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THE STATE, THE MARKET AND ELECTIONS IN LATIN AMERICA: HOW MUCH HAS REALLY CHANGED?

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The State, The Market and Elections in Latin America: How Much Has Really Changed?

Introduction

It is a great privilege to be introduced by Ignacio Arcaya, Venezuelan ambassador to the Court of St. James. An Ambassador's job is not an easy one. The task is made easier, however, if the Ambassador concerned understands the country in which he is living. Ambassador Arcaya has an unrivalled appreciation of Great Britain and the British and that is one of the reasons why I was so delighted to be invited to give this first Andrés Bello Lecture tonight.

The other reason is my deep respect for Andrés Bello whose long association with both London and education makes him a particularly appealing character for a Professor of London University. Furthermore, I think Bello would have approved of the title of this lecture - a lecture that threatens to stray across at least four disciplinary boundaries (economics, political economy, economic history and political science). Indeed, Bello might even have regarded the subject as too *narrow* in view of the following quotation from Miguel Luis Amunátegui's biography of the great man. Referring to the *Reportorio Americano* edited by Bello in London in 1826/7, he wrote[1]:

'Don Andrés Bello also wrote a section entitled Miscellaneous, which included short articles on telescopes, steam, blood, the magnetic needle, kidney stones, river navigation, meteorology, digestion, the source of platinum, the poisonous honey of Uruguay, wild men, the origin of cassava, the rattlesnake, the cultivation of coffee in Arabia, the milk tree, the falls of the Vinagre River, the chemical analysis of the milk of the cow tree.... the shape of the earth.... the cure for yellow fever, rain and floods in the Canary Islands.'

The subject of my lecture is the state, the market and elections in Latin America. All three are linked, although the relationships are not always clear or properly understood. Markets can function without a state, but only at the most 'micro' level. The most important markets - for labour, capital, foreign exchange and technology - nearly always involve the state in one form or another. Similarly, a state without a market is a rare and unappealing prospect: even Cuba has found that markets play a vital role in bringing supply and demand into line. Finally, elections constitute a political market place through which state power may be transferred without the need for violence. The electoral process is increasingly the arena in which different views of the state and the market must be contested.

An Overview

Since the middle of the 1980s Latin America has been engaged in a major process of economic transformation that has only one parallel this century - the 1930s.[2] Then, however, the region was turning inwards whereas now it is turning outwards. Latin America is also in the middle of a major political transformation. This means that both these transformations are taking place at the same moment, the first time this century that the economic and political cycles have fully coincided.[3] This has some advantages, but it has many disadvantages because the agenda has become very complex and at times extremely difficult to manage.

How much has really changed? At one level the answer must be a great deal. The state, for example, has withdrawn from production in most countries or is in the process of doing so.[4] Sectors regarded as too sensitive for private sector investment are now very few[5] and probably fewer on average than in Western Europe. The state no longer intervenes so persistently in setting prices, whether through overt price controls or through manipulation of instruments such as tariff and non-tariff barriers, and the Latin American state has not yet retreated behind the cynical trade policy of many developed countries that preach market forces and then employ restrictive trade practices.[6] The state is also embarked on a complex process of decentralisation whose final destiny is still unclear, but which in principle could deliver greater accountability and efficiency in the future.

There has also been an explosion in the electoral calendar, with scarcely a month going by without some important electoral contest at the national or sub-national level. Election day itself tends to be free from serious incident and, indeed, many of these contests are conducted in an atmosphere of good humour and patience.[7] The press has become much less constrained in its editorial judgements and the level of analysis of leading editorials has become increasingly sophisticated.

International diplomacy has also altered significantly. Latin American governments are no longer seen fighting old battles alongside strange bedfellows from revolutionary socialist states. On the contrary, the Latin American voice is increasingly heard and welcomed in international meetings dealing with the pressing issues of the day: trade policy, the global environment, the restoration of democracy, regional conflicts and so on.

All this is very positive and for many people the analysis stops there: state reform is seen as leading to a market-driven economy and elections to democracy. Pick up any of the literature from the financial institutions responsible for the transfer of billions of dollars to Latin America and you will see this dual equation spelt out in alarming simplicity. Yet it is not sufficent to stop the analysis there, as a sophisticated audience such as this will know all too well.

Furthermore, the real question is *not* how much has really changed. The real question is whether Latin America has now removed the obstacles in the path of its constituent nations' achieving developed country status.[8] Here the situation is much more complex and many doubts begin to surface. I shall demonstrate this by focusing on a number of problems that need to be resolved as a matter of urgency if progress from developing to developed status is to be achieved.

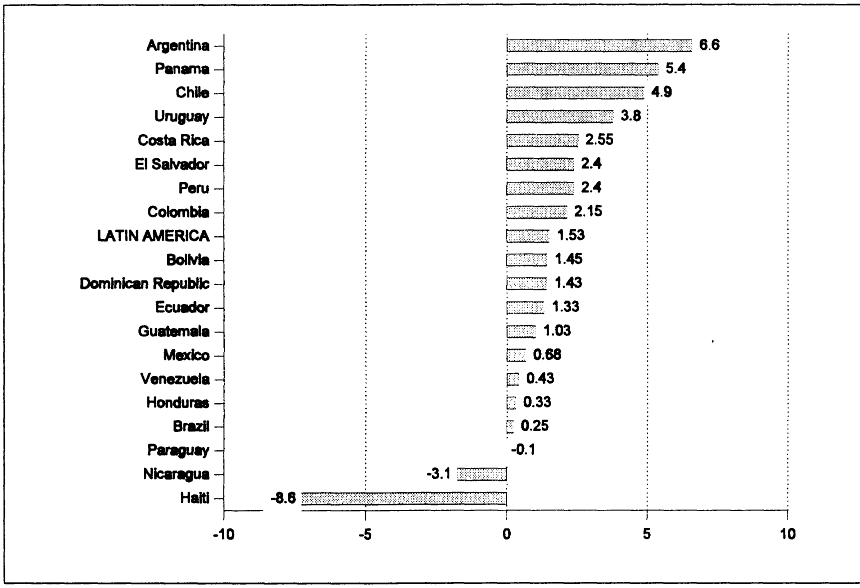
Problem 1:
Despite the favourable international context, the growth of real Gross Domestic Product is still far too low

