the increase in VAT through Congress by a coalition of Liberals and the Andres Pastana wing of the Conservative Party, which favoured trade liberalisation and the substitution of trade taxes by VAT. Urrutia (1994: 310–11) also makes the point that all the revenue-generating tax reforms in the last two decades have been passed by technocratic Ministers of Finance who had no future political ambitions.

The government also instituted significant labour market reforms. There had been growing evidence that job security legislation was actually reducing job security, hence provisions for complete job security after 10 years' employment was abolished and replaced with a steeper severance pay schedule. Companies were given the alternative of hiring skilled and managerial workers with contracts which excluded fringe benefits. Furthermore, the yearly bonus (indexed to pay increases that could be withdrawn periodically without loss of indexing and be paid in full upon severance) was de-indexed and made investible in private pension funds. The generalised crisis and violence of 1989–90 robbed the trade unions of a suitable environment in which to press their opposition to reforms by calling a general strike, with its danger of associated violence.

Compared with these reforms, the liberalisation of foreign exchange transactions had an easy political passage. A constituency against the foreign exchange control regime created in 1967 had built up, as the middle and upper classes had to pay large transaction costs in order to diversify their portfolios. By the late 1970s, thousands of Colombians were involved in illegal foreign exchange transactions in the parallel market. Urrutia points out that only two groups were interested in maintaining the exchange controls, both on ideological grounds; central bank officials thought that controls made the management of monetary policy easier, while politicians identified with the 1967 exchange control legislation defended their past policies. However, a shift in power from the Monetary Board to Congress weakened the influence of the central bank conservatives, while the old-guard interventionist politicians were outnumbered in Congress by a new generation which knew that legalising private foreign currency accounts abroad was popular.

To sum up overall on the part played by the IFIs in Colombia's policy transformation, in the first phase of stabilisation it appears to have been limited to catalysing the negotiation and disbursement of the large commercial loan. At this stage, the Bank was unsuccessful in inducing structural reform, because the political timing of the reforms was not right and because the technocratic team of the day did not see any need for it.

However, as the Barco administration entered its second year, obtaining commercial bank finance became harder and, with the economy hit by a series of external shocks, implementing the conditionalities attached to Bank financing must have seemed unavoidable. Fortunately for Colombia (and the Bank), the political and policy-making environment was conducive to reform: exporters had become a politically significant constituency in favour; there was the gradual realisation that liberalisation was needed to accelerate economic growth; enforcing protection had become difficult in any case; and trade liberalisation became the only means by which a revaluation of the currency could be avoided. Above all, the composition of the technocratic team had changed to include young orthodox economists. Once they realised that liberalisation would be politically acceptable, they pursued the reforms with as much tenacity as their predecessors had guarded their trade barriers.

Given the multitude of pressures pushing towards reform, it is virtually impossible to point to Bank conditionality as the catalytic factor which brought about the policy change. The key factor was the emergence of a political climate conducive to liberalisation.

5. Ecuador

In our sample of Latin American countries, if Chile stands out as the pioneer even in relation to the IFIs, then Ecuador must surely stand as the country which has not yet made the transition. Ecuador's political conundrums have proved too intractable for successive governments to implement and sustain the kind of far-reaching reforms executed in neighbouring countries, where political economy obstacles to reform were dealt with so as to allow reforms to go through. Nevertheless, even if Ecuador's reforms have not matched the range and intensity of those of her neighbours, some of the more successful reforms that were enacted represent significant changes in economic policy at that time.[2]

Dutch disease and regionalism before 1984

De Janvry et al. observe that Ecuador's incomplete performance in both stabilisation and adjustment derive from the economic, social and political features of its institutions of policy-making and implementation (1994: 39). The principal influence on economic policy-making is the sharp economic, social and attitudinal difference between the coast and the sierra. The coast produces the more tradable goods: agro-exports (first cocoa, then coffee, finally bananas) and agro-industrial goods. The services sector, including finance and commerce, is directly linked to coastal tradable activities. In contrast, the sierra economy is tied to the production of wheat, wool and dairy products principally for the domestic market. After the

---

[2] Much of what follows is derived from De Janvry et al. (1994).

discovery of oil in 1967, economic power shifted from the coast to the government in Quito. Consequently, the sierra also absorbs oil rents, in the form of employment in government and the military, and operates import-substituting industries (Mosley, 1991: 412).

Given this sharp contrast in the regional economies, coastal business interests prefer a competitive exchange rate and liberalised trade, whereas for the sierra continued access to public rents, protection and an over-valued exchange rate are the preferred options. There is hence no consensus on policy among business elites, and any policy change that tinkers with the conditions of trade is loaded with highly redistributive effects. 'The result has been stifling on policy initiatives as any policy move is supercharged with inter-regional redistributive implications. With population about equally divided between coast and sierra, a policy stalemate is the frequent outcome' (De Janvry et al., 1994: 39).

As far as the political system goes, the country has been a republic governed by an elective legislature since 1830, interrupted by four interregnums of military government in 1925–31, 1937, 1963 and 1972–79. Political parties are a relatively new feature in Ecuador, long penetrated as it has been by an authoritarianism and personalism providing strong paternalistic leadership (Martz, 1990: 381). Democratically elected presidents have always had to protect their power base by trying to cobble together a package of policies which will command the support of both coast and sierra interests (Mosley, 1991: 414).

Ecuadorian society is also organised in a wide variety of social movements and communal organisations. Corporatist bodies representing trades and labour dominate these organisations and, given the weakness of the political parties and the populist nature of Congress, corporatist organisations play a direct role in policy-making. As a result, instead of being mainly resolved within civil society, conflicts are transferred to the political realm. Consequently, the executive has to deal directly with a great multiplicity of political actors with 'atomised agendas and demands, motivated by predatory gains as opposed to a vision of social gains'. De Janvry et al. further note that the executive, as a result of being exposed to conflicting pressures, is invariably caught between trying to maintain a policy agenda with some consistency while at the same time satisfying clientalist demands to maintain continued political support (1994: 41–42).

The origins of the country's economic crisis of the 1980s lie in the manner in which the government responded to the oil boom of the 1970s. Between the early 1970s and the middle 1980s, petroleum exports rose from a negligible proportion of GDP to over 70% (Mosley, 1991: 413). The government absorbed revenue from oil by financing a range of domestic expenditures whose growth exceeded that of the revenues themselves. For instance, from 1973 to 1982, 80% of petroleum revenues were captured by the government. Over half were spent on subsidies, in particular on oil derivatives for domestic consumption. The remainder went to an expansion of the state sector, import-substituting industrialisation, and to subsidies and investment in energy, transport and infrastructure. In the meantime, non-petroleum export revenues declined. The large public sector deficits which resulted were financed by the accumulation of external debt. When the deficits fed through to the balance of payments and exerted upward pressure on the real exchange rate, no attempt was made to correct the situation (Mosley, 1991: 414).

The combination of Dutch Disease and import substitution had distorted the economy and left it highly vulnerable to external shocks. Oil prices fell by 15% in 1981 but foreign borrowings continued to rise and the current account became strongly negative. The government of Osvaldo Hurtado was forced to devalue the sucre in 1982, the first devaluation in 11 years. The rise in international interest rates was a further blow. The subsequent debt crisis dried up commercial credit to Ecuador. The government tried to reduce the payments deficit by restricting imports but the growing public sector deficit and inflation made it realise that tougher measures were needed.

President Hurtado's advocacy of fiscal restraint and his attempt to deal with the fiscal imbalances by raising taxes and cutting expenditures met with fierce opposition from private business, however, especially from coastal chambers of production. Ever since the shift in the country's power base from the coast to the sierra, following the oil boom, Guayaquil (coastal) business groups had felt excluded from policy-making circles. This time, they feared they would be unable to defend their interests effectively in the face of changing economic policy. The president's attempt to forge a social pact with business (which was asked to keep real wages steady and not seek quick profits), labour (which should scale down wage demands) and political representatives (who were asked not to press for excessive government expenditure on pet projects) met with a barrage of criticism from all quarters. Ecuadorians still believed that the oil reserves would allow them to maintain the benefits to which they had become accustomed, while public sector employment, stable fuel prices and exchange rates, inexpensive imports and all manner of subsidies had come to be viewed as entitlements by the general public.

In an attempt to keep the economic team at least insulated from purely political pressures, Hurtado appointed new heads to the Monetary Board, the Central Bank and the Ministry of Finance. The team replaced the existing set of fixed interest rates with a more simple structure and carried out a selective devaluation. A stabilisation programme was announced alongside, many subsidies were revised, immediate-payment requirements for imports removed, a new luxury tax levied, and exports encouraged through a rationalisation of tariffs, export insurance and other incentives to agribusiness in particular. This programme, too, met with opposition from all sides: labour objected to its impact on the cost of living; coastal agriculturalists protested because their crops required greater imported inputs than highland farms; even agricultural exporters, otherwise happy with the devaluation, complained that official prices for coffee and cocoa were too low.

The government made two more attempts at stabilisation with little success. An October 1982 austerity package, designed to lower the fiscal deficit, included a 120% increase in gasoline prices, and removed the wheat subsidy. Taxes were raised on beer, cigarettes and several consumer durables. However, the resulting widespread protests nearly toppled the government, and confined ministers to the presidential palace for days for fear of being assaulted. The government soon began to back off from many of the measures. A 15% wage increase plus a bonus to offset higher transport fares was decreed in November, after a series of national strikes. This illustrates De Janvry et al.'s point that in Ecuador 'there is neither consensus nor a hegemonic bloc supporting or opposing the reforms among either the corporatist or the populist pressure groups' (1994: 52). As a result, the executive is forced to assume policy leadership and then find itself strongly resisted 'by a constellation of pressure groups'. Consequently, successive attempts by the IFIs to achieve policy reforms through conditionality during this period came to little.

