Latin America and the State-Market Debate: Beyond Stylized Facts

The literature on the political economy of development is rich with descriptions of government action over time and in-depth analyses of the causal relationship among state intervention, public policy, and development outcomes. In broad strokes, the story of the post–World War Two Latin American state has been portrayed in this literature as follows. During the heyday of ISI in the 1960s and 1970s, the state was cast favorably as the main protagonist in high-growth “miracles” such as those underway in Brazil and Mexico (Gereffi and Evans 1981). However, as Latin America fell on hard times during the debt-ridden 1980s, the state quickly became the culprit in explaining this downturn. Any notable economic turnarounds during the 1980s—say, in Chile—were attributed to the “miracle of the market” (Schurman 1996; Kurtz 2000).

Although the affinity for market reform had spread quickly through the region by the early 1990s, by the end of that decade its limits had also become apparent. The state’s stock rose again, as the regressive outcomes of unbridled economic liberalization prompted calls for a more cohesive set of public policies to facilitate adjustment and correct for the many instances of market failure. As common wisdom would have it, the state appears to have come full circle: from its market-supporting role under a primary-export-led development model prior to the Great Depression; to its more encompassing “developmentalist” role during the post–World War Two era of ISI; to its widely hailed post-debt-crisis retreat from playing a direct role in the economy; and finally, back to the pre-ISI liberal state meant to bolster private initiative through the enforcement of property rights and the provision of basic public goods.

When this same phenomenon is examined empirically, there is some evidence to support this notion of the Latin American state having come full circle. Having peaked at an average of 24.3 percent of GDP for the region as a whole in the mid-1980s, public expenditure for the 1995–2000 period stood at about 16.6 percent of GDP—right on par with the 17 percent average reg-

1. The state is defined here as “more than the ‘government.’ It is the continuous administrative, legal, bureaucratic and coercive systems that attempt not only to structure relationships between civil society and public authority in a polity but also to structure many crucial relationships within civil society as well” (Stepan 1978, xii).
istered during the 1970s (see table 3). There has been a similar convergence in public investment as a percentage of Latin American GDP (see table 4), which averaged 6.8 percent in the 1970s, compared to 5.4 percent in the second half of the 1990s. These patterns of holding the line on state expansion contrast with those of the industrial bloc countries, where public outlays continue to rise and are now easily 15 to 20 percent higher than those of Latin America (World Bank 1988, 44; World Bank 1997, 22). While one could surmise from the Latin American trends that policy makers finally came to their senses and reined in state expansion, these data also raise some intriguing questions.

First, if public-spending and investment levels in Latin America have circled back to their levels of two decades ago, and if these coefficients have been consistently lower than those in the industrial bloc, what was so problematic about these trends in the first place? Obviously, there is more to measuring the economic presence of the state than the figures just cited; for instance, the overall regulatory framework and the share of GDP captured by SOEs must also be included in any such assessment. Nevertheless, time-series data on the Latin American public sector from 1960 to 2000 seem to throw cold water on the “weight-of-the-state” argument that has underpinned so much of the market-reform drive in the 1990s. These trends also raise the possibility that the state has taken too much of the blame for the policy failures that erupted in the wake of the 1982 debt shocks.

A second question concerns the loose correlation between espoused development strategies and empirical trends in the Latin American state sector. How is it that public spending and investment as a percentage of Latin American GDP are roughly equivalent for two periods that could not be more different qualitatively—that is, the heavy-handed developmental state of the early 1970s versus the reticent, streamlined state of the late 1990s? Not only are these continuities counterintuitive, but they also suggest the extent to which the state-market debate has fallen prey to ideological posturing and stylized facts. The Chilean case, where high growth rates and deep market reforms have coexisted quite compatibly with a strong state presence, underlines the need for more flexible thinking on this subject.

A third question has to do with policy outcomes. In the face of fairly uniform approaches to market reform, how do we explain the diverse political-economic outcomes that have emerged since the revival of growth and investment flows to Latin America in the 1990s? How is it, for example, that Chile has grown twice as fast as Mexico—the country with the second-longest market-reform track record in the region—over the past decade? Or how is it that Peru, a country devastated by guerrilla insurgencies, debt default, and natural disasters as recently as a decade ago, outpaced Argentina and Brazil in terms of its GDP share of exports and investment during the 1990s? Such variables as the
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Note: Expend = public expenditure as % of GDP; Revenue = public revenue as % of GDP; GovDeficit = Government budget deficit as % of GDP; GovDebt = Public and publicly guaranteed debt as % of GDP.
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shadow of the past, differences in the pace and timing of market reforms, and a country’s ties to the international economy must all be taken into account.

But the one set of variables that differs most across these cases is the institutional dimensions of the state and the nature of the state’s ties to civil society. As a number of authors have pointed out, the gaps between expressed policy preferences, concrete government action, and actual development outcomes are best understood by studying the broader institutional and societal context that frames the reform process (Evans, Rueschemeyer, and Skocpol 1985; Sikkink 1991; Evans 1995; Tendler 1997; Bresser Pereira 2000). Despite the apparent continuities over time in the levels of government economic presence, when viewed through this institutional lens, the state-societal dynamics that underpin the Latin American public sector of the late 1990s are worlds apart from those of the pre-1982 era.

Together, these questions form the basis for this chapter. In exploring them I draw, first, on empirical data that track state-sector trends and economic performance in Argentina, Brazil, Chile, Mexico, and Peru during the three development phases mentioned earlier: (1) the ISI/developmentalist era, which for reasons of data availability I treat here as the time period from 1960 to 1980; (2) the decade of economic retrenchment and state retreat that marked the 1980s; and (3) the era of market reform and state streamlining that was well underway by 1990 in all five countries. Second, I rely on institutional analysis as a means for understanding differences in economic performance among these five countries in the prereform period (prior to the 1982 debt shocks) and in the wake of implementing ambitious market reforms.

In this chapter, and throughout the book, institutions are treated in the classic sense, as those formal and informal rules that shape the behavior of individuals and organizations in civil society (Oliver Williamson 1985; North 1990; Burki and Perry 1997). At the same time, I take a more concrete approach to institutional analysis that considers the coherence of the bureaucracy, the delegation of decisional and operational authority, and the kinds of instruments that policy makers have at their disposal (Ikenberry 1988; Keefer 1995; Graham and Naím 1998). From the standpoint of institutional change the bottom line, as aptly summarized by Adam Przeworski (1999, 15), is to encourage “the state apparatus to do what it should while impeding it from doing what it should not.”

The Latin American State: From Developmentalism to Debt Shocks

The Political Economy of State Intervention, 1960–80

With the advent of the 1982 debt shocks, the debate over economic development and structural reform in Latin America suddenly centered on the
numerous shortcomings of statism as it had evolved over the post–World War Two period. One line of criticism pointed to the bloating of the public sector under the impulse of foreign borrowing in the 1970s and to the erosive effects of rampant state participation on economic growth and income distribution (Balassa, Bueno, Kuczynski, and Simonsen 1986; Edwards 1995). A second criticism stemmed from the comparative success of the East Asian states, as the multilateral institutions were particularly insistent that Asia had effectively avoided the debt crisis through its reliance on a market-led development model over this same period (World Bank 1983). \(^2\) While the crucial role of the state in fostering a high-growth export-led model and more equitable patterns of income distribution in East Asia was subsequently acknowledged (Amsden 1989; Wade 1990; World Bank 1993a), the notion that Latin America’s problems stemmed from the weight of the state in the economy remained firmly embedded in ongoing policy debates. The result: a growing chorus of doubters who held that the Latin American state should step back and assign the task of economic development to the private sector and to market forces (Glade 1986; John Williamson 1990).

What light do the time-series data on the Latin American state sector shed on these debates? Ideally, in answering this question we would want to measure the presence of the state sector over time in terms of the extent to which government activities have transformed the political economy and altered the behavior and economic status of individuals and firms. On this count, public expenditures and investment levels tell only part of the story. The rest has to do with the effect of state regulations, patterns of macroeconomic policy making, and other indirect ways in which the state intervenes. For the lack of any single measure that captures these direct and indirect influences, each will be reviewed in turn.