After falling very severely at the beginning of the 1980s, real Gross Domestic Product (GDP) per head is now rising (see Figure 1), but with a few exceptions, such as Argentina, Chile and Panama, it is not growing fast enough. After a decade (1980-90) in which regional GDP per head *fell* at an annual rate of one per cent,[9] it is now rising at an annual rate of 1.5 per cent. Thus, the 1980 level of GDP per head has still not been reached[10] and the gap between living standards in Latin America and the developed countries is as wide as ever.

This slow growth is a serious problem and, indeed, a major puzzle. After all, the economic reform programme in Latin America began in the middle of the 1980s. It started with trade liberalisation in Bolivia, Chile and Mexico in 1985, with the attempt at inflation stabilisation in Argentina in 1985, Brazil in 1986 and Mexico at the end of 1987, with a process of privatisation in Chile and Mexico that had spread to most of Latin America by the end of the 1980s. It is not something which began yesterday and it is no longer possible to claim it is too early to evaluate because it is only just beginning. The reform programme has really been going on for quite a long time.[11]

Furthermore, after nearly a decade in which poor performance in Latin America was blamed on lack of access to foreign finance, capital inflows to Latin America were strong and surprisingly robust in the first half of the 1990s,[12] and should have provided an excellent opportunity to see economic performance improve substantially.[13] Although there was recession in a number of OECD countries until 1994 (notably Germany), the key market for Latin America (the United States) has not been in recession and indeed has been growing rapidly. Finally, the net barter terms of trade for Latin America, which in the 1980s were a source of severe problems, have been recovering since 1993 with coffee prices in particular rising very fast.[14]

Figure 1
Average Annual Growth Rate (%) of Real GDP per Head, 1991-94



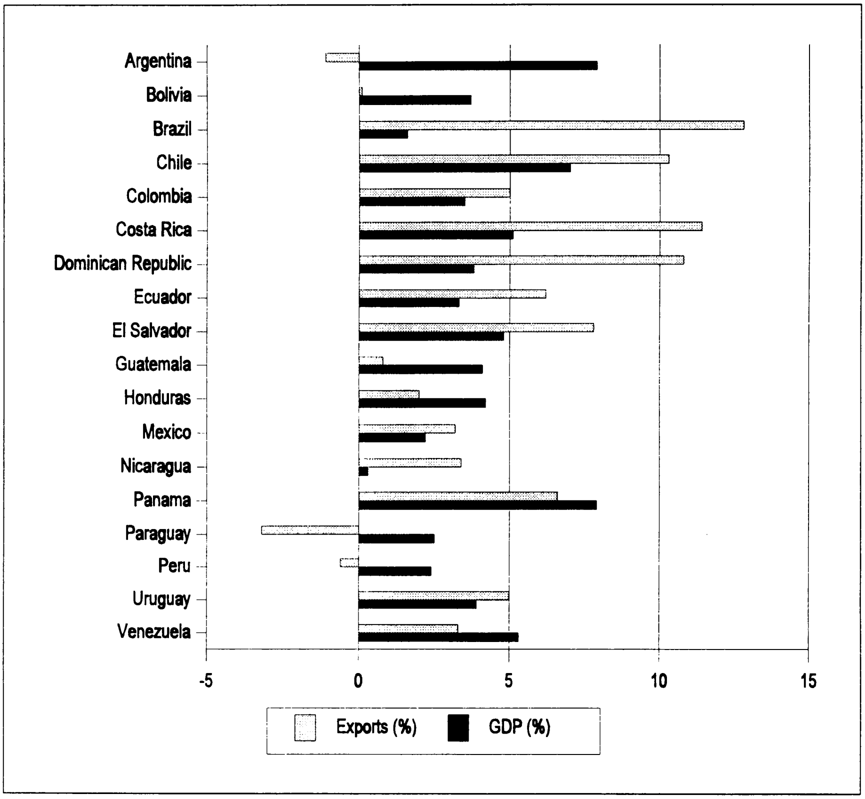
Source: ECLAC (1994), *Preliminary Overview of the Latin American and Caribbean Economy 1994*, Table A.3, p. 38.