A March 1983 package fared little better. During negotiations with the Fund and the private banks over a stand-by loan and the rescheduling of debts due by the end of 1983, the IMF demanded a typical austerity package, including devaluation, limits to public external debt and Central Bank credit expansion, an increase in controlled prices and a gradual elimination of protection of industries and export subsidies. The package was greeted by labour and business with a joint strike/lockout. Even the Vice-President characterised the package as a knuckling under to international pressure, to the detriment of the country's growth prospects.

Coincidentally, extensive flooding along the coast devastated export and food crops, causing a 35% drop in export crop production. Combined with a highland potato blight, the floods resulted in an 80% jump in food prices. It was later in the same year that the first proposals were made within the World Bank for an agricultural sector operation were made. A Bank report of the time noted that the country's agricultural land was under-utilised and that past performance of agriculture had been poor, due in large measure to past governments' trading and pricing policies (World Bank, 1984: 8, cited in Mosley, 1991: 417). Mosley further notes that the social-democratic coalition government of Osvaldo Hurtado 'shared the diagnosis in considerable measure' (ibid.). The government devalued the sucre once again in 1983, so that between 1982 and mid-1984 the currency had been devalued by 65%, and import controls were removed on a number of items. 'Aware that it was swimming with the tide, the Bank drafted a modest set of reforms as conditionalities for an Agricultural Sector Loan in May, 1984' (ibid.). Associated conditions included the removal of taxation on the country's main agricultural exports, a restructuring of the public investment programme, a reform of the principal agricultural development bank, and, certain limitations on the scope of official minimum producer prices.

The 1984–86 turning point

Although the austerity measures implemented by Hurtado aided in scaling-down Ecuadorians' expectations of the role of their government, a full-fledged adjustment programme was implemented only after the election of Leon Febres Cordero in August 1984. As a former head of Ecuador's largest agro-export conglomerate and former president of the Guayaquil Chamber of Commerce, Febres was an outspoken advocate of coastal business interests. With his election, the former agrarian elites in coastal agro-exporting and banking circles regained control, having been gradually pushed out of policy-making during the preceding decade (De Janvry et al., 1991: 1579). Febres also proclaimed an affinity with the neo-liberalism of Ronald Reagan and proposed to win over international investors and creditors by becoming a model debtor and removing remaining trade restrictions (ibid.).

The new president's right-wing coalition, which included a number of bankers and exporters from the coast in ministerial positions, saw the advantages of a competitive exchange rate and open trading policy. The reform impetus was further strengthened by the Frente Progresista – a reformist bloc – which controlled the unicameral Congress (Martz, 1990: 383). By the end of 1984, the currency had been further devalued in real terms and generous measures undertaken to attract foreign investment. In March 1985, the government obtained a second IMF stand-by which called for continuing public austerity and set limits on public domestic credit. The government successfully cut total spending by paring current expenditures. It also managed a modest increase in capital expenditure. Public utility rates and petroleum prices were raised, and the IMF-imposed credit ceiling on the public sector produced a substantial budget surplus in 1985. The Fund programme also required slower monetary growth and the creation of a new savings instrument with market-determined interest rates. Helped by agriculture's recovery from the disastrous floods of 1983 and its strong response to the incentives created by real exchange rate depreciation, GDP growth revived to 4.2% in 1984 and 4.3% in 1985, and inflation reduced from 48% in 1983 to 28% in 1985. Unlike the failed attempts under Hurtado, Febres's stabilisation was clearly a success (De Janvry et al., 1991: 1580).

On its own initiative, the government removed export taxes on the three major export crops – this had been one of the major elements of the World Bank's original draft proposal for the Agricultural Sector Loan. Such measures favouring coastal exporting interests were to be expected from a government made up of Guayaquil businessmen. A team of young technocrats with a broad commitment to economic liberalisation was despatched for negotiation of a Bank SECAL between 22 April and 10 May 1985. Two members of the team, the Minister of Finance, Francisco Swett and the economic adviser to the president, Alberto Dahik, both had experience of working inside the IMF and the World Bank respectively (Mosley, 1991: 417–18).

Unfortunately, the Bank's Latin America Department chose this moment to go in for 'overkill'; it insisted on a considerable toughening of the reform programme originally proposed. Thus, over and above the policy changes sought in the original draft manifesto, the Bank demanded that the 85 different concessionary interest rates offered by the central bank to agriculture be replaced by one lending rate. Moreover, the Bank wanted the government to establish free trade in food crops. The latter included the elimination of quotas on the imports of agricultural products and their substitution by tariffs; elimination of the consumer price ceiling on wheat flour; and elimination of purchases of maize and rice by ENAC (the national food storage and marketing association) or other public enterprises intended to support minimum wholesale prices.

Mosley argues that, 'these proposals amounted to an assault on the entire apparatus by which the Ecuador Government sought to win the support of certain sections of the rural population. In particular, they were guaranteed to antagonise all Sierra cereal farmers, and to make it difficult for the Government to retain any responsibility for food security' (1991: 419). Besides which, even if it had been possible to overcome the political obstacles to these reforms, it would have been for little economic benefit. The reason for this was that although orthodox economic theory predicts that the removal of controls on competition would encourage those unsuccessful in competition to switch to higher-yielding activities, this did not apply to wheat and maize farmers in the sierra. These farmers could, in effect, grow only potatoes plus whichever of the two other crops they did not currently grow. There were no higher-yielding alternative crops to switch to.

While the Ecuadorians were ready and willing to go along with a floating exchange rate, provision of incentives for exporters, and a unified system of interest rates, they did not want a dissolution of ENAC. However, once they made their position clear – a position which was not accepted by the Bank's negotiators – they 'gave in gracefully'. In Mosley's words, 'They needed the money urgently; they were agreed in spirit with a large part of the package; and they knew from their previous experience as Bank and Fund employees that if the conditions were drafted with sufficient care, there would be plenty of scope for a fudge when the time came to release the second tranche' (1991: 420).

No sooner had the Agricultural SECAL been signed than Ecuador was hit by a sharp drop in the price of petroleum which plummeted from US$25.8 per barrel in 1985 to US$13.9 in 1986. The government sought an IMF stand-by, and raised taxes and the charges for electricity, water and telephone services. It also floated the exchange rate in August 1986 (Mosley, 1991: 423).

As far as programme implementation went, Ecuador scored a 'Good implementation' from the Bank on the trade liberalisation condition for the release of the second tranche, because of the floating of the exchange rate, and freeing of interest rates on all transactions apart from central bank credit lines. But as we saw, floating the exchange rate represented 'a rational pursuit of self-interest for most members of the Febres government', which was largely made up of coastal business and banking interests, and was therefore pro forma rather than hard core conditionality. Ecuador was also rated with 'Satisfactory implementation' on the public investment programme. This was mainly due to the fact that when the second tranche review was taking place in early 1987, the government, being under severe financial pressure, shelved the Santa Elena irrigation project which the Bank specifically requested the government to abandon. This project, intended to irrigate cotton, wheat and maize in the Santa Elena Peninsula, was the pet project of the Minister of Agriculture, however, and in 1988 the government obtained joint financing from the IDB and a Brazilian private bank and went ahead with the project anyway.

Implementation of all other conditions was unsatisfactory. This was hardly surprising because they related to all those instruments which the Bank considered to be barriers to efficiency but which were vital to the government 'to purchase the loyalty of its rural clientele'. Mosley shows that the withdrawal of the maximum consumer price of wheat flour, as requested, was 'a piece of sleight of hand'. This was because the key element of protection for cereal farmers – including the President himself, who was a wheat farmer on a large scale – was a producer price substantially above the level of import parity. Thus, the support prices for wheat, as well as the import quota on wheat, continued to protect the incomes of producers throughout the life of the SECAL (Mosley, 1991: 427). Similarly, the government never got round to privatising ENAC, since it was the main instrument by which the Government could claim to be taking responsibility for the food security of the country.

Although the technocrats who negotiated the SECAL had a genuine desire to unify the complex structure of interest rates and free it from government controls, this again attacked one of the selective rural benefits most needed by the government to counterbalance the 'urban bias' of its trade and public investment policies. When the Minister of Finance attempted a minimal freeing up of interest rates in August 1986, he was immediately subjected to a vote of no confidence by the opposition-dominated Congress and lost his job (Mosley, 1991: 428). The unfinished business of the SECAL in this area was picked up by the World Bank Financial Sector Loan of December 1987. The negotiators of this loan were less ambitious in setting real interest rate targets, the Bank's bargaining position having been weakened by the existence of another lender – the Inter-American Development Bank – offering credits to the Banco Nacional de Fomento without any insistence on changes in lending policy (ibid.: 429).

Thus, there was serious slippage in implementing five of the seven loan conditions to which the release of the second tranche was to be subjected. The government resorted to 'strategies of obfuscation and pleas of *force majeure* . . . with considerable success to escape punishment for what, by the Bank's criteria, was not a good implementation performance' (Mosley, 1991: 423). The government was aided in this by discrepancies in the wording of the policy conditions presented to the Executive Board of the Bank and that agreed to by the Ecuador government in its Letter of Development Policy, which enabled the government to fudge implementation. For example, formal conditionality asked for the 'elimination of the maximum consumer price on wheat flour' while the LDP offered only to 'reduce the control of consumer prices' (ibid.: 422).