**Direct state intervention**

Tables 3 and 4 present various measures of direct state intervention: public expenditures and revenues, the public-sector deficit, government debt, public and private investment, and the SOEs’ contribution to GDP. As table 3 shows, the link between state largesse and the region’s external borrowing spree of the 1970s is less robust than the critics would have us believe. For example, the first column in table 3 confirms that the public sector had asserted its economic presence well before the 1970s (Fishlow 1990). For four of the five countries in table 3, the period from 1960 to 1980 includes the first

\(^2\) It was impossible to overlook East Asia’s average weighted growth rate of nearly 8 percent during this same period, not to mention an average annual inflation rate that was well below 10 percent.
ISI phase of producing light manufactures behind high tariff walls, as well as a second developmentalist phase based on a combination of import substitution and the promotion of heavy industries (autos, steel, petrochemicals) geared toward exports. Chile was the one exception to this trend. Upon the installation of a military regime in 1973, Chilean policy makers jettisoned ISI and embraced a staunch market strategy for the duration of the military’s seventeen-year reign. While the Chilean state still maintained its strong presence in the economy, this redirection of public resources into market-supporting endeavors was the harbinger of a more generalized regional trend that took root post-1982.

As private loans on international capital markets became increasingly available to these middle-income borrowers through the 1970s, there was indeed a tendency toward higher public spending. In relative terms, public-spending levels rose in varying degrees in all five countries from 1960 on; yet, in absolute terms, Latin America’s average level of public spending as a percentage of GDP still paled next to that of the industrial bloc countries. Take the example of the United States, a country widely considered to be the least interventionist of this group: U.S. public spending as a percentage of GDP stood at 28 percent in 1960, compared to 16 to 19 percent in Chile or Peru—those countries with the highest levels of state spending at this time. In 1985, this same figure for the United States was 37 percent, versus Latin America’s average of around 24 percent (World Bank 1988, 44). Thus, it appears that state expansion per se was less the problem in Latin America during this period than was the tendency to rely on debt financing to cover a growing public-sector revenue gap.

The universal increase in government-held debt after 1970 reflects two key developments. First was the deterioration of public finances. Although state budgets were generally in deficit throughout the post–World War Two period in Latin America, these deficits accelerated sharply after 1970 (Stallings 1987, 362–63). While tax collections did not collapse entirely, external borrowing made it all the easier for most states to avoid the political conflicts commonly associated with fiscal reform. Second was the way in which these borrowed funds were put to use. Individual country experiences indicate a variety of destinations, including some combination of government consumption (the costs of the state bureaucracy), social transfers, fixed investment, and the financing of capital flight from the region.

As table 4 shows, the link between public investment and governments’ ability to borrow was a direct one. In every country but Chile, public investment as a percentage of GDP peaked during the late 1970s or early 1980s, then gradually declined during the following decade of capital scarcity. Chile differed only to the extent that this same cycle occurred earlier, as public...
investment reached a high during the statist administration of President Salvador Allende (1970–73) and contracted in the period following the debt crisis. Apart from these continuities, individual country experiences indicate considerable differences in how borrowed funds were invested (Larrain and Selowsky 1991, 309–10).

For instance, in Brazil, Mexico, and Peru, governments borrowed to support manufacturing and infrastructure investments; in Argentina and Chile the private sector borrowed to participate more strongly in finance-related activities. In Argentina, Chile, and to a lesser extent Mexico, the explosion of government-held debt post-1982 reflects the degree to which the public sector was called upon to rescue private investors in the throes of the debt crisis. Nevertheless, in the end, Brazil, Chile, and Mexico are considered to have invested these borrowed funds fairly well, while Argentina and Peru did not (Frieden 1991, 74–80). As the following chapters will show, the lost opportunities from debt-backed consumption, versus borrowing for productive investments, emerge as a major theme in the Peruvian case.

The SOEs constitute the final measure of direct intervention and an essential component for understanding the changing economic role of the Latin American state during the developmentalist era. While the SOEs have frequently been singled out as the prime institutional outback for rent-seekers and venal bureaucrats, the disparate trends concerning the SOE share of GDP that appear in table 4 make it difficult to fully pin the blame on the SOEs for the region’s economic disappointments. Two interlocking explanations account for the erratic pattern of SOE presence in the Latin American state sector.

First is the genuinely productive role that the SOEs have played in some countries in areas such as transportation, energy, and mining, where economies of scale and overhead costs simply surpass the resources of private entrepreneurs (Hirschman 1967; Glade 1986). For example, Chile’s disproportionately higher share of SOE activity can be accounted for largely by state dominance of all aspects of copper production. There are also cases like Brazil, where SOE-sponsored infrastructure and other productive investments have succeeded in fostering the growth of downstream private enterprises (Trebat 1983).

The second explanation brings us closer to understanding how the evolution of the state-enterprise sector has been problematic. Along with the oft-cited inefficiencies related to subsidies and the pricing policies of SOEs (Glade 1986), greater access to foreign loans encouraged states to haphazardly assume a more entrepreneurial role through the creation of public companies. For example, debt data show that SOEs in Latin America consumed some US$80–100 billion in foreign loans from 1972 to 1982, but information
is scarce on the ultimate use of these funds (Stallings 1987, 128). Thus, the data in table 4 suggest that, at the height of SOE activity in the 1972–86 period, some of these public entities did indeed serve as slush funds for central governments.

Indirect state intervention

Despite the considerable variation across countries in patterns of state regulation and macroeconomic policy making during this developmentalist era, there were some clear continuities with regard to indirect forms of intervention. Among those regulatory laws that private actors pointed to as most prevalent and distorting of domestic markets were price controls, interest-rate ceilings, onerous corporate tax rates, profit sharing, and high tariffs on trade (Balassa, Bueno, Kuczynski, and Simonsen, 1986; Burki and Perry 1997). It was these regulatory distortions, combined with the rising levels of public investment in the pre-debt-crisis period, that fueled antistatist claims about the public sector “crowding out” private initiative. However, this matter is not so simple. A closer look at the regionwide investment trends portrayed in table 4 suggests that, at least up until the widespread privatization programs of the early 1990s, public and private investment trends moved in tandem and were thus more complementary than adversarial (Pastor 1991, 16). Nevertheless, as amenable as the state may have been to enabling the private sector to knit itself into the public-investment portfolio in most countries, regulations such as those mentioned earlier also sent very mixed signals to domestic entrepreneurs.

Discussions of macroeconomic management in Latin America prior to the 1980s focused on trade, fiscal, and monetary policies, as well as the interplay of these policies with external borrowing by governments in the region. As former Panamanian president Nicolás Ardito-Barletta (1994, 183–84) has pointed out, up until the debt crisis most Latin American governments paid little attention to the technicalities of macroeconomic policy management:

Exchange rates were fixed relative to several of the main hard currencies. Import controls were part of the import substitution policies. Reserves were normally kept low and were not built up with favorable movements in the terms of trade. Fiscal policy consisted in deciding how much of the government deficit would be financed domestically because this would determine the increase in the quantity of money and inflation. Monetary policy was used mainly to keep interest rates low, producing excess demand for credit and allowing governments to direct credit to priority sectors, which they defined.
In general, the leeway created by foreign borrowing throughout the 1970s permitted most governments to postpone the necessary macroeconomic adjustments in the face of oil-price hikes and international interest-rate shocks. At least temporarily, political leaders were also able to avoid confrontation with domestic capitalists and organized labor by delaying any larger economic policy reforms. As seen in table 1, by 1982 the basic pattern of nonadjustment had generated external imbalances in the form of erratic patterns of foreign direct investment (FDI), burgeoning current account deficits, and an explosion in the debt overhang as the U.S. Federal Reserve Bank turned in 1978 to a combination of high interest rates and a strong dollar as its main anti-inflationary strategy. At this point, internal macroeconomic imbalances took the shape of rising inflation and budget shortfalls within the central government and the SOEs.

In hindsight, the broader outcomes under a developmentalist model present a mixed record for the state. On the one hand, as consumption tripled and investment quadrupled from 1960 on, Latin American GDP grew at an annual average rate of 5 to 6 percent until 1982 (Inter-American Development Bank [IDB] 1986, 430). On the other hand, the state-led development strategy fell short of promoting more productive and equitable patterns of growth. While exports expanded two and a half times during these two decades, the increased levels of investment did little to diversify the composition of trade (IDB 1988, 541). Aside from the 40 percent level of manufactured exports achieved by Brazil and Mexico, by 1982 traditional primary exports still accounted for 80 percent of all exports from the region (Sheahan 1987, 90). Moreover, social spending and human-capital investments registered the least impressive performance of all. On the eve of the debt crisis, Latin America had long surpassed the rest of the developing world in terms of income inequality.3

From this mixed record, it is now possible to refine the weight-of-the-state argument by specifying those trends within the Latin American public sector that helped shape much of today’s market mind-set. While it turns out that indirect modes of government action have been just as problematic as direct state participation, the preceding analysis shows how the two worked together to tarnish the overall image of the state by 1982. The institutional backdrop pre-1982 was clearly a contributing factor, a point I return to in much more detail later in this chapter. For now, this problematic state-led

3. It is important to keep in mind the distributional effects of capital flight. By shifting their assets abroad during this period, domestic capitalists protected their wealth from taxes, devaluation, and inflation. Workers and the poor who were unable to evade these price erosions, or to avoid the additional costs of stabilization, suffered harsh drops in real wages (Pastor 1990).
dynamic, which had crystallized to varying degrees in all five of the cases considered here, can be summarized as:

- an over-reliance on external borrowing, which allowed for the chronic mismanagement of key macroeconomic policies;
- an increasing dependence on public enterprises to carry out the state’s development tasks, against the backdrop of weak administrative structures;
- the cultivation of an ambiguous relationship with the domestic private sector, which claimed to lack confidence due to the state’s regulatory intrusions and poor macroeconomic skills, while admittedly benefiting from debt-backed public-investment drives and government bailouts; and
- heightened poverty and inequality, as developmentalist policy makers failed to bridge the gap between distributional rhetoric and social policies that were in fact inefficient, poorly targeted, and regressive in practice.