Problem 2:
Trade liberalisation is not leading to export-led growth

Trade liberalisation is implemented through three instruments: the reduction of tariffs, the reduction of non-tariff barriers and the corresponding change in the real effective exchange rate. What most people focus on are the tariff and the non-tariff barrier reductions, and these have been very impressive. Many countries have reduced the average level of tariffs to around 10% compared with nearer 100% in the mid-1980s and the variation in tariff levels has also declined sharply. At the beginning of the process in Latin America these reductions were unilateral. When countries such as Argentina, Brazil and Mexico first lowered their tariffs, they did not demand in exchange a reduction in tariffs by the United States, Europe or Japan; it was all unilateral. Now it is increasingly bilateral or multilateral either as a component of regional integration schemes (e.g. MERCOSUR or NAFTA) or, indeed, as part of the Uruguay Round of GATT.[15]

Trade liberalisation has allowed a very substantial increase in imports. Latin America's dollar value of imports (f.o.b.) rose from $61 billion in 1985 to $150 billion in 1993[16] and is still rising fast.[17] If all one is concerned about is being able to export to Latin America, it is this that one should focus on: the reduction of tariff and non-tariff barriers and the rapid growth of imports. However, from the point of view of Latin America, all of these things are merely instruments with the aim of establishing external equilibrium, achieving export-led growth and making a contribution to inflation stabilisation.

Figure 2
Rate of Growth of Exports of Goods and Services and Real GDP, 1990-93 (%). 1988 dollars



Source: InterAmerican Development Bank (1994), *Economic and Social Progress in Latin America, 1994 Report*, Tables B-1, p. 239 and B-6, p. 242.

Among these three objectives, the crucial one is export-led growth. Without that, sooner or later the system will go into reverse. Export-led growth implies that exports are growing faster than GDP, at least at the beginning of the process,[18] so that they form the engine of growth for the whole economy. The crucial test of export-led growth, therefore, is what is happening to the ratio of exports to GDP and it is here that there are serious worries. If we look at the data[19] since 1990 (see Figure 2) there are eight republics (Argentina, Bolivia, Guatemala, Honduras, Panama, Paraguay, Peru and Venezuela) in which the rate of growth of exports of goods and services (at constant prices) has been slower than the rate of growth of real GDP, implying a fall in the ratio of exports to GDP. There are a further four countries (Colombia, Mexico, Nicaragua and Uruguay) where the rate of growth of exports of goods and services (at constant prices) has been below six per cent - the minimum required to sustain rapid growth of real GDP per head.[20] That leaves only six countries (Brazil, Chile, Costa Rica, Dominican Republic, Ecuador and El Salvador) with a satisfactory export performance in the period 1990-93 and questions could easily be raised about the long-run sustainability of exports in several of these countries.[21]

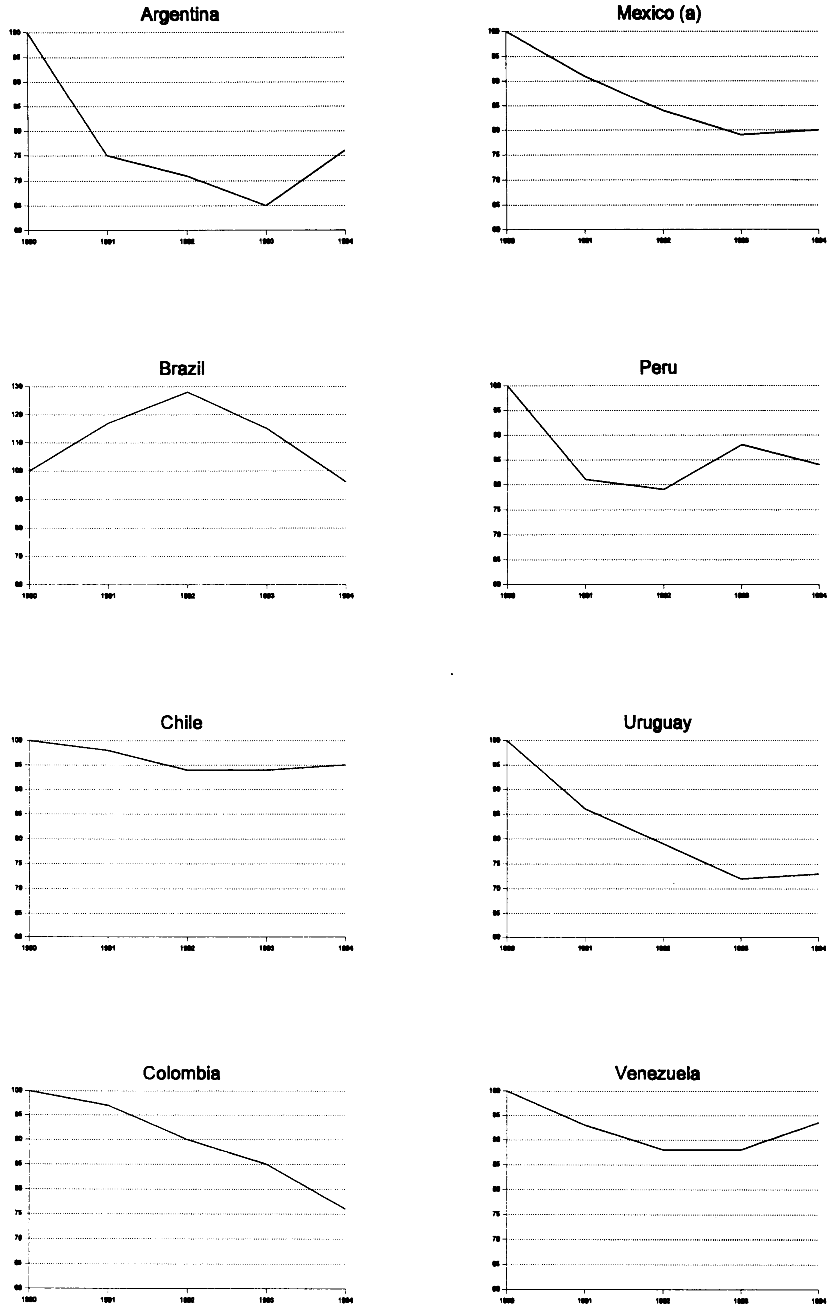
There are many reasons for the relatively poor performance of exports. It can be explained in part by the fact that the infrastructure needed to support exports is in very poor shape and the investments needed to restore that infrastructure have not yet taken place. It is partly a lack of awareness by exporters from Latin America about market opportunities; many of them know the US market, but they do not know the European or Asian markets so well. And there is still, even now, a lot of ignorance about opportunities in neighbouring countries.