In the event, the Bank found mitigating circumstances in all cases of 'unsatisfactory' implementation and the second tranche was released. Mosley attributes the Bank's leniency to the fact that it was in the midst of internal reorganisation; that the Bank country desk was under strong pressure to spend and thus earn a return on the money that was budgeted for their use; and the sympathy aroused by an earthquake in March 1987 which ruptured the main oil-export pipeline, causing an interruption of exports for six months (Mosley, 1991: 430).

As highlighted by Mosley, there were also several design faults in the Bank's SECAL. First, the Bank should have asked for more involvement from the Ministry of Agriculture in negotiating what was designated as an agriculture sector loan. Second, it should have steered away from reform of the wheat industry, as involving a political cost quite out of proportion to any economic benefit since 'it was marginal to the Bank's overriding objective of opening the economy and expanding export production'. Instead, it should have concentrated on developing the infrastructure and incentives for more diversified export production. On the specific matter of interest rates, the Bank should have asked for a gradual approach to achieving positive real rates. But probably the most crucial defect in the SECAL was that the Bank should have examined the distributional impact of its planned measures and, once gainers and losers were identified, devised measures to compensate the losers, enhancing the political feasibility of the programme and its sustainability (Mosley, 1991: 435).

Policies after the 1984–86 turning point

The earthquake of March 1987 was one in a series of events which 'blunted the Febres government's appetite for reform'. The impeachment of the Minister of Finance, Alberto Dahik, was another. This came immediately after a mid-term election in August 1986 had resulted in an opposition-dominated Congress. In any case, as protective barriers to industry were lowered, subsidies removed, and devaluations made imports more expensive, many of the economic elites who had formerly supported him defected from the president's camp. Small farmers in the sierra producing for the domestic market were particularly affected by the reform measures because they could not afford credit at the higher interest rates.

The combination of exogenous shocks, austerity measures and rising inflation provoked riots in many cities, a national strike and violent confrontations between protestors and the police. In February 1987 the President himself was kidnapped by air force paratroopers demanding the release of the leader of the March revolt. Febres's public capitulation and refusal to prosecute the kidnappers demolished what little support he had left. Meanwhile, his spending-spree on public infrastructure around Guayaquil towards the end of his term undermined the fiscal austerity programme, which had thus far been relatively successful. By early 1988, large budget deficits and growing inflation had forced the re-implementation of import restrictions and a multi-tiered exchange rate.

The 1988 elections brought a swing back to an interventionist model, quite similar to that of Hurtado. Voting in the election showed a strong regional divide, as the new president, Victor Rodrigo Borja, who was supported by all the highland and Amazonian provinces, took 47% of the total vote.

Borja entered with three major economic goals: to control inflation (at 58% in 1988); to deal with the problem of external debt (which had reached US$9.2 billion, or 425% of total exports, by the end of 1987 (*World Debt Tables*, 1991–92: 118); and to strengthen public sector finances, especially those of the highly subsidised public companies. A factor in Borja's favour was that the years of economic decline and attempts at stabilisation had made most Ecuadorians realise that austerity was unavoidable for dealing with an economic crisis as severe as theirs. Moreover, the president had much firmer congressional support and had adopted a conciliatory tone which soothed both the elite and the labour force. Consequently, he was initially able to implement devaluation, import restrictions, gasoline and utility rate increases, and a tight monetary policy without the violent opposition that both Hurtado and Febres had faced. Also by this time, the damage to the oil pipeline had been repaired and exports had resumed.

Nevertheless, the economy did not rebound quickly and, with congressional setbacks and the need to rely on fragile coalition politics, the deficit increased again in 1991 and inflationary pressures resumed. In 1992, as Borja's term came to an end, GDP per capita was at its 1977 level and inflation was up to 50%. De Janvry et al. note that, 'With the normal wasting of political power that characterises the end of a presidential cycle, the executive is simply not able to introduce the measures necessary to eliminate this residual inflation and to stimulate private investment' (1994: 17–18).

In conclusion, the one big policy success coming out of the Bank's Agricultural SECAL was the performance of agricultural exports. The latter grew nearly three times as fast during the loan period as during the preceding three years. Nearly all this growth was concentrated on bananas and prawns, but the production of tuna fish and rice also expanded. This success was crucial in enabling the economy to cope with the balance of payments crisis which began in early 1987 (Mosley, 1991: 433).

Nevertheless, Mosley concludes that it was the financial contribution of the SECAL, more than its policy conditions, which was the principal contributory factor behind agricultural growth. The Bank's loan financed almost 30% of Ecuador's imported agricultural inputs during 1986–87. As for the policy conditions, the movement to a free exchange rate regime was of the pro forma rather than of the hard core variety and was therefore well implemented. These conditions corresponded to the kind of policy measures which government supporters saw as directly benefiting their own business and political interests. After all, Febres's government was principally made up of coastal businessmen and bankers.

As for the hard-core conditionalities, the Bank was singularly unsuccessful in eliciting positive policy responses from the government. Shelving the Santa Elena irrigation project for example, as the Bank demanded, would have lost the government an opportunity to bolster its traditional support in the coast. Similarly, establishing free trade in food crops not only went against the governing elite's business interests, it would have also alienated the majority of voters in the sierra. Given the divide between coast and sierra, the loss of political support in the sierra was something which the government could ill afford. Consequently, there was much slippage in implementing the Bank's conditionalities. As usual, when IFI conditions clashed with local political realities, politics won out.

6. Mexico

A system under stress: politics and policies before 1982

The most striking feature of Mexico's authoritarian political system is its firm foundation on the monolithic Institutional Revolutionary Party (PRI) and its allied union and peasant organisations. As Kaufman notes, between the 1920s and the 1980s, government elites deployed the powerful political machinery of the PRI to mobilise electoral legitimisation and co-opt competing labour and business interests in a society characterised by a powerful financial/industrial business class, a politically important popular sector, and a relatively sophisticated and professionalised state apparatus (Kaufman, 1990: 65).

The durability and pre-eminence of the PRI in Mexican politics owes much to the organisation's ability to adapt to changing circumstances and, through it all, to work out tacit understandings and compromises among competing groups in Mexican society. This ability was most clearly apparent during the period of 'stabilising development' of 1955 to 1970, when economic policy was based on a strategy of state-led import substitution combined with highly conservative credit and fiscal policies implemented by technocrats in the Central Bank and Treasury Department (Kaufman, 1990: 92–93).

For example, Kaufman notes that in exchange for the establishment of a 'suitable investment climate', business groups would sustain a relatively low profile in national politics and rely on informal contacts and formal consultations through officially recognised associational groups for political access. Similarly, 'in exchange for their collaboration in the task of social control and electoral mobilisation, the heads of the Mexican Worker's Confederation (CTM) and other allied groups of unionised workers would be provided with the political backing of the state and expanding material resources to distribute to their members' (ibid).

The system began to show signs of strain by the end of the 1960s when expansion began to be constrained by infrastructural and capital goods bottlenecks. Since the government had dealt with resource constraints by shifting spending priorities away from social services and distributive programmes aimed at the PRI's traditional peasant constituency and the urban poor, as growth levelled off these groups became increasingly vocal in their discontent. For example, there was an upsurge in rural land seizures and guerilla activity. Meanwhile, middle-class elements began to resent the authoritarian political system and aspire to a political role commensurate with their abilities and wealth (Purcell, 1990: 405–6).

The response of Mexico's elite to the social unrest was evident in the appointment of Luis Echeverria (1970–76) to the presidency, to be succeeded by Lopez Portillo (1976–82). The new strategy of the PRI was to deflect or co-opt the most radical pressures which challenged the structures of PRI domination (Kaufman, 1990: 95). Echeverria pushed through a controversial land reform programme, increased expenditures in health and education, shifted to the left in foreign policy and provided both official and independent unions with more leeway in bargaining (Kaufman, 1990: 94). In his turn, while Lopez Portillo ended the land reform he added limited reform of the electoral system to the agenda, and continued his predecessor's policies on social spending and labour.

The overall level of public expenditure increased rapidly during this period, with the state's share of all fixed capital formation rising to over 50% by the early 1980s, from around 35% in the 1950s and 40% a decade later (Kaufman, 1990: 95). However, initiatives to increase tax rates were blocked by strong behind-the-scenes lobbying by business elites. Consequently, economic expansion was accompanied by growing fiscal and external account deficits, resurgent inflation and an expanding external debt (ibid.). In 1975–76 a speculative run on the peso triggered a major economic crisis which resulted in an IMF stabilisation agreement and Mexico's first devaluation since 1954. The oil boom in 1978 eased matters but there was little change in the underlying structural problems (ibid.).

Meanwhile, conservative Bank of Mexico and Treasury officials had lost the hegemony they enjoyed earlier to structuralists and neo-Keynesians. At the same time, the shift in government policy towards populism alienated certain sections of the business class, particularly the powerful industrial-financial elites based in the north of Mexico. This group was more extensively linked than most other Mexican business groups to US capital and export markets, and therefore stood to gain from greater liberalisation of trade and capital flows (Kaufman, 1990: 96). From the mid-1970s onwards this group began to sponsor the right wing Partido de Accion Nacional (PAN) opposition party.