The following section examines Latin America’s track record in attempting to rectify this pattern with a more market-oriented management strategy over the course of the 1980s.

The State-in-Retreat, 1982–90

It took the remainder of the decade for policy makers to grasp fully the implications of the price, commodity, and capital shocks that had hit Latin America in the early 1980s. In the wake of the debt crisis, the lax macroeconomic scenario described earlier was simply no longer an option; public and private lending to the region had turned to a net negative outflow, and official aid flows were negligible. Suddenly, the main sources of foreign exchange were export earnings, FDI, and portfolio investment (primarily stocks and bonds), all of which required a more stable and convincing set of market signals. Given the context of severe balance-of-payment crises and these more limited and competitive options for obtaining foreign exchange, policy makers gradually realized that they had little choice but to launch the kinds of market-oriented stabilization and adjustment measures that would appeal to private investors (Schneider 1998; Remmer, forthcoming, 2003).

In the initial phases of stabilization and adjustment, crisis managers generally turned to the orthodox prescriptions that had long been advocated by the International Monetary Fund (IMF) and the World Bank (Kaufman and
Yet, by 1985, attempts at fiscal and monetary tightening had produced mixed results at best. Of the five countries discussed here, only Chile had succeeded in charting a sustainable path of solid economic recovery, largely because of the progress that had been made with trade and fiscal reform prior to the debt crisis—which, in turn, reflected a rigorous process of internal state reform then underway (Velasco 1994; Marcel 1999). In the other four countries, growth rates were erratic, inflation continued unabated, and the debt burden mushroomed.

Argentina, Brazil, and Mexico sought to service their debt by running massive trade surpluses achieved through competitive exchange-rate devaluations and high import tariffs. However, as inflation hit triple digits in Argentina, Brazil, and Peru by 1985, policy makers lost faith in IMF remedies. All three countries launched “heterodox” anti-inflation shock programs that relied on fixed exchange rates and wage and price controls (Crabtree 1992; Pastor 1992; Edwards 1995). The outcome in each case was disastrous, consisting of four-digit inflation and huge losses in GDP from 1987 to 1990. These results provided yet another reality check on the steep costs of reckless policy interventions in the new age of deeper international financial integration and higher capital mobility.

As for the state’s widely acclaimed retreat from the economy during the 1980s, there are two ways of assessing this trend, one quantitative and the other qualitative. On the quantitative front, tables 3 and 4 show that in every country but Brazil there was a clear downward trend in government expenditures, tax revenues, and the SOE share of GDP. It was, however, public investment that bore most of the brunt of state retrenchment in the 1980s, as the prolonged recession forced most governments to cancel their earlier commitments toward infrastructure spending. Cuts in public investment, which are easier to execute than more politically controversial reductions in government consumption, became the prime means for financing the explosive interest payments on the public sector’s mounting external debt (Dornbusch 1986, 68). Although more expedient in the short term, these public-investment cuts slowed the recovery process in Latin America, as governments failed to lay sufficient groundwork for the development of future productive capacity.

Privatization became perhaps the biggest catchword for the state’s economic retreat in the 1980s. Defining privatization in broad terms as the removal of assets from the public sector and their placement under private control, the data in table 4 suggest that this process did not get seriously underway until the early 1990s. Apart from the reticence of the private sector to come forward without the promise of state protection and guarantees for
lucrative returns on liquidated state assets, progress with privatization was slow for other reasons (Glade 1986; World Bank 1995). First was the tension between short-term stabilization and adjustment goals and the longer time horizon needed for the effective curbing of the SOE sector. Second was a misplaced faith in privatization as a quick fix for bolstering public finances or increasing the state’s financial liquidity in the context of a decade-long economic crisis. As essential as privatization may have been for modernizing the state sector in the aftermath of the 1982 debt shocks, country-specific efforts were impeded by intense political and bureaucratic conflict (Schneider 1991).

As for a more qualitative assessment of the state’s retreat post-1982, this period has subsequently been portrayed in the literature as a “first phase” in the implementation of market reforms (Naim 1994)—a process that was cemented by the end of the decade by a “Washington Consensus” over both the efficacy of the market and the role of macroeconomic stabilization as a necessary condition for the success of market reforms (John Williamson 1990). Yet, in retrospect, rather than a purposive set of short- and medium-term strategies geared toward easing the state out of the economy, what stands out in the individual country experiences is the erratic and crisis-driven nature of state retreat. In Argentina and Peru the state had literally collapsed by 1989, while in democratizing Brazil the state actually reasserted itself with a vengeance. In Mexico, despite the apparent success in implementing market reforms based on liberalization, privatization, and deregulation, policy makers were still struggling by the end of the decade to accomplish basic macroeconomic stabilization goals that had been established back in 1982.

Also of note here is the lack of progress in resolving elements of the problematic state-led dynamic described in the previous section. Despite the abrupt halt in external capital flows to the region, government debt exploded across the board in 1985–89. In some cases, such as Brazil and Peru, the pre-1982 reliance on “foreign savings” translated into a de facto moratorium on debt service payments, which allowed for further profligacy on the part of the central government. Moreover, in all five countries examined here, inflation was still running at two to four digits by 1990. Some measured progress had been made with the reform of the SOE sector; however, outside of Chile, private investors showed no signs of rushing back in. The least progress of all had been made on the distributional front, as social-expenditure cuts fell on the poor and revenue generation shifted sharply toward more regressive value-added taxes on goods and services.

Finally, how do we explain the diverse outcomes that emerge from the data? Chile was unique in its ability to sustain economic growth after the 1982 shocks, although a harsh military regime had provided policy makers with
ample political leeway to experiment with market reform until the desired results were obtained. Yet policy makers within Mexico’s semiauthoritarian single-party regime were similarly obstinate and heavy-handed about pursuing market reform at any social cost, but economic recovery proved elusive. Some of these differences have to do with the uneven pace and timing of market reforms and with the array of seemingly interminable pressures that each country faced on the international front. However, other puzzles, such as Brazil’s stubborn resistance to economic stabilization well into the 1990s, demand further explanation.

Throughout this book I seek answers to these diverse and sometimes counterintuitive outcomes by examining the interplay between ongoing international economic trends and those domestic institutional structures that shape the choice of policy and its implementation (Skocpol 1985; Haggard and Kaufman 1989; Evans 1995). Institutional analysis is certainly not alone in tackling this research question. In fact, it has competed with, and been bolstered by, those approaches that emphasize some combination of societal influences and rational choice (Ames 1987; Frieden 1991; Geddes 1994), as well as those that place analytical weight on the nature of the prevailing political regime (Remmer 1990; Haggard and Kaufman 1995). Before an analysis and interpretation of the data on the “streamlining” of the Latin American state in the 1990s, the next section briefly elaborates on the usefulness of institutional variables for explaining the cross-country diversity in political-economic outcomes under the impulse of market reform.