The credit facilities for small and medium-sized firms are also quite inadequate. Large firms can borrow on the international markets at relatively cheap dollar rates of interest. Small firms cannot and real domestic rates of interest are still high even in countries such as Chile. Elsewhere, in countries such as Brazil and Venezuela, real interest rates are a serious disincentive for exporters and this is made worse when the domestic interest rates are calculated in terms of their dollar equivalents.[22]

Overriding all this in the last few years, however, has been one problem: the real effective exchange rate (REER). This is a measure of the relative value of the currency that adjusts the change in the nominal exchange rate for the difference between domestic and foreign inflation. When we look at the main Latin American countries (see Figure 3), the pattern is clear. Since 1990 there has been a tendency for the REER to appreciate, making exporting more difficult.

Real exchange rate appreciation is not necessarily the same as currency overvaluation. Sometimes an appreciation of the REER implies overvaluation, but not always. Chile, for example, which has had a real appreciation (see Figure 2), does not have an overvalued currency; its exports have been growing quite strongly and its performance on that score is quite good. Argentina, on the other hand, does have an overvalued currency and that is undoubtedly a source of concern.

Figure 3
Real Effective Exchange Rates, 1990-94 (1990=100)



[a] Data for 1994 do not take account of devaluation on and after 20 December.

Source: ECLAC (1994), *Preliminary Overview of the Latin American and Caribbean Economy 1994*

The appreciation of the REER in Latin America since 1990 is widely attributed to the capital inflows that have entered the region. In place of the dollar shortage in the 1980s, there has been a dollar surplus that has led to a huge rise in net international reserves. Other parts of the world, however, such as South-East Asia, have been in receipt of capital inflows without suffering the same degree of real currency appreciation. The inability of Latin American countries to absorb capital inflows without undermining export competitiveness is a major source of concern.[23]

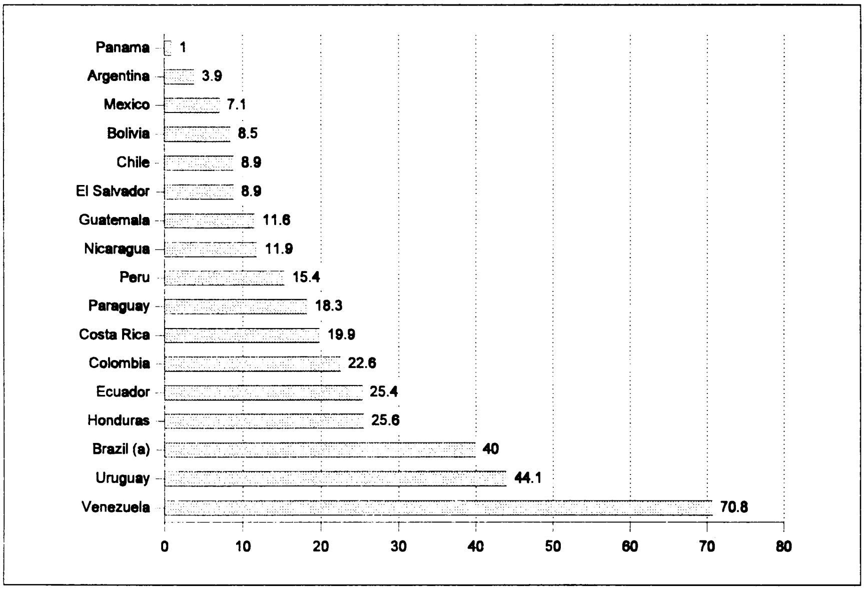
Problem 3:
Macroeconomic reform has not produced international rates of inflation

Macroeconomic reform has a number of goals, the most important of which is price stabilisation. The instruments are well known to us: fiscal, monetary and exchange rate policy. With regard to fiscal policy, it should be said that a great deal has been done in Latin America to reform the tax system, to improve the efficiency of tax administration, to cut out unnecessary expenditures and so on and so forth. A lot more still has to be done, but credit should be given where credit is due. Monetary policy has also improved with the elimination of negative real interest rates, greater autonomy for central banks and the liberalisation of financial markets.

There are other elements at work in macroeconomic reform, but price stability is the key and so a fair test is what has happened to the consumer price index in Latin America. Here the news at first sight is very encouraging. If, for example, we consider Argentina, Brazil and Peru, the three countries that had inflation of more than 1,000 per cent until quite recently, there has been a very strong downward trend. In the case of Brazil, the reduction has occurred since 1 July 1994 with monthly inflation falling from nearly 50 per cent to below two per cent. However, inflation rates (see Figure 4) are still far from converging on international rates, with a few exceptions. We have to remember that the annual average for OECD countries is below four per cent so that only Argentina and Panama (see Figure 4) have achieved international rates of inflation.