The macroeconomic imbalances generated by the policies of Echeverria and Lopez Portillo made the Mexican economy vulnerable to the exogenous shocks of the early 1980s. Tight monetary policy in the US saw interest rates there rise sharply by the end of 1980, and 1980–81 saw a decline in the price of Mexican oil exports. The government's response was to step up external borrowing while allowing the peso to become increasingly overvalued. Consequently, imports surged, speculative pressure on the peso increased and capital flight took off. The bubble finally burst in August 1982 when Mexico was unable to obtain enough loans to service existing external debts. In September, Lopez Portillo made a desperate but unsuccessful attempt to stem capital flight by nationalising the banking system (Purcell, 1990: 408). Emergency negotiations with the international banks and the signing of an IMF agreement averted a default by a hair's breadth. The response of the PRI to the latest crisis was to inaugurate Miguel de la Madrid as President in December 1982.

The turning point in 1982–83

What made Miguel de la Madrid the man for the moment as far as the PRI was concerned? It is true that the negotiations with the banks and the IMF agreement, in a situation of limited access to international credit, and the need to reverse capital flight, generally pointed in the direction of orthodoxy. However, as Kaufman points out, 'the change in policy approach by no means flowed automatically from the crisis itself' (1990: 98).

The political imperatives, as far as Mexican governing elites were concerned, were dominated by the threat posed by the emergence of the Northern financial–industrial sector as a major political force. Following the nationalisation of the banking sector in 1982, scarcely a decade after the land reform, business hardliners had, with some justification, come round to the conclusion that 'the PRI dominated system could not be trusted to refrain from the temptation of arbitrary and demagogic initiatives'. At the same time, the international financial crisis had strengthened the hand of the business elite vis-à-vis the state. This was partly due to the fact that the Northern sectors were in a better position to withstand the credit austerity, due to their links to foreign markets and their liquid asset position. It was also brought about by the fiscal squeeze eroding government support among more inward-looking business groups, in relation to whom the Northern hardliners appeared that much more powerful in terms of leverage over the state (Kaufman, 1990: 98–99).

Kaufman suggests that in addition to international pressure and the exigency of Northern business interests, certain factions of the PRI hierarchy were moving towards conservatism even before the crisis. It was perhaps the combined momentum of these three factors which prompted the party machinery to select de la Madrid as Lopez Portillo's successor. De la Madrid was one of the leaders of the conservative faction based in the Treasury and the Central Bank, and as such, represented orthodoxy. Once elected, he edged structuralist economists from virtually all positions of authority and replaced them with more orthodox advisers (ibid.).

De la Madrid's economic policy was focused on the implementation of a tough austerity programme and limited structural adjustment, mainly consisting of comprehensive trade liberalisation. Adjustment during his administration can be divided into three phases: a stabilisation attempt of 1983–85, which was derailed by the Mexican earthquake; adjustment in the period immediately following, which in turn was bedeviled by a major terms of trade deterioration due to falling oil prices; and finally when a fissure appeared in the strong consensus in favour of the orthodox route to recovery. The principal feature of the last phase of heterodox stabilisation was the Economic Solidarity Pact or 'Pacto'. The government engineered a wide-ranging economic austerity accord with unions and the private sector which involved measures such as the halving of tariffs, devaluation of the peso by a fifth, privatisation of public sector companies, the laying off of 200,000 public employees, increases in prices of public sector goods and services which were thereafter frozen, and an across-the-board increase of 20% in wages and indexation to inflation (World Bank, 1994a: 19).

In December 1988, de la Madrid's hand-picked successor, Carlos Salinas de Gortari was elected as President, having formerly been de la Madrid's Planning and Budget minister. Upon election, Salinas continued the heterodox approach to stabilisation but backed it up with stronger efforts at structural measures (Purcell, 1990: 411). A new pact was agreed between government, unions, employers and peasant organisations, called the new anti-inflationary pact for economic stability and growth. The structural correlates of the programme, the parameters of which were defined by the National Development Plan, included direct foreign investment reform, financial sector reform, deregulation and public sector restructuring, including a stronger privatisation effort (World Bank, 1994a: 19).

Significantly, the World Bank disclaims any Bank input into the heterodox stabilisation strategy, perhaps to disclaim any responsibility for it (ibid.: xix). What then was the contribution of the IFIs, particularly the Bank, to Mexico's reform effort? The *Study of Bank/Mexico Relations, 1948–1992*, published by the Bank's Operations Evaluations Department (1994a), provides some valuable insights in this regard.

Bank influence over Mexican policy reform could have worked through loan conditionality and/or through policy dialogue. As will be shown below, it was the latter which had the more pervasive influence, so much so that the cooperation and trust which developed between Bank staff and Mexican technocrats perhaps even weakened the modality of loan conditionalities.

The success of policy dialogue which was maintained between Bank staff and the Mexican technocratic team drew its strength from three critical factors. First, the two groups were highly compatible in terms of training and experience. Mexican leaders and high officials included from the beginning of the 1980s highly trained economists and others educated in American and European universities. They thus shared a common background with most Bank staff and the two sides were willing to engage each other as intellectual equals. The fact that the recent problems of the Mexican economy had been sufficiently unique that Bank staff 'could no more lay claim to superior expertise based on experience than their client' (ibid.: 44–45), also made for a relatively evenly balanced relationship between Bank staff and their Mexican counterparts.

Further, the Bank seemed willing to play by the rules of Mexican political management. As obvious and high profile Bank involvement in policy decisions was viewed by Mexican officials as politically unacceptable, the Bank agreed to provide loan support for adjustment in sub-sector after sub-sector, and in individual industries, instead of attempting to push for a comprehensive SAL (ibid.: 51). Likewise, the Bank was content to confine its dialogue to areas where advice was acceptable, so that until recently there had been no dialogue on social policy topics like population growth and education (ibid.: 44–45).

The Bank also did not press for reforms that were at odds with the government's own programme. Instead, it provided incentives and encouragement to reform-minded elements in the government. In this respect, the Bank's background analyses are likely to have been used by Mexican technocrats to strengthen their arguments for policy changes (ibid.: xii).

The 'kid-glove approach' was even more evident in the design and operation of loan conditionality. Bank loan conditionality during the 1980s 'was not always explicit in loan agreements and loan documentation, but was the subject of understandings and side letters kept from public view to enhance acceptability in an atmosphere of political sensitivity' (ibid.: 130). Frequently, the conditions reflected actions the government had already taken or announced its intention to take, and were thus of the pro forma rather than of the hard core type. In the case of both the fertiliser and agricultural loans, for example, some conditions believed by Bank staff to be important were dropped during negotiations (e.g. reduction of the coverage on food price controls) and other desirable changes were not even considered because they were politically sensitive (e.g. privatisation of fertiliser production) (Nash, 1991: 510). Not surprisingly, all conditions included in the four trade-related loans, for example, were met and reforms sustained until 1992 at least (ibid.: 512).

The Bank's cautious and conciliatory approach was in all probability due to the fear of a Mexican default, shared by the Fund, the international banks and the US government. During the acrimonious rounds of bargaining with creditors, the government sometimes appeared to be on the verge of declaring a moratorium on interest payments but invariably stopped short of stepping over the edge (Kaufman, 1990: 105). For example, when in early 1986 Finance Minister Jesus Silva Herzog began to advocate a harder line towards international creditors, and Mexico seemed on the verge of defaulting, the Federal Reserve's chairman Paul Volker paid a secret visit to promise a better deal from the international banks. De la Madrid responded by dismissing his Finance Minister (Mares, 1987: 801–2).

The end of the 1986 agreement with the Fund and international banks further demonstrated Mexico's leverage over her creditors. The Fund in particular was under strong pressure from the US government to head off a crisis (Kaufman, 1990: 106). Under a uniquely favourable agreement, nearly one half of public debt was rescheduled; Mexico achieved the lowest spread of Libor given to any debtor; the Fund agreed a generous formula for the calculation of Mexico's deficit; and the package of US$12 billion was to be increased by US$1.7 billion if the price of oil were to fall below US$9 per barrel or if the economy failed to grow by 3–4% in 1987 (ibid.).

Notwithstanding such motivations, it is clear that involvement of the IFIs in Mexico's adjustment eased her external financial situation. Although initial IFI lending was limited, compared to what followed the Baker Plan in 1985, Mexico received 12 Bank SECALs from 1986 to 1992 (see Appendix Table). In total, the Bank made available to Mexico approximately US$6 billion through 13 sectoral operations in 1986–92. During more or less the same period, the Fund lent SDR8.5 billion. About half of the new Bank lending commitments, averaging US$2 billion annually during 1986–87, were to be in the form of quick-disbursing policy-based loans. The Bank also played an important role in triggering the release of up to US$500 million for a Growth Contingency Cofinancing facility from the commercial banks (World Bank, 1994b: xv). But even with these agreements, debt servicing costs were such that Mexico remained a net exporter of capital, and external interest payments continued to absorb major percentages of both fiscal expenditures and export earnings (Kaufman, 1990: 106).

In the event, the Mexican programme was most successful in the area of trade reform. Import tariffs and quantitative restrictions on imports and exports were reduced, while depreciation of the real exchange rate and reduction of distortionary sectoral tax incentives were successful. Privatisation and liquidation of minor state enterprises proceeded well, food subsidies were reduced and inflation declined dramatically in 1988. However, there was little or no progress in reducing total government expenditure, denationalising commercial banks, privatising major public enterprises and reducing labour market regulations (Nash, 1991: 498–9, Table 22–21).

The role of the IFIs after 1983

Kaufman notes that, the economic logic of the programme notwithstanding, implementation of it carried a high political cost for the governmental elites (1990: 107) because the programme failed to generate adequate economic growth. Dissent grew among the trade unions, left-of-centre PRI activists and middle-class supporters. Subsequent to Salinas's designation as presidential successor to de la Madrid, a substantial portion of the PRI's moderate and left wing broke away to support the populist electoral challenge launched by Cuauhtemoc Cardenas. Despite the usual resort to electoral fraud by the PRI, the popular protest vote mobilised by the latter – about 37%, against the 50% polled by the PRI – shook the foundations of a party which had traditionally recorded majorities of 70 to 90%. Simultaneously, the PAN opposition continued to receive considerable backing from powerful conservative business interests.