The Institutional Setting: Four Working Hypotheses

From the standpoint of institutional analysis, the 1982 debt shocks marked the critical point where prolonged economic volatility threw the region’s institutional weaknesses into sharp relief, so much so that in the 1990s institutional renovation emerged as a necessary condition for economic recovery and the completion of market reforms (Burki and Perry 1998). In table 5 I have sketched the main institutional variables that stand out in the literature on the political economy of policy reform, and in the following sections I treat each of the four variables situated on the lefthand vertical axis of table 5 as a working hypothesis. In doing so I trace the ways in which analytical weight considering the nature and importance of each variable has shifted across the prereform (1960–80) and postreform (1980–2000) periods, and I highlight the increasing role these variables have been assigned for successfully sustaining market reforms.
<table>
<thead>
<tr>
<th></th>
<th>Prereform Period</th>
<th>Reform Period</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Bureaucratic autonomy</strong></td>
<td>• Loosely linked administrative structures permeated by special interests</td>
<td>• Insulated political structures with regulated access</td>
</tr>
<tr>
<td></td>
<td>• Clientelism main form of exchange</td>
<td>• Clientelistic exchanges minimized</td>
</tr>
<tr>
<td></td>
<td>• State goals not clearly defined</td>
<td>• State goals not easily subverted</td>
</tr>
<tr>
<td><strong>State economic and planning institutions</strong></td>
<td>• Lack of major planning or economic institution; existing agencies marginalized or made ineffectual for political reasons</td>
<td>• A few powerful economic and planning institutions</td>
</tr>
<tr>
<td></td>
<td>• Narrow decisional leeway with policy making ad hoc and dispersed</td>
<td>• Decisional and operational authority linked to strategic policy areas</td>
</tr>
<tr>
<td></td>
<td>• Hiring and promotion within state bureaucracy</td>
<td>• Technically skilled civil service governed by merit procedure</td>
</tr>
<tr>
<td></td>
<td>• Governed primarily by personalistic ties</td>
<td></td>
</tr>
<tr>
<td><strong>Leadership coalition</strong></td>
<td>• Frequent changes of government and/or regime with unpredictable swings in policy</td>
<td>• At the level of the state, stable leadership in the executive able to legitimize itself through skillful use of incentives and disincentives</td>
</tr>
<tr>
<td></td>
<td>• Undisciplined internal bureaucratic structures easily captured by private actors</td>
<td>• A sophisticated network of public-private ties capable of steering policy without directly interfering in it</td>
</tr>
<tr>
<td><strong>Interest intermediation</strong></td>
<td>• Fragmented and competing interest group organizations</td>
<td>• Policy mediated through peak organizations (industry associations, trade unions) that are recognized and respected by the state</td>
</tr>
<tr>
<td></td>
<td>• Attempts by the state to forge policy circumventing key societal interests or through haphazard mediation</td>
<td>• Ongoing state-societal consultation and predictable rules of the game with regard to negotiation of new policy initiatives</td>
</tr>
</tbody>
</table>
Bureaucratic Autonomy

Working hypothesis: Economic performance is enhanced by political structures that insulate technocrats and economic decision makers from outside pressures, enabling them to maintain organizational integrity while pursuing their own goals. The access of popular-sector groups, and even political elites, is reduced in order to avoid the vagaries of populist politics. These insulated agencies are not entirely cut off from outside influence or from party politics, but intrusions and clientelistic exchanges are minimized, and state goals are not easily subverted.

Discussion

Up through the 1970s, “autonomy” was generally interpreted from the dependency or neo-Marxist viewpoint that focused on the ability of the state to intervene against the immediate interests of domestic capitalists in pursuing policies that worked to reproduce a dependent capitalist model (Franko 1998). Such analyses held that state autonomy was enhanced when elites were divided or when threats from below induced the dominant class to grant the state wider leeway in the policy-making process. The drawbacks to this dependency approach as an explanatory framework became all too apparent when the 1982 debt shocks hit: abstract debates over the “relative autonomy” of the state offered few insights into the sources of policy success or failure (Skocpol 1985, 5; Conaghan and Malloy 1994, 14) and hence into the diverse reform outcomes that began to emerge in the post-1982 period.

A second approach to autonomy concerns itself directly with the question of economic performance and turns to certain characteristics of the bureaucracy as explanatory departure points. Contrary to the dependency view, this basically Weberian position holds that policy success stems not from divisions within the dominant classes but rather from the varying degrees of collaboration among state managers, political elites, and the representatives of powerful interests (Rueschemeyer and Evans 1985). For example, Evans (1989, 581; 1995, 12) argues convincingly that sound economic performance derives from the ability of state policy makers to join well-developed bureaucratic internal organizations with a sophisticated network of public-private ties. Under less successful scenarios, undisciplined internal bureaucratic structures are controlled by the same public-private network, but chaotically, leading to the kinds of erratic policy shifts that ultimately undermine reform programs meant to attract private productive investment.

In further disaggregating this term, Eliza Willis (1986) distinguishes among three main types of bureaucratic autonomy: the ability of politicians and bureaucrats to make decisions independently of dominant social groups;
the freedom of the state bureaucracy from the control of patron-client networks; and the level of managerial discretion afforded government bureaucrats, especially those working within the main economic institutions and state enterprises. Obviously, there is no set measure for the extent to which these features exist or can be cultivated within the state bureaucracy. A more likely scenario is one where strategic sectors of the state bureaucracy are “depoliticized” and managed as if they were private. As in Brazil under the Vargas (1930s) and Kubitschek (1950s) administrations (Nuñes and Geddes 1987; Schneider 1991; Sikkink 1991), or in Peru under a reformist military regime in the 1970s (Stepan 1978; Wise 1994), the bureaucracy-at-large can be plagued by clientelism; however, the creation of pockets of efficiency within certain key sectors can also serve as a crucial countervailing force for accomplishing the development tasks at hand.

The need to professionalize Latin American bureaucracies, and to expand on these otherwise sporadic efforts at cultivating strategic units of efficiency within the main state institutions, came clearly into focus in the post-1982 period. As states subsequently advanced on the market-reform agenda, the need to extend these enclaves of expertise within the general structure of government, and to ground them more constructively in broader reform coalitions (Haggard 1995, 57), became all the more urgent. Within this more recent regional context, political-economic debates over the role of bureaucratic autonomy in the promotion of market reforms have become quite literal. Especially since the early 1990s, the general trend in the five emerging-market countries discussed here has been to tackle the broader tasks of administrative reform in the bureaucracy at large (e.g., strategic planning, performance-based management, integrated budget systems, a modernized civil service), while simultaneously creating a range of autonomous agencies to streamline reform efforts in areas like regulation and service delivery where the state’s capacity has traditionally been weak (Burki and Perry 1998, 131–35; Bresser Pereira 1999).

This more recent brand of bureaucratic autonomy differs from that of the pre-1982 period in Latin America in that today’s enclave agencies tend to sit outside of the central government and are linked not to the line ministries or the congress but directly to the office of the executive. In Chile and Peru, and to a lesser extent Argentina and Brazil, the benefits of this almost strictly vertical arrangement have been the rapid completion of urgent reform goals—for example, in tax and customs administration, banking and insurance oversight, competition policy, and the provision of key public goods (Wilkins

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4. I thank Kwang Kim for his comments and for sharing his insights on this more recent literature on bureaucratic autonomy.
1999). In most of these instances, the autonomous agencies are self-financed through user fees or their equivalent, and personnel selection and compensation are based more on private-sector standards and contractual performance indicators (Shepherd 2000, 5–6). As healthy electoral competition has clearly heightened over the past decade, and consumers and voters have come to expect concrete results from market restructuring, the channeling of reforms through truly autonomous agencies has allowed for a powerful demonstration effect.

However, as successful as some of these agencies have been in “getting the job done,” there is also a downside to this phenomenon of circumventing the public bureaucracy altogether. First, although autonomous agencies in the 1990s were typically self-financed through user fees or other service charges, this has not always translated into financial accountability (Keefer 1995). Second, while heavily dependent on autonomous agencies to make good on their policy goals, Latin American executives have been reluctant to relinquish control in ways that would more firmly institutionalize these agencies. For these reasons, there is a growing consensus that it will be difficult to sustain the integrity of autonomous agencies without integrating them more effectively into the state’s legal and administrative apparatus (Burki and Perry 1998; Shepherd 2000)—a feat that only Chile has thus far accomplished (Marcel 1999).

State Economic and Planning Institutions

*Working hypothesis:* Effective policy outcomes also depend on the consolidation of a few powerful economic and planning institutions that closely link decisional and operational authority in strategic policy areas and have access to a broad range of instruments for implementing policy. Institutional continuity and efficacy rest on a technically skilled civil service governed by merit procedures and bolstered by a network of other public-sector agencies—for example, research institutions, regulatory commissions, and judicial oversight.

Discussion

While the integrity of a certain policy course depends to some extent on the ability of frontline decision makers to distance themselves from the clamor of societal pressures, policy outcomes also hinge on the overall cohesion of state economic and planning institutions (Graham and Naím 1998). Interestingly, however, for all the recent emphasis on institutions as independent variables within political science circles (the “new institutionalism”) and the economics discipline (the “new institutional economics”), in both instances institu-
tional definitions remain somewhat removed from the phenomena that they seek to explain. Classic statements from Oliver Williamson (1985) and North (1990) have held the strongest sway. Each posits institutions as those formal and informal rules that shape the behavior of individuals and organizations in civil society (Burki and Perry 1998, 2). Formal rules refer to constitutions, laws, regulations, and internal procedures that guide the conduct of certain organizations; informal rules are the norms and values that guide state-society relations. Underpinning these definitions is mainly a concern for economic efficiency, as Moe’s (1984, 759) view on institutions reveals: “Given transaction costs . . . rational actors find them more efficient than markets or alternative organizational arrangements.”