One should recognise that a great deal has been done in terms of macroeconomic reform to stabilise inflation, but then I ask myself how robust is it? It may be a cruel question to ask, but it is precisely the other side of the coin of the real appreciation of the exchange rate of the last four years. That real appreciation, although it has made exporting more difficult, has undoubtedly contributed very substantially to the lowering of inflation rates in many Latin American countries. Will the inflation stabilisation survive when the real exchange rate starts to depreciate again, as it probably will in the next few years?[24] In a few cases the answer is in the affirmative. Some of these stabilisation programmes in Latin America – in Chile, Colombia and Costa Rica, for example – have been well designed and could reasonably be expected to absorb a certain degree of real exchange rate depreciation. Yet there are others where I have my doubts and one has to say that all the ingredients for a really permanent and lasting reduction in inflation are not yet in place.[25]

Figure 4
Annual Inflation Rates (%), 1994



Note: Figures refer to the Consumer Price Index
[a] The figure for Brazil is the annual rate based on the last six months of 1994.
Source: Latin American Weekly Report, 26 January 1995, WR-95-03

Problem 4:
Microeconomic reform has barely begun and is still incoherent

Microeconomic reform is extremely complex. We are beginning to know now that microeconomic reform is crucial to successful economic performance; the studies that the World Bank and other organisations have done of South-East Asia have demonstrated this conclusively.[26] The trouble is that in Latin America there is very little knowledge or understanding of how microeconomic reform works best, how to put it in place, which areas should be given priority and so on. Each Latin American country is on a learning curve and, with the possible exceptions of Chile and Mexico, it is not necessarily a very fast or steep learning curve.

If we look for one single test of microeconomic reform, we can do no better than to take the ratio of gross fixed capital formation to GDP for at the end of the day there is no better clue to overall economic performance than what is happening to investment. This ratio, however, is a major disappointment (see Table 1). While in South-East Asia countries regularly invest more than 30 per cent of their GDP, in Latin America only Chile comes close to that figure. The ratio for other countries is in the range 15 to 25 per cent.

Table 1
The Ratio of Gross Fixed Capital Formation to GDP at current prices (%). 1990-4

	1990	1991	1992	1993	1994[a]
Argentina	14.0	14.6	16.7	18.6	20.7
Brazil	21.6	19.0	19.1	19.2	20.0
Chile	26.3	24.5	26.8	28.8	26.5
Colombia	18.5	16.0	17.2	20.5	21.4
Mexico	21.9	22.4	23.3	22.2	23.8
Peru	15.5	16.6	16.6	18.5	23.0
Uruguay	11.8	12.9	13.4	15.9	15.0
Venezuela	10.2	18.7	23.2	18.0	15.3

[a] Estimate
Source: Central bank data for each country.

This unsatisfactory investment performance occurs at a time when capital flows to Latin America have been running very strongly. Imports of capital goods - if the statistics are to be believed - have also been rising very quickly. Indeed, it would be difficult to imagine more favourable circumstances for high rates of growth of capital formation. Yet the investment ratios in Table 1 are far below what is required to establish economic growth on a high and sustainable path.[27]

One of the problems with investment in Latin America is that the burden of responsibility has now fallen almost exclusively on the private sector. Before 1982, when Latin America enjoyed investment rates around 25%, the public sector was typically responsible for one-third of all investment leaving the private sector to invest approximately 16% of GDP. The public sector has now withdrawn from many areas of investment for which it previously had responsibility and thus a high investment rate requires a transformation in investment behaviour by the private sector. This transformation has not yet taken place.

Problem 5:
Institutions are still weak and institution-building has not received the priority it deserves

Institution-building is a vital part of the reform process. Although much has been done to improve the quality of a number of institutions upon which economic performance depends, much remains to be done. Take, for example, the whole question of property rights, where there are still all sorts of undefined areas. Contracts frequently give rise to problems and lead to lengthy disputes that have to be settled through the cumbersome judicial process. Very few countries can truly boast a genuinely efficient and impartial civil service. Institutional deficiencies also prevent the diffusion of technology through the whole of the country as opposed to its appropriation by the largest firms. Insider trading is still a serious problem in most Latin American stockmarkets, while institutions to tackle the problem of the abuse of monopoly power are almost non-existent. This is an area where again a lot of learning has to be done before the right balance can be struck.

It would be wrong to end this section of the lecture on a negative note. Where all areas of reform - trade liberalisation, macroeconomic, microeconomic and institutional - are tackled vigorously and courageously, as in Chile, the results can be quite spectacular.[28] The incentives for reform certainly exist and the rewards are tangible.

The solutions to the problems outlined above are to be found mainly in Latin American hands. The changes needed are clear in some cases, such as trade liberalisation and macroeconomic reforms, less clear in others such as microeconomic reform and institution-building. Nonetheless, it is in general true that the solution lies inside Latin America rather than outside it.

The Role of the State

It is at this point that we must address explicitly the role of the state. It is often said that the state in Latin America needs to shrink. That is only correct if we define the state to include state-owned enterprises - what economists call general government. If, however, we refer to the activities of central and local goverment, it is not at all clear that the state should shrink. Indeed, measured by the ratio of tax income to GDP, the size of the state seems certain to *rise* in the next decade. This is both because the demands on the state are likely to grow and also because economic growth will result in a disproportionately rapid rise in tax revenue.[29]

The issue is therefore not one of size. Instead, it has become common-place to talk about the need for efficiency. Yet this is also misleading since the efficiency of the state is like motherhood and apple-pie; we are all in favour of it and no one would argue for an inefficient state. The real issue is in fact whether the state should be *neutral* or *non-neutral* in decisions over the allocation of resources.