It was perhaps in response to these challenges and impending presidential elections that Carlos Salinas moved to covertly initiate an investment and consumption boom after 1992. In that year, the president removed from calculations of the Public Sector Borrowing Requirement loans funnelled into 'economic-stimulus projects'. The government then vastly increased such expenditures, while presenting an official picture of fiscal prudence. It also began running a large current account deficit, which in reality accommodated an import consumer boom instead of investment, as was made out (*TIME*, 6 March 1995).

The deficit itself was financed by foreign portfolio investments to the tune of at least US$100 billion. Since most foreign investment decisions concerning Mexico depended on investors' ability to pull money out at a predictable exchange rate, a one-shot devaluation of 10–15% was out of the question if the flow of foreign investment were to be sustained. The government began drawing down Mexico's foreign currency reserves in an effort to shore up an increasingly overvalued peso. When reserves reached dangerously low levels, the government began to issue *tesobonos* (high-interest, short-term government securities) which enabled it to continue borrowing from abroad and put off devaluing the currency. But the *tesobonos* meant that any devaluation would be much more costly. 'It was as if Mexico hoped to convince the markets it wouldn't devalue because the self-inflicted pain would be too severe' (*Asian Wall Street Journal*, 7–8 July 1995). Another window of opportunity to devalue the peso without creating a financial panic was missed when Salinas ignored the tradition of devaluing before handing over to his successor, to enable him to start with a clean slate.

The Mexican government even managed to pull the wool over the usually hawklike eyes of the IMF. When a prominent politician, Jose Francisco Ruiz Massieu, was assassinated in mid-1994, some Mexican and foreign money fled but the Managing Director of the Fund, Michel Camdessus, went on record as saying that, 'Mexico has gone through several events of this kind in recent months and, despite that, Mexico has maintained a correct, firm, persevering macroeconomic policy' (ibid.). Wealthy Mexicans knew better. By late October 1994, they started to move money out. When Zedillo's finance minister off-handedly announced the inevitable devaluation on 20 December 1994, he started the panic flight of foreign capital which Mexico had hoped to avoid. The ensuing financial panic halved the peso's value and again brought the country to the brink of default.

The rescue package for Mexico cobbled together by President Clinton to avert the triggering of a crisis in emerging markets by a Mexican default, amounted to US$50 billion. When the US Congress refused to come up with the money, the President used US$20 billion from the (US dollar) Exchange Stabilisation Fund. The IMF provided a stand-by of US$17.8 billion (equivalent to an unprecedented 688% of Mexico's quota with the IMF). The Framework of the Bank for International Settlements, a group of G-10 central banks, provided financing of US$10 billion. At a press briefing on 2 February 1995, Michel Camdessus described the IMF's contribution as 'truly exceptional' and a 'concrete illustration' of IMF support for Mexico's 'unprecedented' adjustment programme (IMF, 1995).

In the light of the debacle of the peso in December 1994, Mexico's adjustment effort does not seem as robust as it did before, even though the policy reforms during the 1980s do represent a significant shift from strategies pursued previously. The Mexicans seem to have led the IFIs by the nose without the latter being aware of it. Furthermore, the cosy relationship between IFI officials and Mexican technocrats may have blunted the vigilance of the former. Easy credit from the IFIs, Washington and Wall Street had engendered complacency and economic recklessness on the part of the Mexican leadership, which seriously reduced the quality of macroeconomic management. It remains to be seen what will change with the new package.

As far as Mexico's adjustment experience goes, therefore, the significant financial support provided by the World Bank and the Fund clearly played an important role in sustaining the reform effort through the 1980s, resulting in favourable programme implementation. But during the early 1990s, as Mexico became the darling of Wall Street and President Salinas the financial *wunderkind* of the multilateral lending agencies, the resulting soft budget constraint undermined continued adherence to financial prudence.

As for eliciting policy reform through policy dialogue and loan conditionality, the effectiveness of the former is clearer than that of the latter. The Bank's background analyses, and the co-operative and fruitful dialogue which IFI officials maintained with Mexican technocrats, seems to have been important in nudging the reform effort along. Moreover, the willingness of the Bank to play by the rules of Mexican political management is likely to have enhanced the acceptability of the Bank's proposals to Mexican political leaders. But loan conditionality was more of the pro forma than of the hard core variety. The most important factor leading to the reform effort was the political challenge to PRI which emerged from the right, necessitating a shift to the right in economic policy if the PRI were to maintain its hegemony. The debt crisis, and the resulting credit crunch, is likely to have expedited this reorientation.

. . .

Of the six sample countries, if Chile is the pioneer whose reforms seem most consolidated, then Ecuador is the country which failed to graduate. Colombia and Argentina have undertaken sweeping structural reforms which have withstood the challenge of the Mexican debacle of December 1994, while Mexico itself has instituted significant reforms despite some backsliding in the early 1990s. Bolivia engineered a successful U-turn on the 1952 revolution, but its internal geopolitics constrain successful diversification of the country's production and export base.

In the concluding Part III we bring together the common elements behind these different experiences in order to draw conclusions about the different internal and external factors influencing reform, among them the relative importance of the IFIs and their conditionality.

III
CONCLUSIONS

The review of country experiences with IFI lending and structural reform in Part II focused on the historical record of adjustment which pivoted on individual turning points in the reform process. The principal objective of using this analytical framework was to bring out the internal and external factors behind each attempt to re-orient economic policy away from a state-led, ISI strategy which placed a low priority on macro stability, to a more outward-looking approach in which the private sector is regarded as the engine of growth.

As set out in the introductory section, the external factors likely to have influenced reform included the key one of the role of IFI conditionality. Other possible external influences included the debt crisis and other external shocks, and access to IFI credits as well as to other (perhaps competing) sources of credit. Against these external factors, we have also examined internal factors which impinge on government 'ownership' of the programme. Principal among these are the configuration of political forces and special interest groups, the nature of decision-making, and the role of a technocratic elite empathising with the 'Washington Consensus' (Williamson, 1994). Table 1 summarises the evidence relating to these hypotheses yielded by the analysis in Part II.

On the crucial question of the role of IFI conditionality, we find little evidence to support the view that conditionality was decisive in bringing about the policy transformation. In the cases of Argentina and Bolivia it is unambiguously clear that IFI conditionality played no role in inducing policy change because in neither of these two countries were Bank or IMF programmes in operation at the turning point (see Appendix Table). In Argentina, in particular, the IFIs resumed lending well after the government had implemented a range of difficult structural reforms and a drastic stabilisation programme in order to bring the macroeconomic crisis under control. IFI conditionality similarly did not push the governments of Mexico and Chile in any direction in which they did not want to go.

Only Colombia provides evidence of the influence of conditionality. Even there, however, dependency on World Bank loans in a climate of reduced export earnings was only one among a number of important factors favouring reform. We have shown that by the late 1980s exporters had become a strong pressure group lobbying for liberalisation. Meanwhile, strong economic reasons for trade policy reform had begun to manifest themselves, in order to accelerate economic growth and prevent a revaluation of the currency. It was this combination of pressures, not IFI conditionality alone, which induced Colombia's policy transformation.

Table 1 Testing hypotheses on policy reform in Latin America

	Argen -tina	Bol -ivia	Chile	Colom -bia	Ecuador	Mex -ico
Turning point	*1989*	*1986*	*1974–76*	*1989–90*	*1984–86*	*1982*
Fund programme in operation at turning point?	No	No	Yes	No	Yes	Yes
Bank programme in operation at turning point?	No	No	Yes	Yes	Yes	Yes
Successful reform?	Yes	Yes	Yes	Yes	(N)	(Y)
Change in political leadership?	Yes	Yes	Yes	No	Yes	Yes
Reasons for success/failure in policy reform						
External factors						
IFI conditionality	No	(N)	No	(Y)	PV	No
IFI policy dialogue	No	Yes	No	No	(N)	Yes
Cathartic effect of debt crisis and/or other external shocks	Yes	Yes	N/A	(N)	(N)	(Y)
Financial support from IFIs	No	Yes	Yes	(Y)	Yes	Yes
Financial support from other creditors	N/A	Yes	N/A	Yes	PV	Yes
Internal factors						
Political leadership committed to reform	Yes	Yes	Yes	Yes	(Y)	Yes
Political consensus for reform	Yes	Yes	N/A	Yes	PV	Yes
Change in interest group pressures	Yes	Yes	N/A	Yes	Yes	Yes
Influence of technocrats	Yes	Yes	Yes	Yes	(Y)	Yes

Notes: Yes – hypothesis satisfied, (Y) – hypothesis satisfied with qualifications, PV – perverse impact, No – hypothesis not satisfied, (N) – hypothesis not satisfied, with qualifications, N/A – not applicable.

IFI conditionality in Ecuador had a perverse effect on programme implementation. There the turning point coincided with some progress in implementing pro forma conditionalities which government elites saw directly as promoting their own interests. Bank pressure for, politically costly, liberalisation of interest rates and establishment of free trade in food crops triggered the general backsliding which followed. In contrast, there is evidence that IMF conditionality played some part in keeping the Bolivian government to the straight and narrow path of reform during the run-up to the 1989 presidential elections. Even here, however, the government was, in the main, committed to policy change and had already voluntarily undertaken sweeping reforms.