But what about the role of these same institutions as a prime locus for political-economic change? Even the Washington Consensus, for all its boldness in ascribing a basically multilateral agenda to the collective policy goals of Latin American reformers, had little to say about the institutional setting that would be most conducive for the realization of such reforms (Birdsall and de la Torre 2001). This is doubly surprising, given that the ultimate success of these reforms would directly depend on the initiation of considerable institutional change in order to sustain them. The region’s cumulative experience with globalization over the past three decades has both revealed the weaknesses of national institutions in guiding this process and given rise to new demands for institutional reform.

Throughout this book, my focus will be on the roles that state planning and economic institutions, in particular, have played in the reform process over time. For most of the post–World War Two era in Latin America, the traditional institutional scenario was one where these state institutions were frequently divided, both ideologically and according to levels of expertise. Central banks and ministries of finance generally embodied the more monetarist views of the IMF and were staffed with economists and accountants; planning and other sectoral ministries were more likely to house the dependency or developmentalist views associated with the Economic Commission for Latin America and the Caribbean (ECLAC) and ISI and were staffed with lawyers, engineers, sociologists, and to a lesser extent, economists. Despite the isolated instances of bureaucratic modernization mentioned earlier, these crosscutting policy preferences rarely took root in any constructive manner. Rather, they were subject to constant interference and frequent coalition shifts and hence helped to perpetuate the haphazard macroeconomic patterns that prevailed in the region up through the 1980s.

Yet, in spite of Latin America’s serious institutional constraints, the impact

of a decade-long economic crisis in the 1980s also created intense pressures and new opportunities for institutional reform (Grindle 1996, 31–34). Some general trends have included the outright elimination of those state institutions that had become relics of a protectionist past, such as Mexico’s former Ministry of Industrial Development or Peru’s National Planning Institute; the creation of numerous new state agencies across the region to enforce the complicated mass of regulations that have been passed to ensure greater transparency and competition in the provision of infrastructure and public services (Burki and Perry 1998, 4); and, in Chile, Mexico, and Peru, the passing of legislation that grants central banks independence from executive interference and from the fray of congressional and legislative politics.

For the sake of parsimony, in this study I approach this complex process of institutional change from two angles. First, institutions are treated as a set of administrative, legislative, and regulatory rules that guide the adjudication of conflict; and second, they are analyzed in terms of the coherence of the bureaucracy, the centralization of decisional and operational authority, and the kinds of instruments policy makers have at their disposal (Ikenberry 1988, 226–27). On the first count, the extent to which market-oriented rules and norms have been generated in Latin America post-1982 is truly remarkable. All five reformers considered here have offered numerous guarantees in the areas of trade (e.g., market access, dispute-resolution panels), investment (e.g., national treatment for FDI, competition policy to uphold antitrust guidelines), and property rights.

Furthermore, all five have also sought to bolster these new rules and norms and to bind their commitment into the future through participation in the World Trade Organization (WTO) and other regional trade and investment schemes such as the North American Free Trade Agreement (NAFTA), the Andean Community, and the Southern Cone Common Market (MERCOSUR). The consistent enforcement of these rules and norms still lags, however, as judicial systems in the region have proved to be the most resistant to internal change; moreover, some powerful private-sector actors have been much more enthusiastic about benefiting from market-based rules than they have been about adhering to them (Glade 1986). Nevertheless, the generation of such rules is clearly an essential step, as well as a necessary institutional condition for the long-run success of market reforms.

On the second count, it has also been recognized that issues of bureaucratic efficacy and decisional and operational authority are equally important, so much so that this subject has inspired a whole cottage industry of literature on the intricacies of bureaucratic and administrative reform in the region (Rauch and Evans 2000). The two main strands within this literature are those analyses that approach the subject from the standpoint of the “New
Public Management” and those that examine the broader political-economic context within which such reforms must be finessed. The former, unfortunately, tends to rely on normative policy prescriptions and public-administration platitudes (World Bank 1997), while the latter recognizes that bureaucratic and administrative change digs into much deeper institutional tissue than the kinds of rule-based reforms discussed earlier (Haggard 1995; Centeno and Silva 1998; Heredia and Schneider 1998). Indeed, across the region, the generation of “first-phase” institutional rules to support liberalization, privatization, and deregulation was done mostly by executive decree; although the pain of adjustment was widely dispersed, so were the gains in terms of macroeconomic stabilization and the restoration of growth (Naím 1994; Pastor and Wise 1999a).

In contrast, bureaucratic and administrative reform inflicts more concentrated pain (loss of power and access to patronage), while the benefits (greater public accountability, increased efficiency in the delivery of key public services) are far less tangible—hence, the relegation of this brand of institutional change to the category of “second-phase” market reform, that is, policies that are also necessary for the successful sustainability of a market-based development model but that are not as easily implemented due to their potential for generating opposition and political conflict (Naím 1995; Pastor and Wise 1999a). To put this another way, it is one thing to shut down a set of defunct institutions plagued by some combination of backward thinking and fiscal crisis or to create new economic institutions; however, the lasting change of internal rules within existing institutions has turned out to be quite another matter and one of the most challenging second-phase tasks of all.

Those who analyze institutional reform from this political-economy perspective identify three main challenges (Haggard 1995, 17; Heredia and Schneider 1998): (1) the need for more penetrating civil-service reform, which entails the reduction of favoritism and politicization of the state bureaucracy through greater reliance on merit criteria in recruitment, promotion, and tenure decisions (Chaudry, Reid, and Malik 1994); (2) the need to strike the right balance between bureaucratic autonomy, as discussed earlier, and the grounding of key administrative agencies in broader reform coalitions; and (3) the need to democratize the reform process, such that greater legislative oversight and citizen input can better offset the excessive power that has been concentrated in the office of the executive since the onset

6. The goals of the New Public Management (devolution of decision making, performance and market orientation, and client focus) are sound, but in borrowing heavily from the private sector and the Organisation for Economic Cooperation and Development (OECD) experience, they beg the question of the politics of implementing these strategies in a much different bureaucratic setting, like that of Latin America (see Burki and Perry 1998, 125).
of market reforms. These are also the guidelines that will direct my analysis of Peruvian institutional reform in the chapters that follow.

The Leadership Coalition

Working hypothesis: Effective modes of economic reform are furthered by stable leadership that enjoys the support of dominant groups that can legitimate, through the skillful use of incentives and disincentives, the policy changes they initiate. It is the coherence of this group, backed by autonomous segments of the bureaucracy and the state’s sound economic institutions, that accounts for effective negotiations with external actors, as well as the relatively successful shifts in development strategy when the economic need has arisen.

Discussion

Theories of coalition formation commonly presume that political ties are forged around market positions and that the participation of all the various partners is a reflection of sectoral interests and what they hope to gain (Olson 1968; Frieden 1991). For the most part, however, these theories treat coalition formation in an analytical vacuum, with insufficient regard for the broader institutional context. In understanding the two main coalition patterns that have prevailed in Latin America—the populist movements of the early ISI era and the “triple alliance” among the state, foreign capital, and domestic entrepreneurs that followed in the 1960s and 1970s—this interest-driven model provides a useful starting point for analyzing how coalitions are formed but not for explaining the policy outcomes that have emerged. For this, the state’s institutional backdrop must also be considered, as it bears strongly on how interests are formulated and then put into action.7

The constellation of interests that pushed for the continuation of ISI dates back to the broad, multiclass, populist coalitions that sprang up around this development model at its inception in the 1930s and 1940s.8 Over time, entrenched ISI interests succeeded in maintaining the model long after it had proved ineffective. Beginning in the 1960s, recurrent balance-of-payment crises and the consistently low returns on the state’s wide range of economic endeavors forced a shift to a second, “developmental” phase of ISI. In

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7. As John Zysman (1983, 295) has argued, “Institutions help determine which political issues emerge as subjects of debate, which groups become allies in the ensuing fight, and how capable of acting on its interests a given coalition will be.” Up until the late 1980s in Latin America, policy outcomes under both coalition patterns readily illustrate this point.

8. The Vargas administration in Brazil (1938–45), the Cárdenas era in Mexico (1930s), and the first Peronist government in Argentina (1940s) all exemplify this populist coalition pattern.
Argentina, Brazil, and Mexico, for example, political and economic elites regrouped to promote a more sophisticated industrial pattern of vertical production based on private investment, capital-goods exports, and the staking out of new niches in the international economy (Sikkink 1991). But despite the emergence of the famous triple alliance among the state, foreign capital, and domestic entrepreneurs around this developmentalist strategy (Evans 1979; Gereffi and Evans 1981), it turned out to be no more stable, coherent, or skillful than the unruly multiclass populist coalitions that preceded it.