What is a neutral state? A neutral state is one that encourages domestic prices to move as close as possible to international prices and then allows the private sector through its investment decisions to determine the allocation of productive resources between the different sectors and branches of the economy. The state's role is then limited to altering the distribution of those resources through a system of transfers. An example of a neutral state is Mexico today, where the allocation of resources is by and large determined by the private sector on the basis of relative prices that are increasingly in line with those in the United States, while the Mexican state uses agencies such as PRONASOL and PROCAMPO to carry out a series of income transfers in pursuit of greater social welfare.

A non-neutral state does not mean traditional state intervention, although an interventionist state is of course non-neutral. The non-neutral state deliberately interferes with relative prices to send signals to the private sector that alter the allocation of resources from what would take place under a neutral regime. The non-neutral state, for example, might subsidise credit for small firms in order to compensate the disadvantages such firms often face in competition with large firms. An example of a non-neutral state in Latin America is Brazil, where relative prices are still heavily influenced by the allocation of resources desired by the authorities.

Both kinds of state have their advantages and disadvantages. In Latin America, however, there is a special problem. This is because the ideology of neo-liberalism favours a neutral state, while tradition and the lessons of economic history favour a non-neutral state. This frequently causes confusion and even incoherence. The Chilean state, for example, is in the process of moving from neutrality to non-neutrality, but it is obliged to do so within an ideological context that favours neutrality. Argentina is ostensibly committed to neutrality, and aggressively so in terms of rhetoric, but the consequences are in some cases deemed unacceptable and elements of non-neutrality are creeping in more and more.

A further problem arises because a precondition for an efficient non-neutral state may well be a neutral state. To move from an orthodox interventionist state directly to non-neutrality in the sense discussed here is likely to be very dangerous. One can see, for example, that in states such as the Dominican Republic or Paraguay, this would simply become a formula for business as usual. Indeed, even in Brazil it is likely to be a serious problem. The neutral state is much more likely to be consistent with an impartial civil service, an absence of corruption and administrative efficiency. Yet the lesson of South-East Asia is surely that fast economic growth and high rates of investment require a non-neutral state. This is the dilemma that Latin America faces today.

Elections

Latin America is in the middle of a complex political transformation and much of the news is very encouraging. There are frequent elections. Brazil, for example, went to the polls in early October with an electorate of 95 million people. A very festive atmosphere seems to have ruled and few cases of misdoings were reported.[30]

A peaceful transfer of power has been observed in many Latin American countries in recent years. Even Venezuela, for example, was able despite all its problems to transfer power at the beginning of 1994 from one party to another, one president to another, without a constitutional crisis. The same has been true of many smaller countries where a peaceful transfer of power from one civilian to another was until recently exceptional.

The international context is now much more positive for establishing the political process on a sound basis. For example, in the last two or three years there have been major political upheavals in a number of countries that could easily have destroyed the democratic process: the failed *autogolpe* in Guatemala, the successful one in Peru, the overthrow of President Aristide in Haiti and the attempted military coups in Venezuela. Without doubt the response of the international community was very positive in bringing each of these countries back to the democratic fold in one form or another.

Another element that is worth stressing as far as good news is concerned is the fact that the press is now much freer, and generally of better quality, than it has been in the past. It is freer to criticise and it uses that freedom with enthusiasm. I cannot yet say the same about television coverage, which is often more important than press coverage, but nonetheless the quality of journalism and the press has substantially improved in the last ten years.

Finally, on the good news side, it is interesting and encouraging to note that some governments have found that the response to tough economic decisions has been a reward from the electorate. In other words, taking tough economic decisions does not necessarily mean one is voted out of office; on the contrary, as President Menem is likely to find in Argentina, tough economic decisions can indeed be rewarded electorally.[31]

However, there is another side to this particular coin. Throughout Latin America there is now a contempt for political parties and many political institutions, such as Congress, the likes of which we have not seen for many years. This is very strange when we remember that so many elections are taking place in such a relatively free atmosphere. For example, Peru is currently preparing for elections in April 1995, with fifteen presidential candidates offering themselves to the electorate.[32] Most of these candidates are going out of their way not to be defined as traditional politicians from traditional parties, because to do so would be to destroy their credibility in the eyes of the public. This is not a healthy situation. In the end, one does need strong political institutions, strong political parties. Without them it is very difficult to see how the momentum in favour of political reform can be sustained.

It is also not true that elections are fair in the way that we would understand it in Europe. They are much improved compared with what they were ten or fifteen years ago, but even in Brazil the situation leaves something to be desired. I spent six weeks in Brazil between July and September 1994 and watched the whole electoral process at work. The machinery of government was brought to bear in favour of one candidate, in this case Fernando Henrique Cardoso, in a way which we in Europe would have to regard as unfair. Of course, Cardoso could probably have won even if he had not had the support of this enormous machine, backed up by TV, the press and radio. Yet such an observation misses the point. The playing field is not yet level and the candidates favoured by the elites still have formidable advantages.

It is also true that the really solid democracies, such as Costa Rica and Uruguay, or Chile once again after its long military interlude, are the countries that were democracies before. Those countries that were weak democracies, or not democracies at all, are still facing a number of problems in terms of consolidating the political process and removing the threat of a return to direct or indirect military rule.