A further feature that emerges is the IFI's reluctance, or inability, to punish the many slippages in programme implementation. Even in the apparently strong case of the Bank withdrawing support from Argentina as a result of contravention of macroeconomic policy conditions, we saw that, in fact, this was more to extricate itself from an agreement it had been forced into rather than to pressure the government to implement the second tranche trigger conditions. In Ecuador's case, the Bank did not punish Ecuador despite widespread slippage on loan conditions, not only because it was sympathetic towards Ecuador following the earthquake but, more significantly, because its country desk was under strong pressure to spend due to budgetary imperatives within the Bank itself.

Policy dialogue was an enabling factor in successful programme implementation in Bolivia and in Mexico. In Mexico, in particular, dialogue between Bank staff and Mexican officials was especially fruitful in forging a policy consensus and in tailoring the formalities of Bank conditionality to suit Mexico's political imperatives. Consequently, conditionality in Mexico was pro forma rather than hard core. The Bank's approach in Mexico can be contrasted with that followed in Ecuador, where there was little useful policy dialogue. When the Bank insisted on politically unpalatable reforms, the Ecuadorian negotiating team pretended to go along with it but with every intention of fudging implementation when the time came to release the second tranche. In this case, the record on implementation is likely to have been more favourable if the Bank had concentrated on working for a consensus package with the government.

We find strong evidence from Argentina and Bolivia in support of the proposition that the cathartic effect of the debt crisis and the drying up of external credit jolted the governments into new policy directions. This was the dominant factor in Argentina's policy transformation. Decades of distributional conflict had driven Argentina to bankruptcy and Carlos Menem was forced to align himself with the business community to effect strong stabilisation measures backed by sweeping structural reforms only when it became evident that no international creditor, not even the IFIs, were willing to lend. In this case, the withholding of financial assistance until internal conditions conducive to reform were in place played a pivotal role in bringing about the change. Similarly, in Bolivia, the hyperinflation of 1985 seems to have been the catalytic factor, in turn triggered by the debt crisis and other exogenous shocks. These events forced Victor Paz to face up to a set of harsh domestic and international realities – particularly the financial limitations of state capitalism – with a new pragmatism. The desire to obtain debt relief under the Brady Plan encouraged them further down the path of reform.

There is also a strong possibility that policy-makers in Argentina, Bolivia, Mexico and Colombia were favourably influenced by the demonstrated success of the neo-liberal experiment in Chile, and perhaps in South-East Asia. However, the country materials analysed failed to yield any specific evidence on this.

Financial support from the IFIs was an important factor in facilitating adjustment, by easing the foreign exchange constraint, in all countries in the sample except in Argentina. In Ecuador the financial contribution of the Agricultural SECAL was significant in releasing the import constraint and enabling agricultural growth. Likewise in Mexico, financial support provided by the IFIs and their role in enabling Mexico to reschedule its debts with international commercial banks provided the government with a breathing space during which reforms could be undertaken. Nevertheless, it is likely that the soft budget constraint resulting from the IFIs' credits in the 1990s blunted the reform effort and contributed indirectly to the Mexican peso crisis of December 1994. The evidence also shows that where financial support was available from other creditors, it was useful in promoting the reform effort only in countries where the government was convinced of the need for reform, as in Colombia and Mexico. In Bolivia, the breathing space that other creditors were forced to provide took the unusual form of a 'consensual default' on commercial debt. But in Ecuador, availability of credit from alternative sources merely enabled the government to evade hard-core Bank conditionality and go ahead with its own agenda, exemplified by the Santa Elena irrigation project.

Turning to the internal factors behind implementation success or failure, we find overwhelming evidence in support of the proposition that a political leadership committed to reform is a *sine qua non* of successful reform. In all the countries in the sample other than in Colombia, re-orientation in economic policy coincided with a change in political leadership (see Table 1). This enabled a fresh approach to tackling the economic crisis, with new leaders and technocrats coming to the fore. In some countries, this also signalled a favourable change in the attitudes of special interest groups which constituted the support base of the governing parties.

Committed political leadership can arise through having to face harsh economic realities in the face of a severe budget constraint, as in the case of the erstwhile Peronist Carlos Menem, or Bolivia's one-time Revolutionary, Victor Paz. Alternatively, it can bring to political ascendancy reform-minded leaders leaning towards orthodoxy, like Miguel de la Madrid in Mexico or the Chilean military junta. Committed political leadership was probably the most important determinant of reform in Chile, where we saw that moving towards economic orthodoxy was integral to Pinochet's agenda for the total rejection of Allende's Marxist economic model.

On the other hand, the commitment of political leaders towards reform can depend on changes in interest group pressures. In Colombia, for example, the emergence of exporters as a powerful group lobbying for liberalisation, and gradual acceptance by industrialists that outward-orientation would generate a stronger growth dynamic than producing for the internal market, convinced Barco's administration that trade liberalisation might have become politically expedient. This point is reinforced by evidence from Ecuador; like Menem and Paz, Presidents Hurtado, Febres and Borja were all convinced of the need for policy change but were none of them able to overcome the adversarial regionalism of Ecuadorian politics to assemble a consensus for sustained reform. Some progress was made during Febres's tenure, when the coastal elites who came to power with him saw the advantages of providing incentives to exporters through policies such as exchange rate reform. But the prospect of alienating political support in the sierra if the marketing of food crops were to be liberalised or interest rates were to be rationalised, made his government reluctant to act. In Mexico, it was the rise of the right-wing PAN, representing Northern industrial interests, which made it politically expedient for the PRI to move towards orthodoxy in economic policy.

The countries in the sample provide strong evidence in support of the hypothesis that a political consensus for reform is often an important determinant of successful programme implementation. While in Mexico, the PRI's rightward shift ensured a tacit consensus between itself and its right-wing challengers, an opposition-dominated Congress in Ecuador made it impossible for Febres's government to move on interest rate reform. In contrast, the rightward shift in the economic policy stance of both Menem and Paz enabled them to command enough congressional support to pass their respective economic reform packages. Even in Colombia, where politics had traditionally been consensual, VAT reform required a coalition of some Liberals and a faction of the Conservative Party to be pushed through Congress.

Thus, the extent to which there is a political consensus for reform at the turning point and after is paramount to successful implementation in democratic or quasi-democratic political systems (Argentina, Bolivia and Mexico). The need for a consensus disappears in a strong military dictatorship, whose leaders can afford to wait for the reforms to bear fruit in order that the reforms become self-sustaining thereafter, as in Chile. The case studies also show that, even in democratic systems, political leaders sometimes have to resort to some degree of authoritarianism to force reforms past potential losers, like labour. For example, Menem broke up strikes so that he could implement public enterprise reforms and Victor Paz went even further and detained union leaders or confined them to remote locations. Mexico might be thought to have had a natural advantage in this area, as the *modus* *operandi* of the PRI had always been to internalise and transmute dissent by labour and other groups by co-opting unions and resorting to electoral fraud when necessary. Nevertheless, even Mexico's leaders were forced to strike a deal with labour through the *Pacto* to compensate workers for harsh stabilisation measures. Similar compensatory measures may have bought support for Ecuador's reforms had the government sought it.

Compared with these internal political factors, the evidence suggests that technocrats have little leverage over policy-making unless they are supported by their political leaders. Technocrats function as facilitators rather than as catalysers in the adjustment process. They provide the expertise for the design of programmes for which the politicians provide leadership. Ecuador in 1984–86 provides a good example of a committed technocratic team which made little progress because it lacked support from the political leadership. In some countries the political leaders were themselves economists, intellectually convinced of the need for reform because of their background and training, such as Miguel de la Madrid, Carlos Salinas and Cesar Gaviria. In Argentina, Bolivia and Chile the political leaders, though not economists themselves, were committed to orthodox reform but depended on their technocratic advisers to formulate and implement the reforms. We also saw that the technocratic elite in these countries shared similar educational and professional backgrounds. Largely educated in free market economic theory at North American universities, many of them had close links with the IFIs and some had worked in the IMF or in the Bank.

What then are the positive lessons we can learn from these experiences?

Clearly, when there is little congruence between the reform agenda of the government and that envisaged for it by the IFIs, the odds are heavily stacked against donor attempts to induce changes through policy-based lending. On the contrary, IFI involvement in adjustment lending in these situations can provide a recalcitrant government with a degree of financial ease that enables it to put off reforms. Meanwhile, the lending agency concerned almost always suffers a loss of credibility, especially because the IFIs' – particularly the Bank's – record on meting out punishment is poor. Donors would therefore be better advised to withhold financial assistance until the drying up of external credit and subsequent financial stringency forces the government to grasp the nettle of reform for itself, as in pre-1989 Argentina. Alternatively, they should wait until internal political changes create a more favourable environment for change.

In contrast, we have seen that where there is consensus between donors and recipients on the reform agenda, this makes for a significantly better implementation record. In this regard, our evidence on the internal factors influencing reform showed that the degree of congruence is determined by a favourable configuration of domestic forces at the time of reform. This emerges as the key factor enabling successful policy change. Foremost among these forces is a leadership convinced of the need for change, backed by a political consensus favouring reform.

Further, our evidence shows that policy dialogue with government technocrats and political leaders by IFI staff can play an important role in forging a consensus on programme objectives and the reform agenda. Moreover, policy dialogue can help to tailor the programme to what can realistically be achieved given the configuration of domestic political forces. This requires a greater awareness and monitoring of the internal political situation and technical capacity of borrowing countries than is currently normal. The demonstrated success of a limited programme may well generate a consensus, and momentum for more ambitious reforms later, whereas an over-ambitious programme which ignores the political imperatives driving policy-making may generate a momentum of opposition which can derail the reform effort altogether.