In the post-1982 period, the incentives for devising more cohesive and skilled leadership coalitions, and for launching more penetrating institutional reform, changed dramatically. As the debt shocks of the early 1980s marked the unraveling of authoritarian military regimes everywhere but Chile, newly elected civilian politicians and bureaucrats were at once challenged to leverage new private investment from the ruins of ISI and to appease their constituents within an increasingly vocal and competitive political market. This confluence of political liberalization and a virtual capital drought gave rise to two distinct coalition patterns post-1982. The first was a regrouping of state-business relations, as intense pressures to raise both domestic and foreign investment induced government policy makers to devise a more targeted and sophisticated range of incentives to attract private capital. Given the context of state retrenchment, stabilization shocks, and deep structural reform, domestic private actors were drawn in to market-reform coalitions through a combination of direct and indirect compensatory policies (Edwards and Lederman 1998, 28–31). As a way of further signaling their commitment to private investors, political leaders across the region also stacked their cabinets with highly trained promarket technocrats (Schneider 1998, 84–90).

The second coalition pattern post-1982 reflected the efforts of civilian leaders to maintain broad political support in the midst of implementing sweeping programs of market reform. Having basically cast their loyalties with the private sector, the corresponding trend of democratization meant that politicians and technocrats still had to find credible ways to accommodate recently enfranchised groups within civil society. In Argentina and Mexico, for example, leadership coalitions were able to survive politically and retain support for market reform by selectively accommodating those factions that were best positioned to thwart the ruling coalition’s chance for reelection (Geddes 1994; Corrales 2000a). In all five countries considered here, executive leaders also reached out to appease their poorer constituents

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9. Direct compensation includes the transfer of cash or financial securities, while indirect compensation implies compensating affected groups through policies that either raise their revenues or reduce their costs (Edwards and Lederman 1998).
by offering short-term social-adjustment relief in the form of safety-net programs and support for emergency employment efforts (Graham 1994).

Interest Intermediation

*Working hypothesis:* State policy making is enhanced by the organization of societal interests along tripartite lines, where policy is mediated through peak organizations (business and industry associations, trade union federations) that are sanctioned by the state. Such organizations serve as “strategic levers” that facilitate a consultative relationship with the private sector and allow government officials wide leeway in the filtering of social demands onto the political agenda.

Discussion

Whereas the question of interest intermediation in the advanced capitalist countries has long been dominated by pluralist analyses of the role of voters, political parties, and congressional coalitions as the main determinants of policy, in post–World War Two Latin America the numerous interludes of authoritarian rule rendered such explanations less relevant. Rather, with the expansion of the developmentalist state, and with it more centralized and politicized trade unions and producer associations, interest intermediation in Latin America was conducted along more corporatist lines. At its most benign, corporatism can be defined as a political order based on functional socioeconomic organizations in civil society, operating independently but united with each other and the state in sectoral and national decision-making bodies (Stepan 1978, 46).

However, critics rightfully contend that such parallel corporatist arrangements in Latin America have rarely conformed to this ideal type of tripartite exchange (O’Donnell 1988). Corporatist practices in the region have varied according to the degree of centralization and inclusiveness in the bargaining process and the extent to which the state was a benevolent or more forceful sponsor. Although corporatist strategies spanned civilian and military regimes alike prior to the 1980s, the track record suggests that corporatist intermediation succumbed most frequently to state coercion and selective exclusion in the resolution of conflict between competing interests. This was certainly the case in authoritarian Brazil post-1964; in Chile post-1973; and in Mexico, where a single ruling party went uncontested until the late 1980s. Nevertheless, on the eve of the debt crisis in all three countries, even this heavy-handed mode of corporatism resulted less in a coherent set of policies formulated via state-societal consultation and more in the subordination of public policy to private interests.
With the advent of the 1982 debt crisis, and the concomitant collapse of authoritarian rule in most of the region, patterns of interest intermediation moved along two main axes. The first was the state-capital-labor axis, which began to shift from the more clientelistic and inefficient “prereform” column in table 5 to the more effective modes of interaction detailed in the “reform” column. With the hardening of the external sector in terms of aid, trade, and lending to Latin America, domestic groups found themselves face-to-face on their own in search of solutions for the first time since the period following the Great Depression. Suddenly, the success or failure of ongoing reform efforts depended more than ever before on the presence or absence of “responsible” workers’ organizations and employers’ associations and on levelheaded leadership from within the state. As discussed earlier, newly elected political leaders responded, first, by resurrecting the kinds of state-capital alliances that had long been recognized as essential for signaling a serious commitment to private investment; and second, by offering a much more sophisticated mix of incentives and compensatory schemes in order to successfully carry out the reform tasks at hand.

The second venue for interest intermediation was the political party–congress–executive axis, which came to life during the widespread transition to civilian rule in the 1980s. Operating within Latin America’s highly presidentialist political systems, executives across the region relied initially on legislative decrees and the advice of insulated technocratic teams in the implementation of the first-phase reform measures. The fact that the bulk of these reforms were generated outside of congress and the political-party structure was due both to the conditions of economic urgency that prevailed and to the fragmentation and ideological polarization that plagued political parties in many of these countries. Yet, against this backdrop of strong executive leadership and increasingly coherent governing coalitions, political-party systems in some countries—for example, Argentina and Chile—gradually regrouped along more centrist and pragmatic lines (Mainwaring and Scully 1995).

Whereas greater compromise and participation on the part of congress and political parties have been recognized as essential elements for economic success over the past decade, political incentives in some countries have simply not stacked up in favor of greater reliance on the party-congress-executive axis.10 In Brazil, historically low levels of party organization and weak internal discipline have hindered the development of more constructive patterns of legislative oversight and greater citizen influence over executive-level deci-

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10. The Achilles heel for each reformer—Brazil’s continued struggle with fiscal restraint, Mexico’s prolonged banking crisis, or Argentina’s decade-long stalemate over labor-market deregulation—can easily be traced to the weakest links in the institutional bases for interest intermediation.
sions (Mainwaring 1995). In Mexico, despite explicit promises to fully liberalize politics on the part of the executive and powerful elite coalitions within the longstanding Institutional Revolutionary Party (PRI), these ruling-party faithful repeatedly proved incapable of managing this transition (Pastor and Wise 2002). Peru, the only country in the region to suspend democratic rule in the 1990s, confirms that there is indeed more than one path to economic recovery. However, the full consolidation and ultimate success of Peru’s reform program will depend on the ability of leadership coalitions to forge more reciprocal and cohesive ties with broader segments of civil society along this party-congress-executive axis.

Summarizing the Argument from an Institutional Perspective

Despite the obvious role of international factors in shaping the economic fate of these countries, these external variables fall short of explaining the wide diversity in economic performance over the long run. I have argued here that a more complete explanation lies in the nature of state and societal structures and in the quality of the ties between the two. To summarize the cases, the countries examined here have followed two distinct institutional paths (see table 6). The launching of market reforms in Chile, Mexico, and Peru was largely a state-centered phenomenon, although Chile since the transition to democratic rule in 1990 has also made important inroads in the modernization of state-society relations (Scully 1995). Mexico is in the midst of a similar transition, as reflected in the democratic defeat of the ruling PRI party in the July 2000 presidential elections (Pastor and Wise 2002). Argentina has relied largely on interest intermediation and the transformation of institu-

<table>
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<th>TABLE 6. Different Institutional Paths to Market Reform</th>
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<tr>
<td><strong>State Initiated</strong> (bureaucratic autonomy, modernization of economic institutions)</td>
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<td>Reform implemented</td>
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<td>Reform recently initiated</td>
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11. This led to the PRI’s loss of the executive office in the July 2000 presidential election.
tional ties among the executive, political parties, and other civic organizations (Corrales 2000a). Brazil, as the table shows, has a foot on each reform path, which perhaps explains the difficulties that policy makers have faced in quickening the pace of market reform.

In the following section, and the next five chapters on Peru, these four institutional dimensions of state-society relations become intervening variables, as they shape a given country’s response to exogenous trends and set the parameters for policy choice, implementation, and outcome. While this explanatory framework expands considerably on the gray territory between policy input and development outcome, it is not set in stone: because these institutional variables can change over time and across a broad range of tasks, the framework is best viewed as a continuum that allows for a more nuanced assessment of a given state’s ability to formulate and follow through on a designated policy course. In line with the preceding analysis of state-society relations over the post–World War Two era in Latin America, there is every reason to expect that more favorable policy performance will correlate with reforms that promote more cohesive state institutions and more coherent ties between the state and civil society. At least thus far, this has been the regional trend since the early 1990s.