If we look at the electoral panorama of the main Latin American countries, we find an interesting situation (see Table 2). Not everyone would agree with my assessment, but I have tried to show for eight major countries the two parties – in the case of Chile the coalition – that have a reasonable chance of winning presidential elections today. There is a question mark against the PAN in Mexico because I am not sure that that is really a legitimate place to put it. On the right-hand side we have the main opposition party which is not yet electable: 'not yet electable' raises all sorts of questions about what I mean and I will define it shortly. However, in all the countries except Chile this 'not yet electable' main opposition party is on the left, sometimes very far on the left: Frente Grande in Argentina, PT in Brazil, M-19 in Colombia, PRD in Mexico, Izquierda Unida in Peru, Encuentro Progresista in Uruguay, Causa-R in Venezuela.

Table 2
Political Party Profile: 1994-2000

Country	Parties Capable of Winning Presidential Elections		Main Opposition Party not yet Electable
Argentina	Peronists	Radicals	Frente Grande
Brazil	PSDB	PMDB	PT
Chile	Concertación		Renovación Nacional
Colombia	Liberals	Conservatives	M-19
Mexico	PRI	PAN (?)	PRD
Peru	Cambio 90	Unión por el Perú	Izquierda Unida
Uruguay	Colorados	Blancos	Encuentro Progresista
Venezuela	Acción Democrática	Copei	Causa-R

There are two possibilities why these parties are not yet electable. The first is that they may not be very popular. The other possibility is that the electoral process works against them. For the purpose of this lecture it does not really matter which of these explanations is true (for other purposes it does). What it means is that there is a huge burden of responsibility on those parties that have a reasonable chance of winning elections in the next few years to ensure that economic growth accelerates, and that the benefits of that economic growth are reasonably and fairly distributed. That is easy to say, it is much more difficult to achieve.

It is crucial that this happens whichever interpretation we put on the non-electability of the parties listed to the right of Table 2. For example, suppose they are not being elected because they are not yet popular. They will certainly become more popular if the reform process in Latin America fails to deliver the economic growth and the distribution of benefits in a way that people regard as fair, and it will certainly be problematic if they are not being elected because they are being disadvantaged by the electoral process. They will not stay inside the electoral process for ever if they feel that the machinery is being used against them.

The next five years are crucial. In a sense it is a wonderful opportunity for those parties that have a reasonable chance of forming governments; they have in front of them a reform process that can, under the right circumstances, offer widespread economic advantages. Where the reform process does so, there is every reason to believe that when - perhaps in a few years time - one of the other parties is elected, it will be unwilling to undermine what has been achieved in the past. That is the challenge that Latin America faces today.

Conclusions

It would be very surprising if the economic and political transformations in Latin America in the last decade had produced a smooth transition towards economic prosperity and political stability. Instead, we observe a patchwork where almost all countries can take pride in their progress in some areas, while no country - not even Chile - can yet be fully assured of long-run success and a swift transition to developed country status. I want to end, therefore, with a series of conclusions that put the story in proper perspective.

First, the process of trade liberalisation is now irreversible and this will eventually lead to more competitive markets and greater choice for consumers. However, the high levels of concentration of economic activity in Latin America will place limits on the degree of competition in the domestic market and this will make it very difficult to achieve international rates of inflation.

Secondly, reform of the state will continue and economic growth - even if modest - will generate additional resources for the public sector. These can be used either directly to alleviate social tensions (e.g. PRONASOL in Mexico) or indirectly by encouraging the growth of small, labour-intensive firms. Either way, poverty will decline in Latin America, although the impact of economic growth on income distribution is much more uncertain.

Thirdly, the neutral state will cease to be a major objective and non-neutrality will become intellectually and ideologically respectable. Only in a few countries, however, will this non-neutrality be achieved by a truly impartial state. Thus, non-neutrality will go hand in hand with a continuation of corruption by public officials and rent-seeking by private sector agents with periodic attempts at greater transparency and accountability by members of the economic and political elites.

Fourthly, elections are here to stay and will become more contested as the main opposition parties become better at using modern electoral techniques. Non-party politicians will do well at local level, capitalising on the widespread disillusionment with traditional party politics, but will not be able to win the Presidency and other national prizes.

Finally, the real test of liberal democracy will come, just as it did in Europe, when economic and social elites have to live with governments whose programmes do not favour their interests. Elite responses will in large part determine the future of Latin American democracy. That test has yet to be faced. The experience of the past is not encouraging, but the younger generation of elites is not the same as its predecessors. Globalisation, trade liberalisation and education have all altered their perceptions and the prospects for Latin America are, in that sense, much healthier.

Notes

1. See Caldera (1977), pp. 50-1.

2. An account of economic reform in Latin America in the 1930s and 1980s can be found in Bulmer-Thomas (1994), Chapters 7 and 11.

3. They coincided in the last century in the 1820s at the time of independence. This is not a happy precedent, however, as the outcome was little short of disastrous. See Bulmer-Thomas (1994), Chapter 2.

4. In those countries, such as Bolivia, Paraguay and Uruguay, where popular support for privatisation is weak, ingenious methods have had to be used by governments to divest state-owned enterprises. In the case of Bolivia, where the process is known as capitalisation, see the *Financial Times* Supplement, 9 November, 1994.

5. Examples are the oil industry in Mexico and Venezuela, dominated by PEMEX and PDVSA respectively, and the copper industry in Chile, where CODELCO remains a major force. Even in these cases, however, the private sector is increasingly being allowed to play a role.