References

General

Balassa, Bela, Gerardo M. Bueno, Pedro-Pablo Kuczynski and Mario Henrique Simonsen (1986) *Toward Renewed Economic Growth in Latin America*. Washington, DC: Institute for International Economics.

Balassa, Bela (1989) 'Outward Orientation' in Chenery and Srinivasan.

Birdsall, Nancy and Carlos E. Lozada (1996) 'Recurring Themes in Latin American Economic Thought: From Prebisch to the Market and Back' in Hausmann and Reisen.

Bruton, Henry (1989) 'Import Substitution' in Chenery and Srinivasan.

Carvounis, Chris C. (1986) *The Foreign Debt/National Development Conflict: External Adjustment and Internal Disorder in the Developing Nations*. Connecticut: Quorum Books.

Chenery, Hollis and T.N. Srinivasan (ed.) (1989) *Handbook of Development Economics*, Volume II. Elsevier Science Publishers BV.

Corbo, Vittorio (1994) 'Economic Policies and Performance in Latin America' in Enzo Grilli and Dominick Salvatore (eds) (1994) *Handbook of Comparative Economic Policies*, Volume 4, Economic Development. Westport, CT: Greenwood Press.

Diaz-Alejandro, Carlos (1985) 'Good-bye financial repression, hello financial crash', *Journal of Development Economics* 19(1/2), September–October: 1–24.

Hausmann, Ricardo and Helmut Reisen (eds) (1996) *Securing Stability and Growth in Latin America, Policy Issues and Prospects for Shock-prone Economies*. Paris: OECD.

Hirschman, Albert O. (1968) 'The Political Economy of Import-Substituting Industrialization in Latin America', *The Quarterly Journal of Economics* LXXXII(1): 1–32.

IMF (1992) *International Financial Statistics Yearbook*, Volume XLV. Washington, DC: International Monetary Fund.

IMF (various) *Annual Reports*. Washington, DC: International Monetary Fund.

Johnson, John H. and Sulaiman S. Wasty (1990) *Borrower Ownership of Adjustment Programs and the Political Economy of Reform*, World Bank Discussion Papers. Washington, DC: World Bank.

Killick, Tony (forthcoming) *Conditionality and the Improvement of Policies in Developing Countries*.

Larrain, Felipe and Marcelo Selowsky (eds) (1991) *The Public Sector and the Latin American Crisis*. San Francisco, CA: International Center for Economic Growth.

Little, I.M.D., Richard N. Cooper, W. Max Corden and Sarath Rajapatirana (1993) *Boom, Crisis and Adjustment: The Macroeconomic Experience of Developing Countries*. Oxford: Oxford University Press for the World Bank.

McKinnon, R.I. (1973) *Money and Capital in Economic Development*. Washington,

DC: Brookings Institution.
McNelis, P.D. (1987) 'Indexing, Exchange Rate Policy and Inflationary Feedback Effects in Latin America', *World Development* 15(8), August: 1107–17.
Nelson, Joan M. (ed.) (1990) *Economic Crisis and Policy Choice: The Politics of Adjustment in the Third World.* Princeton, NJ: Princeton University Press.
Pastor, M., Jr. (1990) 'Capital Flight from Latin America', *World Development* 18(1), January: 1–18.
Prebisch, Raul (1959) 'International Trade and Payments in an Era of Coexistence: Commercial Policy in the Underdeveloped Countries', *American Economic Review*, Papers and Proceedings, pp 251–73.
Singer, H.W. (1950) 'U.S. Foreign Investment in Underdeveloped Areas: The Distribution of Gains Between Investing and Borrowing Countries', *American Economic Review*, Papers and Proceedings, pp 473–85.
Solimano, Andres (1990) 'Inflation and the Costs of Stabilization: Historical and Recent Experiences and Policy Lessons', *The World Bank Research Observer* 5(2), July: 167–85.
Thomas, Vinod, Ajay Chhibber, Mansoor Dailami and Jaime de Melo (eds) (1991) *Restructuring Economies in Distress: Policy Reform and the World Bank.* Oxford: Oxford University Press for the World Bank.
Wiarda, Howard J. and Harvey F. Kline (1990) *Latin American Politics and Development*, 3rd edition. Boulder, CO: Westview Press.
Williamson, John (ed.) (1990) *Latin American Adjustment: How Much Has Happened?* Washington, DC: Institute for International Economics.
Williamson, John (ed.) (1994) *The Political Economy of Policy Reform.* Washington, DC: Institute of International Economics.
Williamson, John and Stephen Haggard (1994) 'The Political Conditions for Economic Reform' in Williamson (ed.) (1994).
World Bank (1992a) *Review of Adjustment Lending III.* Washington, DC: World Bank.
World Bank (various) *World Debt Tables.* Washington, DC: World Bank.

Argentina

Dornbusch, Rudiger and Juan Carlos de Pablo (1990) 'Argentina' in Sachs (1990).
Erro, David G. (1993) *Resolving the Argentine Paradox: Politics and Development 1966–1992.* Boulder, CO and London: Lynne Rienner Publishers Inc.
Sachs, Jeffrey (ed.) (1989) *Developing Country Debt and the World Economy.* Chicago, IL: University of Chicago Press.
Sachs, Jeffrey (ed.) (1990) *Developing Country Debt and Economic Performance*, Volume 2. Chicago, IL: University of Chicago Press.
Snow, Peter G. and Gary W. Wynia (1990) 'Argentina: Politics in a Conflict Society' in Wiarda and Kline.
Tussie, Diana and Mirta Botzman (1990) 'Sweet Entanglement: Argentina and the World Bank 1985–89', *Development Policy Review* 8(4), December: 391–409.
World Bank (1993a) *Argentina: From Insolvency to Growth*, World Bank Country Economic Report No. 12463. Washington, DC: World Bank.

World Bank (1993b) *Performance Audit Report: Argentina – Agricultural Sector Loan*, Operations Evaluation Department, Report No. 11925. Washington, DC: World Bank.

Bolivia

Cariaga, Juan L. (1990)'Bolivia' in Williamson (1990).

Gamarra, Eduardo A. and James M. Malloy (1990) 'Bolivia' in Wiarda and Kline.

Graham, Carol (1992) 'The Politics of Protecting the Poor During Adjustment: Bolivia's Emergency Social Fund', *World Development* 20(9): 1233–51.

Harberger, Arnold C. (1988) 'Introduction' in Sachs and Morales.

Klein, Herbert S. (1992) *Bolivia, The Evolution of a Multi-ethnic Society*, 2nd edition. New York: Oxford University Press.

Pastor, Manuel Jr. (1991) 'Bolivia: Hyperinflation, Stabilisation and Beyond', *Journal of Development Studies* 27(2), January: 211–37.

Sachs, Jeffrey (1994) 'Life in the Economic Emergency Room' in Williamson.

Sachs, Jeffrey and Juan Antonio Morales (eds) (1988) *Bolivia 1952–1986*, Country Studies No. 6, International Centre for Economic Growth. California: ICS Press.

Chile

Edwards, Sebastian (1991) 'Comments on Mexico' in Thomas et al.

Meller, Patricio (1991) 'Adjustment and Social Costs in Chile During the 1980s', *World Development* 19(11), November: 1545–61.

Moran, Cristian (1989) 'Economic Stabilization and Structural Transformation: Lessons from the Chilean Experience, 1973–87', *World Development* 17(4), April: 491–502.

Moran, Cristian (1991) 'Chile: Economic Crisis and Recovery' in Thomas et al.

Oppenheim, Lois Hecht (1993) *Politics in Chile: Democracy, Authoritarianism, and the Search for Development*. Boulder, CO: Westview Press.

Pinera, Jose (1994) 'Chile' in Williamson (ed.).

Sigmund, Paul E. (1990) 'Chile' in Wiarda and Kline.

Stallings, Barbara (1990) 'Politics and Economic Crisis: A Comparative Study of Chile, Peru and Colombia' in Nelson.

Thomas, Vinod, Ajay Chhibber, Mansoor Dailami and Jaime de Melo (eds) (1991) *Restructuring Economies in Distress: Policy Reform and the World Bank*. Oxford: Oxford University Press for the World Bank.

Colombia

Kline, Harvey (1990) 'Colombia' in Wiarda and Kline.

Schloss, Miguel and Vinod Thomas (1986) 'Adjustment with growth: Colombia's experience', *Finance and Development* 23(4), December: 10–13.

Stallings, Barbara (1990) 'Politics and Economic Crisis: A Comparative Study of Chile, Peru and Colombia' in Nelson.

Thorp, Rosemary and Sarah Ross (1991) *The 1985 Stabilisation Programme in Colombia: Case of Adjustment with Equity?*, ILO Working Paper, WEP 2-46/WP.33. Geneva: International Labour Organisation.

Urrutia, Miguel (1994) 'Colombia' in Williamson.

Ecuador

De Janvry, Alain, Elisabeth Sadoulet and Andre Fargeix (1991) 'Politically Feasible and Equitable Adjustment: Some Alternatives for Ecuador', *World Development* 19(11): 1577–94.

De Janvry, Alain, Alison Graham, Elisabeth Sadoulet, Ramon Espinel, Walter Spurrier, Hans-Peter Nissen and Frederico Welsch (1994) *The Political Feasibility of Adjustment in Ecuador and Venezuela*. Paris: OECD.

Martz, John D. (1990) 'Ecuador: The Fragility of Dependent Democracy' in Wiarda and Kline.