The Streamlined State of the 1990s: Reconstruction and Economic Recovery

The sheer magnitude of the crises that erupted in the late 1980s in Argentina, Brazil, and Peru sent policy makers back to the drawing board in launching another set of macroeconomic stabilization and structural adjustment measures. While there was anything but agreement within these civil societies over the pursuit of the larger set of market reforms embodied in the Washington Consensus, a newly elected group of political leaders realistically assessed that they had few other options at the time. Given the very tenacity of these reform-minded executive coalitions, a first round of crisis-driven market restructuring had more or less been completed by the mid-1990s. The initial goals of macroeconomic stabilization and balance-of-payments adjustment had basically been met, and incentives and relative prices had been restructured according to more competitive criteria.

These advances are confirmed by the data, which show that economic

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12. The most recent empirical studies on the relationship between institutional development, broadly defined, and sustainable growth in the emerging-market economies state unequivocally that the correlation is a positive one. For a review of these empirical studies see Burki and Perry 1998, 17–24.
Latin America and the State-Market Debate

recovery for the decade peaked in 1997: average regional growth surpassed 5 percent of GDP for the first time in twenty-five years, and the average inflation rate had been reduced to single digits. While portfolio flows remained volatile, net annual flows of FDI in the 1990s were running eight times higher than in the 1980s (Naím 1995, 2).\(^\text{13}\) The extent to which these Latin American economies had been reoriented toward the external sector was reflected in the trade figures, which showed that commercial exchange between the region and the rest of the world had doubled since 1990 (Wise 1999, 118). These trends suggest that progress had finally been made in implementing policies based on liberalization, privatization, and deregulation and that, with the exception of deepening income inequality, the worst excesses of the problematic state-led dynamic identified earlier had been tamed.

Perhaps most remarkable from the standpoint of this analysis was the drop in global patterns of government expenditure and public investment to those levels that had prevailed in the early 1970s. The Latin American state’s newfound reputation as “streamlined” in the 1990s was based on three main trends. First, as table 3 shows, government deficits had been reduced dramatically by 1995–2000, down from an average of 9.3 percent of GDP in 1985–89 to less than 1 percent of regional GDP (Brazil is the outlier here). While still high, aggregate levels of government-held debt as a percentage of GDP had also been cut in half over these same time periods. Second, across the board, public investment as a percentage of GDP had been reduced to a historical low over the course of the 1990s. Finally, as can be seen in table 4, the SOEs’ share of GDP had shrunk considerably from the peak levels that had persisted through the 1980s. Outside of Brazil, this reduction in public expenditure, investment, and SOE presence ran against the grain of longstanding arguments concerning the secular tendency for state spending to rise the world over (David Cameron 1978; Larkey, Stolp, and Winer 1981; Iversen and Cusack 2000).

Despite any outward quantitative similarities between the developmentalist state of an earlier era and this most recent rendition of the Latin American state, the two could be distinguished by the latter’s fiscal advances alone. A second distinction, reviewed in the previous section, was the steady if uneven momentum toward institutional renovation, both within the state and at the level of state-society relations. Yet, while these achievements in the way of fiscal and institutional modernization were indisputable, the highly varied economic performance of the five countries summarized in table 1 suggested that there was more to state reform than widespread privatization and fiscal

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\(^\text{13}\) These figures are cited from the ECLAC Web page <www.eclac.org>.
retrenchment. Both had perhaps been necessary conditions for the restoration of growth at the macroeconomic level; yet dismal microeconomic indicators, including falling real wages, high unemployment, low productivity, and rising income inequality, suggested that, far from doing too much, the streamlined Latin American state was doing too little in the way of providing public goods and facilitating the adjustments associated with market reform (Stiglitz 1997; Przeworski 1999).

In large part, it was this gap between macroeconomic dynamism and stagnation at the microeconomic level that triggered debates about the need to launch a second phase of market reform to help correct for these shortcomings. As for the state’s role in prompting a call for a second reform phase, Moisés Naím (1995, 2) has observed that by the mid-1990s, even in those countries that had gone the furthest with market reform, “the state continued to perform functions better suited to the private sector while exhibiting an appalling incompetence in discharging core public functions.” It was insights such as these that caused a metamorphosis of the Washington Consensus, as even its original author acknowledged that there had indeed been some important blind spots with regard to the crucial role that the state still must play in the economy (John Williamson 1996). First was the need to translate the gains from fiscal restructuring into much higher savings rates, while simultaneously targeting public expenditure toward more productive and equity-enhancing endeavors such as health and education. Second was the need to harness institutional reform in ways that promoted efficiency, competition, and transparency (Tineo 1997).

How do these realizations apply to the five countries considered here? A brief review of where these countries stand along both dimensions of institutional reform (state and societal) and the relationship between institutional reform and economic performance in the 1990s is in order. Of the five, Chile easily surpasses the other four on every microeconomic variable mentioned earlier but income distribution. Despite the tendency for antistatists within the Chilean military government and the multilateral institutions to claim this impressive record as a victory of market over state, it is now widely held that the country’s success lies in the complementary and mutually enhancing ties that have been forged over time among state, society, and market (Velasco 1994; Schurman 1996; Marcel 1999; Kurtz 2000). It is thus no coincidence that Chile is the only country that ranks highly on economic performance; the implementation of deep market-based structural reforms; and the renovation of state and societal institutions, broadly defined.

Especially since the return to civilian rule in 1990, Chile has maintained the strongest state presence in terms of public spending, investment, and SOE activity, but also the lowest levels of government debt and public employ-
ment (ECLAC 1998, 111). And, in contrast to the other four countries, Chile has run a fiscal surplus throughout the 1990s (see table 3). This confluence of high economic growth and dynamism and a comparatively higher state presence underlines the need to redefine the streamlined state of the 1990s along more qualitative lines (Tanzi 2000). In Chile, for example, these qualitative institutional differences range from the government’s advances on administrative and civil-service reform (Burki and Perry 1998, 132; Heredia and Schneider 1998); to the credible enforcement of property rights and rules around fair business play; to the increased accountability of policy making via greater oversight by political parties, congress, and the judiciary (Haggard and Kaufman 1995; Scully 1995; Patricio Silva 1998; Weyland 1999). Partly as a result of this broad institutional change, and in response to the failures of a purist authoritarian market model that was pursued from 1975 to 1982, Chile has developed a more competitive strategy that recognizes an active role for public policy and greater citizen input in the face of adjustment stress or outright market failure.

Whereas the Chilean case personifies the streamlined state of the 1990s—that is, the efficient use of public resources to foster productive growth and target social spending (e.g., health, primary education) in ways that directly bolster microeconomic development—Brazil still lies at the other end of this continuum. The long-term neglect of state financial institutions under an extended period of military rule (1964–85) and the disproportionate influence of a sorely divided congress have clearly slowed the reform process. With the election of President Fernando Henrique Cardoso in 1994, and the implementation of a highly professional Master Plan for Reform of the State Apparatus (Bresser Pereira 1999), the Brazilian state is quickly modernizing. In fact, Brazil now ranks second only to Chile in terms of the quality of its elite civil service and state bureaucracy (Edwards 1998, 28–29).

However, given a broader institutional context of a weak executive, fragmented political parties, and an unwieldy congress, economic policy is still too subject to clientelism and the political aspirations of regional and party bosses (Heredia and Schneider 1998). This is evident, first, in Brazil’s comparatively poor progress in rationalizing public finances in the 1990s. In fact, it was Brazil’s failure to put its fiscal house in order that triggered the dramatic currency crisis of January 1999 (Cardoso 2000). Second, Brazil’s economic performance for the 1990–2000 period is the worst of the five-country sample, most notably on the distributional front. Underpinning these regressive trends is a pattern of asset concentration that surpasses Chile’s by as much as 65 percent (Burki and Perry 1998, 80) and a comparatively weak record on government transparency and the protection of property rights (Edwards 1998, 28–29). Despite the successful inroads that have been made
in the way of internal state reform, a concomitant modernization of state-society relations is still in order.

If Brazil and Chile lie at opposite institutional ends of the reform continuum, Argentina, Mexico, and Peru lie somewhere in between. In all three countries, policy makers have forged ahead with sweeping market-reform strategies, while institutional development has been uneven. In all three, the state sector rebounded in the 1990s in ways that partially follow the Chilean pattern of streamlining: public expenditures recuperated from the steep cuts of the late 1980s/early 1990s with a much stronger emphasis on social spending, and fiscal deficits were well below the regional average. Moreover, private investment in all three countries was notably higher in the 1990s, a trend tied directly to the privatization of SOEs. Nevertheless, public investment in Argentina was just half the regional average for the 1990s, and government-held debt was still far above the current average for the region. This second group of trends, combined with each country’s decidedly mediocre performance at the microeconomic level, suggests that the state could, indeed, be doing more to address these shortcomings.