6. All comparative studies of non-tariff barriers, such as Voluntary Export Restraints (VERs), concur that the worst offenders are developed countries. See, for example, Winters (1991), Chapters 10 and 11.

7. As a member of an international delegation of observers to the Panamanian elections in May, 1994, I was able to see this at first hand. Delays that might have been regarded as intolerable in Western Europe or the United States were accepted with remarkable stoicism and even amusement.

8. There is some dispute over the circumstances under which a developing country becomes developed. The World Bank currently regards an income per head of $10,000 as the dividing line. The highest income levels in Latin America are still some way below. See World Bank (1994), Table 1, pp.162-3.

9. See Inter-American Development Bank (1994), Statistical Appendix, Table B-2.

10. Real GDP per head in 1994 was still 2.4 per cent below its level in 1980. See ECLAC (1994), Table A.1, p. 37.

11. This is particularly true of Chile where the economic reform programme could be said to have started in 1974 following the overthrow of the Allende government and the imposition of the Pinochet dictatorship. See Bosworth,

Dornbusch and Labán (1994), Chapter 1.

12. Most commentators were surprised by the ability of Latin America in general and Mexico in particular to capture foreign sources of finance in the wake of the Chiapas rebellion and the assassination of Luis Donaldo Colosio. After a slight pause in the second quarter of 1994, capital was again attracted to the region in the second half of the year although total portfolio investment did decline. See World Bank (1994a), p. 204.

13. After a negative net transfer of resources (i.e. net capital flows to Latin America below interest payments and profit remittances) between 1982 and 1990, the net transfer of resources turned positive in 1991 and has remained positive subsequently. In 1994 net capital inflows are estimated at $56.6 billion compared with $65.1 billion in 1993. See ECLAC (1994), p. 52.

14. See ECLAC (1994), pp. 47-8.

15. Virtually all Latin American countries are involved in one regional integration scheme and some are involved in several. Mexico, for example, in addition to being a member of NAFTA, has free trade agreements with Chile, Colombia and Venezuela, Costa Rica and Bolivia.

16. See Inter-American Development Bank (1994), Statistical Appendix, Table D-4. The reader should note that the source defines Latin America to include a number of small Caribbean countries (e.g. Jamaica) and to exclude Cuba.

17. In 1988, I predicted that imports would double from their 1988 level by the year 2000. See Bulmer-Thomas (1989), p.208. That target, regarded by many as hopelessly optimistic at the time, has already been passed.

18. Eventually, export-led growth may be so successful that the non-export sector grows as fast or even faster than the export sector. This has happened in Japan in the last 20 years. However, rapid growth of exports is needed at the beginning of the process both to finance imports and to service the foreign capital required to modernise the economy.

19. The source excludes Cuba. In addition, Haiti has been excluded as both exports and GDP were falling.

20. With population growth at 2 per cent per year, a doubling of living standards every 25 years implies GDP growth of 5 per cent per year. This in turn requires at least 6 per cent growth of exports in an export-led model.

21. In the Dominican Republic, Ecuador and El Salvador, for example, the value of exports of goods (excluding services) is virtually unchanged or even

lower compared with the beginning of the 1980s. See IDB (1994), Table D-3, p. 264.

22. An export firm needs to deflate nominal domestic interest rates by the change in the domestic price of exports. This may be much less than the price indices normally used to convert nominal interest rates to real rates.

23. On the differential impact of recent capital inflows on Latin America and South-East Asia, see the *Economist*, 29 October 1994, p.118.

24. The huge capital inflows of the last few years can be expected to decline in the second half of the 1990s, thereby removing one of the main factors behind the recent real exchange rate appreciation.

25. The acceleration in inflation in Venezuela in 1994, following the sharp depreciation of the nominal exchange rate, is an indication of the sensitivity of the price level in many Latin American economies to external shocks.

26. See, for example, World Bank (1993).

27. The figures in Table 1 are calculated from current dollar prices for both investment and GDP. Since trade liberalisation has lowered the cost of imports of capital goods, it is sometimes argued that current price calculations bias downwards the investment ratio. However, a large part of investment consists of construction and the latter is a non-traded good, whose relative price has increased sharply since 1990 as a result of REER appreciation. On the measurement of capital formation in Latin America, see the different chapters in Bacha (1993).

28. Since the mid-1980s Chile has enjoyed rapid growth of income and income per head. Annual inflation has now fallen to single figures and the unemployment rate has averaged five per cent in the last three years. There has been a sharp reduction in poverty since 1987 and a more modest improvement in income distribution. See Marcel and Solimano (1994).

29. There is a positive correlation between income per head and the ratio of tax revenue to GDP. Developed countries in general have a higher ratio than developing countries and richer developing countries a higher ratio than poorer countries. The ratio of central government revenue to GDP in Latin America currently averages around 20% compared with around 30% in OECD countries. See World Bank (1994), Table 11, pp.182-3.

30. The worst case was in Rio de Janeiro where the voting process was subject to interference by the drug-dealers that hold sway in the *favelas*. The election in the city was therefore rerun on 15 November at the same time as the second

round ballot.

31. The most spectacular case of tough economic reform being rewarded by the electorate must surely be the election of Fernando Henrique Cardoso to the Presidency in Brazil in October 1994. All analysis concurs that the reduction in the monthly rate of inflation made possible by the Cardoso Plan was crucial in bringing victory.

32. See Embassy of Peru, Press Release, 24/94, London, p.3.

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