Mosley, Paul (1991) 'Ecuador' in Paul Mosley Jane Harrigan and John Toye (1991) *Aid and Power: The World Bank and Policy-based Lending*, Volume 2, Case Studies. London: Routledge.

World Bank (1984) *Ecuador: An Agenda for Recovery and Sustained Growth*, Report no. 5094-EC. Washington, DC: World Bank.

Mexico

International Monetary Fund (1995) *IMF Survey*, 6 February.

Kate, Adriaan Ten (1992) 'Trade Liberalization and Economic Stabilization in Mexico: Lessons of Experience', *World Development* 20(5): 659–72.

Kaufman, Robert R. (1990) 'Stabilization and Adjustment in Argentina, Brazil, and Mexico' in Nelson.

Mares, David R. (1987) 'Mexico's challenges: sovereignty and national autonomy under interdependence', *Third World Quarterly* 9(3), July: 788–803.

Nash, John (1991) 'Mexico: Adjustment and Stabilization' in Thomas et al.

Purcell, Susan Kaufman (1990) 'Mexico' in Wiarda and Kline.

World Bank (1994a) *OED Study of Bank/Mexico Relations, 1948–1992*, Operations Evaluation Department, Report No. 12923. Washington, DC: World Bank.

World Bank (1994b) *Performance Audit Report: Mexico: Industrial Policy Loan*, Operations Evaluation Department, Report No. 13050. Washington, DC: World Bank.

Appendix Table

World Bank and IMF adjustment lending in Latin America, 1980–93

Country	*Bank/IMF*	*Loan*	*Amount (US$m/SDRm)*	*Period*
Argentina	Bank	Agricultural Sector Loan	350	July 86–June 89
		Trade Policy Loan	500	Aug 87–June 90
		Banking Sector Loan	400	
		2nd Trade Policy Loan	300	Nov 88–June 90
		Pub Entrp Ref Adj	300	June 91–Dec 93
		Public Sector Ref	325	Sep 91–Dec 93
		Total	**2,175**	
	IMF	Stand-by	780	July 91–Mar 92
		Stand-by	1,500	Jan 83–April 84
		Stand-by	1,182	Dec 84–May 86
		Stand-by	947	July 87–Sep 88
		Stand-by	736	Nov 89–Mar 91
		Total	**5,145**	
Bolivia	Bank	SAL I	50	June 80–June 81
		Imports Reconstruction Loan	55	Oct 86–June 90
		2nd Import Reconstruction Loan	47.1	Mar 88–June 90
		Financial Sector Loan	70	April 89–June 90
		SAC (SAL)	50.4	Dec 91–July 90
		Total	**272.5**	

Bolivia cont.	IMF	Stand-by	66.38	Feb 80–Jan 81
		Stand-by	50	June 86–July 87
		SAF	63.49	Dec 86–July 88
		ESAF	136.05	July 88–July 91
		Total	**315.92**	
Chile	Bank	SAL I	250	Nov 85–Oct 86
		SAL II	250	Nov 86–Dec 87
		SAL III	250	Dec 87–June 89
		Total	**750**	
	IMF	Stand-by	500	Jan 83–Jan 85
		EFF	825	Aug 85–Aug 89
		Stand-by	64	Nov 89–Nov 90
		Total	**1,389**	
Colombia	Bank	Trade and Export Divers. Loan	300	Jun 85–Jun 88
		Trade and Ag Policy Loan	250	Jun 86–Dec 89
		Energy Sector Loan	300	Jun 86–Jan 90
		Public Sector Reform	304	Feb 91–Dec 92
		Total	**1,154**	
Ecuador	Bank	Agricultural Sector Loan	100	Feb 86–June 89
	IMF	Stand-by	157.5	July 83–July 84
		"	105.5	Mar 85–Mar 86
		"	75.4	Aug 86–Aug 87
		"	75.35	Jan 88–Feb 89
		"	109.9	Sep 89–Feb 91
		"	234.4	Dec 91 –Dec 92
		"	75	Dec 91–Dec 92
		Total	**933.05**	

Mexico	Bank	Export Development loan	352	Dec 83–June 89
		Trade Policy Loan	500	Nov 86–Nov 90
		2nd Trade Policy Loan	500	Jan 88–Dec 88
		Agricultural Sector Loan	300	Mar 88–Nov 90
		Fertiliser Sector Loan	265	Nov 89–Dec 93
		Financial Sector Loan	500	June 89–June 93
		Public Enterprises Reform Loan	500	July 89–June 92
		Industrial Sector Loan	500	June 89–June 91
		Industrial Restructuring Loan	250	Feb 90–Dec 94
		Rd. Trans/Telecom Sector Adj	380	June 90–June 91
		Spec. Interest Support	1,260	Feb 90–May 91
		Agric Sector Adj II	400	Dec 91–Feb 93
		Export Sector	300	May 91–Dec 93
		Total	**6,007**	
	IMF	EFF	3,410	Jan 83–Dec 85
		Stand-by	1,400	Nov 86–April 88
		EFF	3,729.6	May 89–May 93
		Total	**8,539.6**	

Note: Turning points in policy reform in Argentina, Bolivia, Colombia, Ecuador and Mexico took place in the 1980s and 1990s. Chile's turning point took place much earlier in 1974–76. There were two Fund stand-bys operational in Chile during this period, from January 1974 to March 1976. The Bank too had several project loans on highways, agriculture and industry operational during this period.

Sources: IMF, *Annual Reports* (various years); World Bank (1992a) *Review of Adjustment Lending III.*

76: The Changing Role of NGOs in the Provision of Relief and Rehabilitation Assistance: Case Study 3 – Northern Ethiopia/Eritrea, *John Borton*, 1994, £6.00, ISBN 0 85003 210 5
77: The Impact of Drought on Sub-Saharan African Economies: A Preliminary Examination, *Charlotte Benson and Edward Clay*, 1994, £6.00, ISBN 0 85003 212 1
78: Financial Integration and Development in Sub-Saharan Africa: A Study of Informal Finance in Ghana, *Ernest Aryeetey*, 1994, £6.00, ISBN 0 85003 214 8
79: Financial Integration and Development in Sub-Saharan Africa: A Study of Informal Finance in Tanzania, *Mboya S.D. Bagachwa*, 1994, £6.00, ISBN 0 85003 215 6
80: Devolution of Management in Public Irrigation Systems - Cost Shedding, Empowerment and Performance – A Review, *Hugh Turral*, 1995, £6.00, ISBN 0 85003 221 0
81: Changing Public and Private Roles in Agricultural Service Provision, Diana Carney, 1995, £6.00, ISBN 0 85003 222 9
82: Structural Adjustment and Sustainable Development in Mali: A World Wide Fund for Nature Study, *A.S.Maiga, B. Teme, B.S. Coulibaly, L. Diarra, A.O. Kergna, K.Tigana, with J. Winpenny*, 1995, £6.00, ISBN 0 85003 223 7
83: Structural Adjustment and Sustainable Development in Cameroon: A World Wide Fund for Nature Study, *R.Tchoungui, S. Gartlan, J.A. Mope Simo, F. Sikod, A. Youmbi, M. Ndjatsana, and J. Winpenny*, 1995, £6.00, ISBN 0 85003 224 5
84: Regional Integration in Latin America: is Mercosur a New Approach? *Douglas Zormelo*, 1995, £6.00, ISBN 0 85003 225 3
85: Financial Integration and Development in Sub-Saharan Africa: Informal Finance Sector in Malawi, *C. Chipeta*, 1996, £6.00, ISBN 0 85003 226 1
86: The Formal Financial Sector in Ghana After the Reforms, Ernest Aryeetey, £6.00 ISBN 0 85003 227 X
87: Financial Linkage and Development in Sub-Saharan Africa: the Role of Formal Financial Institutions in Tanzania, *Mboya S.D. Bagachwa*, 1996, £6.00, ISBN 0 85003 228
88: Financial Linkage and Development in Sub-Saharan Africa: the Role of Formal Financial Institutions in Nigeria, *Adedoyin Soyibo*, 1996, £6.00, ISBN 0 85003 229 6
89: Financial Integration and Development in Sub-Saharan Africa: the Formal and Semi-formal Financial Sectors in Malawi, *C. Chipeta and M.L.C. Mkandawire*, 1996, £6.00, ISBN 0 85003 230 X
90: Financial Linkage and Development in Sub-Saharan Africa: the Informal Financial Sector in Nigeria, *Adedoyin Soyibo*, 1996, £6.00, ISBN 0 85003 231 8
91: Planning and Policies on Extensive Livestock Development in Central Asia, *Carol Kerven, John Channon and Roy Behnke*, 1996, £6.00, ISBN 0 85003 238 5
92: Institutional Change within the Forest Sector: Centralised Decentralisation, *Mary Hobley*, 1996, £6.00, ISBN 0 85003 239 3
93: Decentralising Forest Management and Conservation in Central America, *Michael Richards, Guillermo Navarro, Alberto Vargas and Jonathan Davies*, 1996, £6.00, ISBN 0 85003 240 7
94: Conditionality and South-East Asian Adjustment, *Ana Marr*, 1996, £6.00, ISBN 0 85003 242 3
95: Is Aid Conditionality Consistent with National Sovereignty? *Douglas Zormelo*, 1996, £6.00, ISBN 0 85003 244 X

Overseas Development Institute
Portland House
Stag Place
London SW1E 5DP
UK

Telephone +44 (0)171 393 1600
Fax +44 (0)171 393 1699
Email: publications@odi.org.uk
Internet (World Wide Web): http://www.oneworld.org/odi/

£6.00