Argentina, for example, scores the highest of all five countries on a recently compiled market-reform index (Morley, Machado, and Pettinato 1998), and the country ranks close to Chile on such crucial institutional variables as the quality of the judiciary and elite civil-service corps and the protection of property rights (Edwards 1998, 28–29). At the same time, however, Argentina ranks even lower than Brazil on the degree of transparency in economic transactions and the ability of the state to project an image free from corruption. In line with these less favorable trends, Argentina’s concentration of private-asset holdings is 45 percent higher than Chile’s (Burki and Perry 1998, 80), and the poorest 40 percent of the country’s working population has suffered the steepest distributional losses of the five countries considered here. If we return briefly to the working hypotheses introduced earlier, what is still missing in the Argentine reform effort is significant progress in the overhaul and renovation of the larger public bureaucracy and of those various state economic and planning agencies that house it.

This lopsidedness can be at least partially attributed to the distinct nature of the economic strategy that prevailed from 1991 to 2001 in Argentina, whereby the exchange rate was fixed one-to-one to the U.S. dollar and the responsibility for monetary policy was placed in the hands of a currency board (Pastor and Wise 1999b; 2001). This greatly reduced the policy role of the central bank, and while the Ministry of Economics was transformed into a super-agency and prime champion of market reform, the overall reform effort still lacked the far-reaching institutional innovations within the state.
bureaucracy that have provided a more stable base for economic dynamism elsewhere.

With the launching of the currency board in 1991, accompanying efforts at state reform were driven by textbook remedies for freeing markets through downsizing and tight fiscal austerity (Ghio 1998). As a result, key economic decisions and policy implementation have been relegated to an autocratic executive, a handful of elite economic policy makers, and representatives acting on behalf of the country’s largest producers and conglomerates (Wise 2000). It is no wonder, then, that a centrist coalition swept the late-1999 presidential election on a platform that advocated a more aggressive approach to correcting the market’s numerous shortcomings through the reform and strengthening of state institutions. The utter failure of that coalition, including the December 2001 resignation of President Fernando De la Rúa amid violent social protests just two years into his term and the unraveling of the currency board in early 2002, is further testimony that market reform represents just one side of the coin, and state reform the other.14 In the absence of the latter, De la Rúa and his coalition of center-left parties never gained the footing they needed to truly advance the second-phase reform agenda on which they had been elected.

Whereas state streamlining in Argentina has relied too heavily on fiscal retrenchment and the circumvention of public institutions in the pursuit of private interests, the pattern in Mexico and Peru has been the reverse. In both countries, state economic and planning institutions have been the main locus for market reform, while questions of a concomitant transformation in state-society relations have been continually pushed onto the back burner. Even Argentina and Brazil, despite the many challenges they still face with regard to internal state reform, are following more of a Chilean pattern where deep market restructuring has prompted civic demands for greater participation, accountability, and responsiveness from state agencies. In contrast, such demands have been muted until very recently in Mexico and Peru, where the pace of democratization and the shift to more representative forms of governance have been more halting. This is evident, for example, in each country’s comparatively low ranking on the quality of the judiciary and the degree of transparency and honesty in government (Edwards 1998, 28–29).

In both countries, the launching of market reforms within more narrow institutional parameters helps explain the impressive advances that have been made with the modernization of public finances and the recovery of growth

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and private investment in the 1990s. But in both cases, the isolation of the leadership coalition and the reliance on bureaucratic autonomy at the expense of public debate and interest mediation over key policy initiatives have also detracted from these gains. In Mexico, this overly autocratic approach to policy reform accounts for the reckless errors that gave rise to the 1994 peso crisis and to a massive bailout of the domestic banking system, both of which have undermined Mexico’s ability to achieve the same levels of macro- and microeconomic dynamism that Chile and even Peru have registered in the 1990s. Mexico’s full economic recovery from these financial setbacks has been further prevented by a startling upward concentration of wealth stemming from the combination of low educational achievement, a pattern of oligopolistic asset holdings that surpasses even Brazil’s, and the government’s failure to credibly enforce a sophisticated body of antitrust legislation that was passed in 1992. These failures at social and economic inclusion were not lost on the Mexico electorate, which in July 2000 handed the ruling PRI party its first presidential defeat in more than seven decades.

In Peru, the extremities of executive authority and the heavy reliance on an entire array of new autonomous state agencies have resulted in a decade-long pursuit of the same purist version of market restructuring that dominated the Chilean reform program from 1975 to 1982. This is not to take away from the enormous inroads that have been made at the level of internal state reform; but the prevailing strategy precluded the kinds of policy flexibility and give-and-take between the state and representatives of civil society that will be essential for shifting the economy onto a higher-wage, higher-productivity, higher-growth track. This is most evident in Peru’s surprisingly low ratio of exports to GDP, itself a reflection of market failure in light of the small, open nature of the economy, as well as the government’s espoused commitment to an export-led development model.

Underpinning this lackluster trade performance is an investment portfolio composed largely of commodities and privatized services, neither of which has provided the necessary stimulus for the kinds of high value-added exports that have proven most conducive to employment expansion and productivity gains in Chile (Edwards 1995; Meller 1997; Marcel 1999). The current juncture in the Peruvian economic-reform program reflects the need for a deeper level of institutional reform, one where public policy encourages stronger linkages among higher value-added investments, trade-related activities, and human-capital development. Just as similar reform shortcomings in Argentina, Brazil, and Mexico catalyzed voter demands for public policies to stimulate jobs, growth, and more productive investment, in Peru citizens have followed suit in articulating such “second-phase” demands. Especially with the abrupt 2000 resignation of President Fujimori amid a complicated
web of corruption charges, Peru’s electorate has displayed a more markedly
distributional response in national opinion polls. The remainder of this book
examines the potential for state institutions, public-policy makers, elected
representatives, and interest-group leaders to rise more fully to this develop-
ment challenge in Peru.

Conclusion

In light of the trends reviewed in this chapter, it would be difficult to dispute
that the Latin American state has indeed come a very long way: from the
indiscriminate interventions of the developmentalist era, to the collapse of
the 1980s, and now to the revival and redefinition of the state since the 1990s.
A main purpose here has been to specify how the state’s economic role has
changed and to define what constitutes effective state action in today’s
markedly different political and economic environment. The analysis
showed, first, that to varying degrees past problems related to reckless state
intervention—excessive borrowing, macroeconomic incoherence, a fickle
private sector, and predatory SOEs—have been solved. The main exception
to this trend is the persistence of abysmal poverty rates across the region and
the worsening of distributional trends in the 1990s—a theme that I explore in
more detail through the Peruvian case study.

Second, the analysis challenged the still prevalent view that the advances
that have been made are due primarily to the implementation of deep mar-
etket-based structural reforms. While the resolution of the larger macroeco-
omic problems was definitely related to the streamlining of the state
through privatization and fiscal modernization, the comparative analysis in
this chapter confirmed that the reactivation of regional economies and the
basically sound political-economic performance over the past decade also
stemmed from the renovation of state and societal institutions, broadly
defined. In fact, state reform and the success of market policies consistently
stand out as two sides of the same coin. However, with the exception of Chile,
the one country where high growth, market reforms, and penetrating institu-
tional renovation have gone hand in hand, the current juncture in the region
is one in which the prospects for sustained economic recovery are still fragile.

This raises a third and final point of the chapter, which is to identify the
reform tasks that remain on the institutional agenda. Taking into account the
chain of external shocks that hit the region beginning with the Asian crises of
1997–98, I argue nevertheless that the continued vulnerability of the coun-
tries examined here has mainly to do with the uneven and incomplete nature
of institutional reform over the past decade. As these countries are now hard-
pressed to pursue policies that more aggressively promote greater productivity, efficiency, and equity, the answers lie in the realm of deeper institutional reform. This includes everything from advances on administrative and civil-service reform; to the credible enforcement of property rights and rules around fair business play; to the increased accountability of policy making via greater oversight by political parties, congress, and the judiciary. In short, as witnessed in the implosion of the Argentine political economy in late 2001, those countries that relied heavily on a societal-based reform path (see table 6) can no longer avoid the tough tasks of internal state reform. The same goes for the state-centered reformers, Mexico and Peru in particular, where civil society’s insistence on greater inclusion and a voice in the reform process can no longer be ignored. The extent to which a sustained economic turnaround for these countries lies increasingly at the core of stronger institutional ties between state and society is well exemplified in the Peruvian case.